COMMONWEALTH OF AUSTRALIA

JOINT COMMITTEE

of

PUBLIC ACCOUNTS AND AUDIT

Reference: Review of Auditor-General's annual reports second quarter 1997-98

CANBERRA

Wednesday, 29 April 1998

OFFICIAL HANSARD REPORT

CANBERRA

JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

Members

Mr Charles (Chair)

Senator Coonan	Mr Anthony
Senator Crowley	Mr Beddall
Senator Gibson	Mr Broadbent
Senator Hogg	Mrs Crosio
Senator Murray	Mr Fitzgibbon
Senator Watson	Mr Georgiou
	Mr Griffin
	Mr Sharp
	Mrs Stone

The terms of reference for this inquiry are:

Review of Auditor-General's annual reports second quarter 1997-98.

WITNESSES

JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

Review of Auditor-General's reports second quarter 1997-98

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Wednesday, 29 April 1998

Present

Mr Charles (Chair)

Senator Hogg	Mr Anthony
	Mr Beddall
	Mr Georgiou
	Mr Griffin
	Mrs Stone

Committee met at 11.03 a.m.

Mr Charles took the chair.

BEWLEY, Mr Phillip James, Team Leader, Evaluation, Research and Statistics, Public Service and Merit Protection Commission, Edmund Barton Building, Barton, Australian Capital Territory

KENNEDY, Mr Peter, Deputy Public Service Commissioner, Public Service and Merit Protection Commission, Edmund Barton Building, Barton, Australian Capital Territory 2601

OATES, Mr Christopher John, Member, Equity and Merit Team, Public Service and Merit Protection Commission, Edmund Barton Building, Barton, Australian Capital Territory

TIM, Ms Louisia Kerrie, Team Leader, Equity and Merit, Public Service and Merit Protection Commission, Edmund Barton Building, Barton, Australian Capital Territory

DAHLENBURG, Ms Kathryn, Audit Manager, Performance Audit, Australian National Audit Office, GPO Box 7070, Canberra, Australian Capital Territory 2601

LEWIS, Mr Michael Kenneth, Executive Director, Performance Audit, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory 2601

MCPHEE, Mr Ian, National Business Director, Performance Audit Business Unit, Australian National Audit Office, 19 National Circuit, Barton, Australian Capital Territory 2600

NICHOLAS, Mr Roderick, Audit Manager, Performance Audit, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory 2601

CHAIR—Good morning, ladies and gentlemen, thank you for coming. I will open today's public hearing which is the second in a series of quarterly hearings to examine reports tabled by the Auditor-General in the financial year 1997-98. This morning we will be taking evidence on two audit reports: *Audit report No. 16 1997-98: Equity in employment in the Australian Public Service*; and *Audit report No. 24 1997-98: Matters relevant to a contract with South Pacific Cruise Lines Ltd*. We will be running the sessions in a round table format which means that all relevant participants will be present to hear what others are saying about the Auditor-General's report.

I must ask participants to observe strictly a number of procedural rules. First, only members of the committee can ask questions to witnesses if this hearing is to constitute formal proceedings of the parliament and attract parliamentary privilege. If other participants wish to raise issues for discussion, I would ask them to direct their comments to me, and the committee will decide if it wishes to pursue the matter. It will not be possible for participants to respond directly to each other.

Second, given the length of the program, statements and comments by witnesses should be kept as brief and succinct as possible, and I emphasise that. Third, I remind witnesses that the hearings today are legal proceedings of the parliament and warrant the same respect as proceedings of the House itself. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of the parliament. The evidence given today will be recorded by Hansard and will attract parliamentary privilege.

Finally, I refer any members of the press who are present to a committee statement about the broadcasting of proceedings. In particular, I draw the media's attention to the need to report fairly and accurately the proceedings of the committee. Copies of the committee statement are available from secretariat staff.

The audit report being considered in this first session is *Audit report No. 16 1997-98: Equity in employment in the Australian Public Service.* I welcome representatives from the Australian National Audit Office and from the Public Service and Merit Protection Commission to the first session of today's hearing. We have convened this public hearing to examine the main issues raised in the Auditor-General's report No. 16 on equity in employment in the Australian Public Service. The JCPAA will take evidence today on a number of issues, including the Public Service and Merit Protection Commission's proposal for the collection, interpretation and reporting of data. The committee also wants to examine the contribution the commission can make to assist agencies to maximise the benefit of employee diversity.

The Auditor-General's views have been set out in the report and has had the initial responses from the audited agency. However, the committee would be interested to learn if any action has already been taken, or is planned, to address the issues raised in the Auditor-General's report. Mr Kennedy, do you wish to make a brief opening statement to the committee before we proceed to questions?

Mr Kennedy—Yes, thank you. Firstly, as indicated in our responses, we have found the report by the audit office very helpful. We have broadly accepted all the recommendations. Since then, the minister, the Hon. Dr David Kemp, has launched new workplace diversity guidelines which will see the development of workplace diversity plans. We are also in the midst of sending out to agencies and discussing with them new proposals for HRM data collection to replace the continuous record of personnel, which will include efforts to see if we can lift the response rate in the provision of EEO data. We are also starting to look at and rework the harassment guidelines.

CHAIR—Mr McPhee, do you wish to make an opening statement?

Mr McPhee—Yes, thank you. I would like to give you some background on the audit. Our aim in conducting this audit was to inform the government and the parliament of progress in achieving equity outcomes and to assist agency heads and the PSMPC to respond to changes signalled by the Public Service Bill 1997 and the Workplace Relations

Act 1996.

These changes reflect a strategic shift taking place in Australian organisations from developing and implementing EEO programs to the broader management of diversity. In reviewing the results achieved across the APS, the audit was concerned primarily with the usefulness of the information provided to the government and to the parliament to make an informed judgment of the extent of equity in employment in the APS. The audit particularly concentrated on evidence of overall progress and on the relative performance of individual agencies.

Overall, we found that, although a number of EEO targets have been met, there is scope for improvement in the management and reporting of equity in the APS, particularly if agencies are to reap the benefits of fully utilising the skills of a diverse work force. There can be high costs associated with poor management of equity, for example, in terms of turnover and in morale, dedication, confidence and commitment, which impact on agency performance. At the agency level, the quality of EEO programs and achievements vary significantly. A significant number have not met the 1995 targets. Thirty per cent have not met both of the targets for women and 47 per cent have not met the targets for disabilities.

Although the ANAO findings that two-thirds of the EEO programs had achieved a medium to higher level of progress are encouraging, almost a third of programs had achieved only minimum progress. While recognising various levels of performance between agencies, many agencies would benefit from greater attention to the development of a strategic link between diversity management and other corporate objectives such as more visible leadership in achieving diversity outcomes, stronger accountability for outcomes and ensuring consultation with an evaluation program for each of the EEO groups.

There has been little empirical work on measuring the extent of discrimination and harassment in the workplace. There is a risk that agencies may not meet the standards necessary to successfully defend a vicarious liability claim for harassment and discrimination particularly where EEO program plans are not supported by a genuine commitment. Our report also encourages caution in relation to the possible impact of the new workplace relations environment on EEO groups. We encourage caution because, while there are opportunities to improve equity in employment in the APS through these mechanisms, there is also a risk that EEO groups may be disadvantaged unless the agreement making process and agreements themselves are considered with a view to ensuring equitable outcomes for all employees.

At an aggregate level, monitoring and reporting should provide information that permits the government and parliament to judge the extent of equity in employment in the APS. While recognising that the provision of EEO status information is a voluntary one, concern underlying the capacity to inform the government and the parliament is the level

of EEO status information missing on the central record and the variation in the EEO information between the central record and some agency records. It is a matter of priority to ensure that the information collected and reported can be relied upon to accurately reflect reality. We understand the PSMPC have already taken action to improve the data in this area.

The information presented to date has been limited in its scope and usefulness. It has focused on representation levels and analysis by EEO groups. It has not facilitated the assessment of the performance of individual agencies or their relative performance taking into account their size or the relative representation of EEO groups in each workplace. Nor has it considered the important element of agency performance over time which would allow an assessment of the extent to which the APS is continually improving or not, as the case may be. Unfortunately, it has also included some inaccurate trends and invalid community comparisons which have delayed opportunities to refine and redirect strategies which are needed in the representation of people with disabilities. I am pleased to say that the PSMPC has made the downward trend in representation of people with disabilities in the APS a very prominent issue in a recent PSMPC sponsored APS diversity management conference.

In conclusion, the report notes opportunities to improve on the information presented to the government and parliament, employment practices in agencies and the capacity of the PSMPC to better fulfil its role. The PSMPC supported the overall thrust of the report and agreed with all the recommendations but did flag the difficulties in reconciling definitional differences in relation to disabilities in order to compare their representation in the APS to that in the community. We understand that work is being done in this area to refine the definitions. Throughout the audit, we achieved a very good rapport with the PSMPC and they were very constructive in the way that they responded to the audit process. Mike Lewis and Kathryn Dahlenburg were the senior staff on this particular audit.

CHAIR—Thank you for those statements. I will open by asking a question of the commission. From the audit, it seems to me that one of the central issues is the fact that we do not have consistency of data collection across agencies to allow assimilation of data that makes some sense or, indeed, comparison between agencies to be necessarily statistically valid. Would you like to give us your view on that issue and, if you agree with the audit office and the committee, tell us what is being done about it?

Mr Kennedy—It is a very difficult issue because the provision of EEO data is voluntary and there are a number of people who work in agencies who have concerns about the provision of that data to their central personnel area. Even in a small agency like the commission, when our EEO coordinator—in 1993-94—talked to every member of staff, we could still only achieve a 95 per cent return rate. This was despite a direct personal approach to every member of the organisation with the request, ‘Please, will you help us?’

So I think that it is always going to be the case that there will be variations in the level of responses across agencies.

As I mentioned earlier, we are now working out how we will collect the data to replace the continuous record of personnel. I could provide for the committee the circular we have sent out which indicates what EEO data we will be collecting in the future.

In addition, Mr Bewley is about to start on a project of actually going to agencies and seeing if we can lift their performance. I might ask him to explain the strategy he will be following to do this.

Mr Bewley—The work that we are about to do has involved us in looking at the level of reporting across each agency: firstly, to identify those agencies that have a very high level of reporting; and, secondly, to make some contrasts with those that have, consequently, very low levels of reporting. Our strategy is to work with the agencies that are achieving very high levels of reporting to find out exactly what they are doing and what strategies they have used. We want to see if we can learn something from their actions which we can take to other agencies to encourage them to follow similar sorts of procedures. The approach that we are taking is one in which we work with agencies to identify the reporting practices—the procedural things that they do to actually gather the data—the systems they use, and the ways in which they report.

CHAIR—Thank you for that.

Senator HOGG—One of the things that interests me is the fact that we hear about the monitoring and the reporting, the setting of targets and so on; and yet the ANAO report refers very much to costs associated with the poor management of diversity. How much are you focusing on those costs associated with the poor management and where are they being reflected; because the ANAO report mentions a number of issues which might be relatively unquantifiable, but some that are. It mentions large true replacement costs, estimated at 70 to 200 per cent of annual salary, different and patchy productivity, increased and ad hoc absenteeism, reduced commitment and morale, and damage to public image and business activity from media coverage perceptions of inequity among employees.

It is one thing to have targets but, obviously, according to this report, there are also costs associated with it and, if you are bringing down new guidelines, what are you doing to look into the hidden costs associated with poor management of diversity?

Mr Kennedy—I agree. While noting that the ANAO's estimates are essentially estimates, we would agree that, in the ideal world, we would not want to lose staff for any of these reasons. One of the reasons we have moved from a traditional approach of EEO plans and processes into workplace diversity is to try to capture the attention of agencies as to the benefits that come from an active approach to the productive use of diversity in

the work force. We hope to be putting out some guidelines shortly to agencies to help them and I will ask Ms Tim, who has been responsible for the development of those guidelines, to say some of the things we are doing with agencies.

Senator HOGG—The point of my question is that there is a cost associated with this and that cost is something which is borne by the taxpayer. Can we identify the cost? Can we identify the savings that can be made by having a properly run diversity program? It says in this report from the ANAO that poor management practices are costing us money. What are we doing to redress the situation?

Mr Kennedy—I think it is very easy for the audit office to say that. It is true that any poor management practices cost the taxpayer money and are to be avoided, but it is less easy to know how you split the poor management practices and work out how to calculate the costs in a particular area. We have felt that a more positive way to go with agencies, given the devolved framework in which the Public Service is managed these days, is to try to draw their attention to the costs and the problems because, in the end, in a devolved environment, you cannot manage these things centrally and I do not think you would be successful if you tried. Perhaps if we were able to explain some of the things we are trying to do, you would get a bit of a feel for the approach.

Senator HOGG—I do not think that answers my question, but go ahead, we would be interested in some of those things.

Ms Tim—Probably the main approach, as Mr Kennedy has outlined, is to encourage agencies to take much more responsibility for diversity management, to see that in the light of their broader human resource management and to link that much more strategically with their agency's business. So what we have seen previously, and I think what is identified and what you see in the report, is that agencies have seen EEO in some ways off to the side and separate to the business of their organisation. The approach we are taking is to encourage them to see the business imperatives of adopting a diversity approach. That includes agencies looking at the costs of not doing it right so they start to identify that there are costs involved in high turnovers.

Mrs STONE—Ms Tim, I see the merit in what you have just said but, on the other hand, we know, for example, that there are extraordinarily different achievements in terms of equal employment opportunity outcomes across different Public Service sectors. You have a lot of indigenous people where you would expect to find them—that is, in the provision of services to indigenous people—but if you take the business plan approach that you have just suggested, maybe the audit office might not think there was much merit in employing indigenous people in their area because they do not have much direct service delivery to indigenous communities. Is there also an attitude that right across every public sector area there should be a general achievement of the goals in all areas—that is, NESB, indigenous, disabled and so on? At the moment, what we have got, as I said, is a very patchy performance and very little mainstreaming of any of those minority groups across-

the-board. Are you also addressing that issue so it is less service delivery but more access to opportunity for the individuals?

Ms Tim—I think what you will see when you look at the figures is that, in some ways, it looks like we have done really well across the APS in employing people from the target groups, but what we have recognised and what the report has identified is that we cannot afford to be complacent, and behind those aggregate figures lies real cause for concern.

Mrs STONE—Exactly.

Ms Tim—The strategy we are adopting now aims to look at not only service delivery but policy development in agencies, so we actually have an opportunity to tap into the talents and skills that a diverse range of people can bring to our work forces so that we are not cloning in the work forces. I do not think in the environment of the Public Service today or in the future we can afford not to have a diverse range of skills or policy advice available to government, so I think the strategy fits in quite well with that approach.

Mr GEORGIOU—I have a problem with the generalisation that the prima facie figures look quite good. The situation with the disabled has actually gone backwards. The situation with women has not significantly improved since 1992. The report says on page XX, paragraph 26:

After early annual increases, the representation of women, Aboriginal and Torres Strait Islander and NESB employees has been fairly stable.

Can I have some more on the record of achievement? We set a target of four per cent on representation of people with disabilities. In fact, the level of actual representation in 1992 was 5.3 per cent. It then fell to 4.9 in 1995 and to 4.6 in 1996. Similarly, there have not been outstanding advances in the other categories either.

Mrs STONE—Plus you can add to that the separation rates—you mentioned disabilities. In indigenous areas, there are very substantial separation rates. That would also, presumably, be of great concern to you.

Mr Kennedy—There are probably a lot of different questions to answer in that.

Mr GEORGIOU—We could start with people with disabilities.

Mr Kennedy—I think there are a couple of issues with people with disabilities. It is fairly clear that for a while the data was trending down. It seems to have stabilised for the moment at its current level, but we do not know whether or not it will start to drift down again. This is an area where there is—

Mr GEORGIOU—It was 5.3, 4.9, then 4.6 in December 1996.

Mr Kennedy—Yes, but our impression is that it is moving about that area. It was much higher and it has come down. The impression was that it seemed to be stabilising. We do not know whether it is about to drift down again. It is very hard to take just one year's figures.

Mr GEORGIOU—It is a trend.

Mr Kennedy—The other area of difficulty with people with disabilities is that you get two groups of people essentially: people who have a disability when they join and people who then acquire a disability after they have been in the particular employment. The second group, often for a variety of reasons, are often reluctant to identify. So we would have a feeling that there is probably more under- identification in that group than in any others. It is not a satisfactory result, but appointment and promotion in the Public Service is based on merit. We do not come across many complaints of direct discrimination, so we are left to promote fairly actively how people have to be treated, given reasonable adjustment, and they are intractable figures. No-one in the commission pretends they are happy with them.

Mr GEORGIOU—With respect, you did drift around a fair bit in that. Basically, you have a trend going downwards on the disabled. You are saying it was four per cent when the actual representation was 5.3. In order to stabilise the position, the 5.3 has come back to 4.6 in December 1996 and you are saying it has stabilised somewhere. On what day do you make that statement?

Mr Kennedy—I apologise, I must have been incorrect. That was my recollection of the figures.

Mr BEDDALL—The Public Service has shrunk by some tens of thousands. In your recruitment policies to get EEO, how much of a weighting do you have to give to the various groups to reach an acceptable target? Obviously, you are in a situation where there has been a large separation rate. Within that separation rate, are you losing the target groups in EEO?

Mr Kennedy—When we look at the retrenchments for 1996-97, which is the latest year, there was 47.7 per cent of women as a proportion of the people leaving and their representation in the service was 47.8 per cent. So the women seem to be leaving under retrenchment at about the same rate as the group as a whole. With indigenous Australians, their representation was 2.2 per cent, and their proportion of retrenchments in this year was 2.3 per cent, although it had been higher than that earlier. That has been an area of concern to us, because it seems that more indigenous Australians have been leaving as a proportion than you would expect.

People with disabilities, again, have been leaving disproportionately. They make up 6.3 per cent of the people leaving as a result of retrenchments; whereas their representation is 4.8 per cent, subject to the qualifications I made about the nature of the data. With people from non-English speaking backgrounds, their representation was approximately 16 per cent as at 30 June 1997 and as a proportion of retrenchments it was 13.3 per cent. So they were slightly below.

Mr BEDDALL—Can you address the recruitment?

Mr Kennedy—On recruitment, we have encouraged agencies in the development of their EEO plans to make sure that they are targeting all groups in the community. The proportion of women being recruited into the service now is greater than the proportion of men. If that continues over time, we would expect that the rate should get up to 50 per cent. Our initial calculation was something like the year 2005, although it has been stuck at this proportion for a bit longer than we expected. I do not have in my head the data for the proportions of the other three groups coming in at the moment, I am sorry.

CHAIR—When women get above 50 per cent of the APS group, will we then switch the guidelines and make it men?

Mrs STONE—We need 52 per cent women as a reflection of the population.

Mr Kennedy—Mr Chairman, no, the act provides for women as a specific group.

CHAIR—I will now ask a serious question. You state in paragraph 3.67:

There is no information on the EEO status of 23 per cent of permanent APS employees.

You then state:

The incidence of missing information is greater (38 per cent) for recent appointees.

Could you tell us the implications of that for statistical analysis and reporting?

Ms Dahlenburg—What we are trying to highlight there is that the level of 23 per cent is too high when you are looking at percentages—even between men and women where their percentage is around 50 per cent. When you look at representation levels of the other groups—ATSI at two per cent and people with disabilities at four per cent—23 per cent missing data is far too high. We are saying that that figure has to be brought down to be able to give reliable trends and so on for those lower groups.

Our analysis indicates that, for recent appointees, the incidence of missing information is even greater than that 23 per cent—it was 38 per cent. We also raised a couple of other points: that disability acquired while employed is not reported under the

present system; and that employees at lower levels seem to be more reluctant to record their EEO status. We are saying that if effort is not put in to bring this number down, it could go up. There are indications that it may well blow out further.

CHAIR—Mr Kennedy, you told us about your success rate of 95 per cent in your organisation and you talked about what you were trying to do to encourage people, but where do you place on the priority scale of things you need to do this issue of raising that level?

Mr Kennedy—We would give it a considerable priority, recognising that it is unfortunately one of those things that you have to keep revisiting. For example, in our own agency, our level of data has dropped significantly since that exercise. We are going to have to undertake another exercise to get the data up.

We constantly stress to agencies the importance of it. It is a priority for all the reasons that members have mentioned and for the reasons that the ANAO has mentioned. As I said, Mr Bewley will have as one particular activity to consider for the next few months while we are talking about the new data set to replace the continuous record of personnel: can agencies work to improve the level of identification?

CHAIR—The report tells us that there is widely varying compliance, if you want to use that word, across agencies. What do you intend to do to try to encourage agencies to use a best practice formula—something which consistently works to identify what works and tell the poorly performing agencies how they might lift their performance?

Mr Kennedy—Perhaps if I could get Mr Bewley to elaborate a bit more on the strategy because he has been addressing this issue of the good and the bad performers.

Mr Bewley—We have done an analysis of the reporting levels across agencies. I table the document for the committee. It identifies by agencies the level of under-reporting in relation to Aboriginality, disability and persons of non-English speaking background. What we have observed is that whilst the level of under-reporting is around 23 per cent it remains constant across each of those three groups. What that is suggesting to us is that either the question in those agencies which are under-reporting simply has not been asked or if the question has been asked it has been asked in such a way that it has not evoked either a positive or negative answer.

Our belief, certainly in talking to the agencies that have some very good levels of reporting, is that much hinges on the way in which the questions are structured and the way in which the particular categories are defined and presented. We have got two particular agencies—one is AusAID and the other is the Australian Broadcasting Authority—which have levels of reporting, in one case, of 97 per cent and, in the other case, 96.4 per cent. One is an agency with 560 staff and the other is an agency with 139 staff. Those two agencies have undertaken monthly reconciliations and run processes which involve

staff personally going out and completing questionnaires through processes of explanation so that people understand what it is they are reporting on.

As we move down the list, we have other agencies, some large agencies—for example, the Australian Customs Service which has an 87 per cent level of reporting. The Customs Service has adopted processes which involve regular review of the status and regular explanation to staff of the meanings of particular questions that they ask to elucidate the information sought. It is those kinds of practices we will be going out to agencies which under-report and commending to them.

The second strand of our activity is the development of our new system. We are being pushed to replace the existing continuous record of personnel because of the changes to the existing payroll system run by the Department of Finance and Administration. It will mean that we will be looking at picking up data from agency HR systems rather than the current payroll system. As Mr Kennedy mentioned, we have communicated our data requirements to agencies and in the lead-up to communicating those requirements we have gone through a fairly extensive exercise in defining or redefining data so that the kinds of questions that people will be asked to elucidate information on the EEO category will be much clearer.

For example, questions on disability are now defined so that people can readily define what constitutes a disability. We have been very much clearer in terms of specifying fathers, mothers, first and second languages. We have also gone down the track of asking people to consciously choose whether or not to give the information. At the moment, if a person is asked a question and chooses not to answer it the method of choosing not to answer is invariably one of simply ignoring the question. In the future, we will be asking people to make a conscious choice whether or not to answer the question.

Rather than a level of under-reporting, we may well find that, if people choose not to give, they will be identifying as choosing not to provide information. Our belief is that, through those two sets of activities, the level of overall reporting should improve.

Mr BEDDALL—Why isn't this a management responsibility in that managers are required to provide the data as part of their job? Why do we have all this other stuff about people not filling in a form? I do not understand. In a sector where managers are responsible for reporting data, the data is not reported. I do not understand the concept. It is not hard to tell how many females there are, surely?

Mrs STONE—It seems to me that the agency is spending too much time on this issue because, if there is under-reporting, if someone is not choosing to say, 'I am a Torres Strait Islander' or 'I am disabled', therefore presumably they are not presenting in the workplace as such, so you have lost that cultural diversity and input in terms of policy input and so on. The manager can certainly pick up if they are female, male or disabled in a way that means that you are actually getting a special input from them because they

represent the views of other disabled people.

If you have to spend a lot of time working out if someone sitting over there in a corner has a non-English speaking background or is Aboriginal, then if you are not sure and they have not said yes or no you do not know, and to me that is not achieving the sorts of goals we are trying to achieve—the ones Ms Tim described before—of using their input and their influence on policy which is derived from their specific background or experience of life. Do you understand what I am trying to say?

Mr Kennedy—I do understand. To answer Mr Beddall's question, first, there is no non-identification for women, so that one works. But, for the rest, it is not always clear whether people fall into the other three groups, as Mrs Stone said.

Mr BEDDALL—If people do not say that they are Aboriginal then they would not be classified. That is my point.

Mr Kennedy—That is right. Ms Tim could tell me, for example, that she is Aboriginal, but that does not actually mean that she has filled in a form with personnel which declares her Aboriginality. I have no right to go and do that for her, even if I know.

CHAIR—At paragraph 3.74 you said that, for the central data collection arrangement:

A threshold issue for the review will be whether the CRP in its current form is the most effective means of central data collection and analysis.

While you briefly touched on that in your opening statement, I do not believe that you told us exactly what it is that you propose to do.

Mr Kennedy—I will hand over to Mr Bewley who has been involved in the details, but a decision has been taken not to maintain the continuous record of personnel. That decision was not made by the commission; it was made by the Department of Finance and Administration. I will get Mr Bewley to explain the detail of what we are doing.

Mr Bewley—The continuous record of personnel is being phased out by the department of finance as part of their move to a new payroll system. In addition to moving to a new payroll system, agencies will have a choice as to whether or not they retain that payroll system for their own purposes. CRP data currently flows automatically through the pay system, and therefore agencies which choose to move off the pay system will no longer be able to provide CRP data. That, together with the fact that we recognise that there are deficiencies in CRP reporting, has put us in a position where we have identified options for the future. In brief, what we propose to do is to develop a new system that will draw data from agency HR systems.

As part of the arrangements under the Office of Government Information and Technology, most agencies are currently in the process of either improving existing HR systems or purchasing new HR system. We believe that those systems, through discussions with vendors of systems and with agencies themselves, will have far better capacity to record the kinds of data that we would like to see recorded, and to provide that data automatically through electronic means to the commission on an ongoing basis.

As I mentioned previously, we have done a fair amount of work in defining our data requirements, and certainly in refining them over and above what we were receiving through CRP. Those data requirements have been communicated to agencies through a fairly extensive circular—No. 1998/5, which I think has been tabled. Our view is that, if we work closely with agencies in implementing that new system, we will have a far better level of reporting.

Mr GEORGIOU—Can you tell me why it is that 12 per cent of agencies have not had approved EEO programs, and which ones they are?

Mr Kennedy—In the end, we have discussions with agencies. There are various reasons—it might be a new agency, or it might have a view of its place in the scheme of things which suggests that it is not appropriate to do so. We keep discussing that with them. I am not sure whether Ms Tim has the list with her, but we could provide it for the committee.

Mr GEORGIOU—Staying on agencies, there are a number of agencies which have not achieved any of the 2000 targets. Are there any agencies that have not achieved the 1995 targets and, if so, can we have them specified, because I do not believe the report actually specifies by department those failing to achieve 1995 targets? Related to that, and given that ANAO does sit in judgment on a lot of things, does ANAO regard its achievement of one 2000 target as satisfactory? Does ANAO apply the same strictures to itself that it applies to others?

Mr McPhee—As you know, we have reported on ourselves. Basically, we are working on improving our position. Clearly through our graduate intake we are taking more women—a very high percentage of women this year. In the last two years we have had a scheme for introducing Aboriginal cadets, and have taken two in the last two years. And I think we are ahead on NESB. Like other agencies, we are underperforming in terms of targets for people with disabilities. We have sought to address the issue in recent years.

Mr GEORGIOU—What has the Public Service and Merit Protection Commission done about agencies such as Treasury that have not achieved targets? Are you in constant discussion with them, or are they in the too hard basket?

Mr Kennedy—We have discussions with all agencies at the time of the approval of their EEO plan—in the old days. We have a lot of other discussions through our

networks. We try to discuss these issues with agencies. You will often find that the groups from which agencies tend to draw their staff or their historical structure, depending on their turnover rate, has a big impact on the speed with which change can take place. Often, it is harder for some agencies to attract people in the particular groups than it is for others.

Mr GEORGIOU—That sounds like a rationale for not doing much. With respect, that sounds like all the justifications that departments would trot out.

Mr Kennedy—Ms Tim can elaborate on Treasury.

Ms Tim—Using Treasury as an example, they have certainly identified that as well. They have an officer who has been working with us fairly closely for the last two months. They are trying to address the culture in their organisation as part of developing their strategy and the new workplace diversity plan.

Mr GEORGIOU—Have Treasury got an approved EEO program?

Ms Tim—I do not have the figures in front of me, but I am sure they do.

Mr GEORGIOU—Can I just conclude by saying that the finer reaches of statistics are fine, but you have a substantial number of departments and agencies that you have simply not reached an agreed program with. That strikes me as being a difficult situation.

I think it is one that you need to take very much on board for the future because, unless you have got bottom line agreement with departments, you are going to have great difficulty even implementing what those targets were. They were, essentially, people on the ground at the particular time that the targets were set and, indeed, in the case of the disabled, more people on the ground than the targets required.

Mrs STONE—How do you compare the data in the private sector with data in the public sector? Have you done a comparison of performance?

Mr Kennedy—We have, and we try to keep an eye on it. The audit office, as you probably know, did a comparison. I do not think it is any secret that we would have some concerns about their methodology. They obviously do not share those concerns; it is very hard because the private sector is so different. Our feeling is that in some comparable areas we do reasonably well, and in others we do not; it is a very varied picture in the private sector as well.

CHAIR—Thank you very much, ladies and gentlemen. I think we will move on now to the next audit report.

[11.52 a.m.]

BUTLER, Ms Sheila Margaret, Assistant Secretary, Programme Management Branch, Department of Employment, Education, Training and Youth Affairs, 16 Mort Street, Braddon, Australian Capital Territory

CAMPBELL, Mr Robert Ian, First Assistant Secretary, Employment and Purchasing Division, Department of Employment, Education, Training and Youth Affairs, Level 5, 14 Mort Street, Canberra City, Australian Capital Territory 2600

SEDGWICK, Mr Stephen Thomas, Secretary, Department of Employment, Education, Training and Youth Affairs, Level 6, 16 Mort Street, Canberra City, Australian Capital Territory 2601

GOLIGHTLY, Ms Malisa, Executive Director, Performance Audit, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory 2601

NICHOLAS, Mr Roderick John, Senior Director, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory 2601

CHAIR—We now come to the second session of today's public hearing. I remind witnesses that hearings today are legal proceedings of the parliament and warrant the same respect as proceedings of the House itself. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of parliament. The evidence given today will be recorded by Hansard and will attract parliamentary privilege.

The audit report being considered in this session is *Audit Report No. 24 1997-98: Matters relevant to a contract with South Pacific Cruise Lines Ltd*. I now welcome representatives from the Australian National Audit Office and representatives from the Department of Employment, Education, Training and Youth Affairs to the second session of today's hearing.

From the committee's perspective, the main purpose of this session is to examine the key issues identified in *Audit Report No. 24 1997-98: Matters relevant to a contract with South Pacific Cruise Lines Ltd* and to discover what action has been taken or is planned by the Department of Employment, Education, Training and Youth Affairs to address issues raised in the report. The committee wishes to examine DEETYA's administrative processes and guidelines, particularly in relation to the preparation of contracts, assessment of proposals and risk management. I would like to provide an opportunity for a brief opening address from DEETYA and ANAO. Mr Sedgwick, do you have a brief opening statement you would like to make?

Mr Sedgwick—Yes. The facts of this matter are succinctly set out in audit report 24, and I will not go over that ground unless the committee has a particular interest. The

department is already on the record in acknowledging that there were significant shortcomings in our administration of the SPCL matter. Guidelines were not adhered to, proper risk management procedures were not followed, some advice to the minister was inaccurate and the Commonwealth's funds were put at an unacceptable risk.

The ANAO acknowledges that these events occurred at a time of considerable challenge for both the Queensland area office and the department at large. While accepting that these challenges need to be properly weighed in any fair assessment of our performance, we do not believe that they constitute an excuse. It is our firm belief, however, that heightened awareness within the department of the value of good project and risk management, coupled with the new arrangements we have put in place for the management of labour market assistance programs, progressively and dramatically reduce the risk of a recurrence. I propose in these remarks to address what changes have been made since SPCL to minimise the risk of recurrence and to update the committee on other actions which have been taken.

The ANAO has made five recommendations, with a dominant theme being the need for more systematic project and risk management. Each of these recommendations has either been actioned or is in the process of being actioned. In particular, the department's management of the employment services market tender, the work for the dole tender, the job placement, employment and training tender and the current literacy, numeracy and career counselling tender involves a clear definition of the roles and responsibilities of those responsible for managing a project, a requirement for tenderers to establish their credentials as a supplier of the services to be provided—including by reference to past performance if they are a current provider or, if not, by reference to performance in a related field—a requirement for tenderers to provide information relevant to an assessment of their financial capacity to perform, which could include an examination of appropriate financial accounts, cash flow projections and credit checks, and a probity check of the standard sources regarding directors, et cetera. The precise details will and should vary with the nature and significance of the proposed contract.

The arrangements for the new employment services market tender, for example, were quite elaborate. I have here, and I am happy to pass it around a bit later if you like, a statement which was recently provided to the Senate estimates committee which sets out the procedures that were followed in the case of the employment services market tender.

The committee will recall that the bulk of the labour market programs previously administered by the department—including the training for employment program which led to the contract with SPCL—ceased on Friday. The guidelines for both terminating and ongoing labour market programs have been tightened, nevertheless, to require no advance payments in excess of 50 per cent or $500,000, whichever is the smaller, of the contracted sum. In addition, projects in excess of $1 million need to be referred to the national office for approval. Moreover, management of the residual labour market programs has been more heavily centralised since December as we have managed the transition to the new

employment services market.

The guidelines for the remaining labour market programs—Aboriginal employment and training assistance program, advanced English for migrants program and a new program called the regional assistance program—are being revised to reflect their changing character and the lessons learned from the SPCL exercise. Our legal, fraud and audit areas are all required to sign off on new or revised program guidelines before they are issued. They are also actively engaged in the design and conduct of major tenders.

The ANAO acknowledges that our guidelines were broken in the management of the SPCL contract. There is no doubt that risk would have been better managed if the guidelines had been honoured. However, the ANAO recommended that the department's approach to risk management be given clearer expression in the guidelines and, as we interpret it, there be more practical support for program managers in the management of risk.

The department's support for risk management principles and the responsibility of managers to apply them have been made clearer in the Chief Executive's Instructions issued at the beginning of this year with the introduction of the Financial Management and Accountability Act. We are also in the process of letting a tender to provide training to SES and relevant senior officers in project, program and risk management. The intention is to support the Chief Executive's Instructions with more practically oriented instruction, drawing on management advisory board material, as the ANAO has suggested. Value for money, risk management, rigour, accuracy, attention to detail and taking personal responsibility for getting it right also figure prominently in our recently released corporate plan. Release of the plan followed, and has been followed up by, an active program of discussion and dialogue involving staff at every level of DEETYA.

Finally, following publication of the ANAO report, I commissioned an external review focused on the accountability of individuals, given the facts which had been established. That review recommended action in respect of four officers, ranging from counselling to more severe disciplinary action. Those recommendations have been acted upon in three of the cases. The fourth officer is now employed by another agency and the recommended formal counselling would be ineffective.

In conclusion, I would like to agree with the ANAO's assessment that while our procedures were defective and the promised employment with the cruise line did not eventuate, significant outcomes were nonetheless achieved from the SPCL contract in that a significant number of individuals received high quality training which is relevant to their future employment opportunities.

CHAIR—Thank you, Mr Sedgwick. Mr McPhee, do you have a brief opening statement?

Mr McPhee—In September 1997, the Minister for Employment, Education, Training and Youth Affairs asked the Secretary to DEETYA, Mr Sedgwick, to refer the South Pacific Cruise Lines contract to the Auditor-General for investigation and the Auditor-General agreed to undertake an audit. This morning, Mr Sedgwick has provided a very frank assessment of the audit findings and what his department has done in response to them, including agreeing with all of the recommendations. I do not intend to cover the same territory.

The audit office considers that there would be value in developing better practice guidelines on risk assessment of new suppliers and we are in fact doing that and propose to publish them for the benefit of the service as a whole by the middle of this year. We intend to take some of the experience from the SPCL contract and distribute it in terms of good practice for agencies.

CHAIR—Thank you. Mr Sedgwick, I come out of the private sector and I do not understand, I have absolutely no comprehension of how on earth DEETYA could have let a contract to a contractor or a supplier without testing the financial viability of that contractor, and then to turn around and shift the contract from one contractor to another without seeking legal advice. Can you tell me how on earth this sort of action can occur?

Mr Sedgwick—Not easily. We do not attempt to defend what happened here. The procedures that were followed in many cases were not consistent with our own guidelines and they were certainly not consistent with best practice. They are certainly not consistent with the way that we now let tenders of this scale. I can only say to you that in the course of the arrangements that were put in place for the new employment services market tender, for example, a $1.7 billion tender, over 5,300 separate bids were assessed. We had very stringent procedures.

Mr GRIFFIN—Like Hospitality Horizons?

Mr Sedgwick—Like Hospitality Horizons. We had very stringent procedures in place. We did probity checks on the directors. We examined the accounts of prospective tenderers. We had a look at their cashflow projections and, in the event of any doubt, we sought further information. That systematic approach to examining the credentials and the viability of a tenderer was not followed in the case of SPCL, and we have acknowledged that. It would have been far better if it had been.

In defence of the people concerned, the project began with a reputable training provider, William Angliss 2000, who is based in Victoria. It changed late in the process. It changed in circumstances in which there was a representation that was made to the staff who were involved that it was important to SPCL and its accounts that the contract be drawn up with them rather than with William Angliss. Others may have taken a different view on that judgment, but it was a judgment that was made. William Angliss agreed to the contract being put in the name of SPCL rather than them and it flowed from there. It

should not have happened, but it did happen. I do not think it will happen again.

Mr GRIFFIN—Just taking the example of Hospitality Horizons, can you explain how that fits into the new improved process that you outlined before?

Mr Sedgwick—I will be a little careful because I think that all of the parties who were involved in the tender are entitled to have the commerciality of their dealings with us in the tender protected.

Mr BEDDALL—You can go in camera.

Mr Sedgwick—I do not have the precise file with me at the moment so I do not think that that would be a good idea. The process was really quite simple. This is the statement that we provided to the Senate estimates process. It sets out in detail the steps that were followed in this case. It was a multistage process.

If you were a tenderer and you put in a bid the first thing we did was to check to make sure that you conformed with what the RFT said you had to put in place. If you got through that stage—that is, you put in all the right forms and signed them in the right places—you then went in to two different streams of assessment. One stream looked at the financial viability issues. It examined the accounts and it investigated the standard databases for what was known about the company and its directors and key office holders. If a tenderer passed that stage then they were ready to move on to the next stage.

That assessment process was oversighted by a bunch of accountants and it used some very sophisticated tools to identify entities that were at risk. If we had any concern out of that then, depending on the nature of the concern, they did not proceed further in the process, there were questions that needed to be clarified in the final contract round or they were identified as a tenderer who needed to provide further information before they could proceed further, in which case our tender rules said that they were only considered after other possibilities in a region had been exhausted. That is the financial viability loop.

There was a second process which was to assess the suitability of the tender on other grounds. So there was a very detailed process. In here it will tell you about how we had different teams doing different things and some 3,500 of the 5,000 tenders were reassessed at least once and people in teams were changed in order that there was not a systematic build-up of bias within a team and various other things. Each tenderer was assessed against the selection criteria that were set out in the RFT. If it was a price based tender it was a pass or a fail. You were either judged as suitable or unsuitable. If you were judged as suitable you were able to go forward into the next stage provided you had also passed in the financial viability stage. If you were unsuitable you were stopped.

VICE-CHAIR—On that question of price, when you say suitable, was the price within the range that was acceptable?

Mr Sedgwick—No, suitability here was only in terms of their capacity reflected in the way they had responded to the selection criteria. The selection criteria required them to provide information about the strategies that they would apply in the new market not the old one. They were asked to detail what their experience had been in either the old market or in a similar field. If it was a new body they had to provide references to support their claims. They were asked to provide a statement about the kind of facilities that they would provide in support of the market.

If they were judged to be suitable against those criteria then they went forward to the next stage which is where price came into it. If it was not a price competitive tender—Intensive Assistance, for example, was not price competitive—then they were given a ranking score. They moved forward on the basis of their ranking score. If you were ranked at a score that was high enough to justify being considered in the next phase or if you were judged as being suitable for price competitive tenderers and you had been judged to have passed the financial viability test you then went into the next stage.

VICE-CHAIR—In terms of the way you have explained the price aspect of it, am I correct in saying that there were some tenderers who were judged as being price competitive—when you say price competitive, the price that they were looking at charging was seen as being competitive—

Mr Sedgwick—No, at this stage the price they bid had not been considered at all. At this stage, we simply looked at their suitability to be further considered against the selection criteria that were laid down in the RFT.

Mrs STONE—FLEX 3 was price given so there was not any requirement to put in a price bid.

Mr Sedgwick—In FLEX 3 what happened was that you were given a quality ranking. When we assessed your suitability against past performance, your strategies for the new market and the facilities that you were going to offer, you were ranked in a numerical way. They had a score which was then attached to their tender and they went forward. If their score was high enough they went forward to the next phase.

If they had passed financial viability and had been judged suitable against the selection criteria they went into the next phase. When they went through to the next stage the tenderers were ranked either according to price or according to their quality score depending on which service we were dealing with. In the business allocation phase we then worked through in a price order or rank order the claims of each tenderer to each service in each region. The judgments that were made were again quite sophisticated because we took into account, as the RFT said we would, things like geographic coverage and the extent of competition that was being provided in a region.

At times we passed over a more highly ranked provider in order to achieve a

coverage gain, for example. We would pick up somebody who offered service in areas of a region that previously had not been serviced, for example, or we would pick up somebody who would offer broader coverage across a region. We had some technology available to us that allowed some very sophisticated 'what ifs' to be played to enable us to make sure that we had coverage in the region, we had competition in a region and that we were able to meet specialist needs in a region having regard to the ranking which a tenderer had achieved either because of their price or because of their quality score.

We then sent out contracts to people who either accepted them or they did not. We took account of the fact that some people's volume bid was too high, that they wanted too much of the business in a region—too much of the business that was left by the time we got to them—and that there would not be enough competition. It was a very sophisticated process.

VICE-CHAIR—At that stage, how many tenderers were you down to?

Mr Sedgwick—Well 5,300 got to that stage.

VICE-CHAIR—When you were at the stage of sending out contracts, what were you down to then in terms of the number of contracts?

Mr Sedgwick—Contracts, we were down to about 300.

VICE-CHAIR—So the 5,300 was down to about 300 at that stage.

Mr Sedgwick—Different things. We had 5,300 tenders, we had 1,016 tenderers. So we ended up with 300—

VICE-CHAIR—So the 1,016 tenderers was down to 300 tenderers.

Mr Sedgwick—Yes.

Mrs STONE—I know this is not really the basis of what we are here to talk about today in particular, but one of the problems we have is that there was not really tight definitions from DEETYA about what outreach programs meant, was there? There was not a specified expectation of what an outreach service constituted. Am I right in saying that?

Mr Sedgwick—No, I do not think so. It was up to a tenderer to tell us what kind of outreach services they were proposing to provide and we took those into account.

Mr BEDDALL—So you were absolutely confident, when you got to that stage, that every single person who was offered a contract had a viable business and knew the industry they were engaged in?

Mr Sedgwick—By the time that we got to the point that we had issued a contract—can we be very clear about the financial viability test?—we never tested the capacity of a business to survive at the price that they offered because their capacity to survive depends on the business that they attract.

Mr BEDDALL—That is fine. I am asking: were you convinced they had a viable financial business?

Mr Sedgwick—We were convinced, on the basis of the information that we had available to us, that their balance sheet information and their financial history was consistent with believing that they could run a viable business.

Mr BEDDALL—Were any contracts offered to start-up businesses?

Mr Sedgwick—Of course.

Mr BEDDALL—If so, how were they seen to have a viable business, if you do not take into account their contract price?

Mr Sedgwick—Again, we are a fair way away from report 24, excepting that this process—

Mr GRIFFIN—The point we are trying to get at here is that we all agreed that the SPCL business was a debacle. The question was, as you emphasised in your opening statement, the lessons learnt and the fact that things are a lot better now. So, given there is some information in the public domain which suggests some issues around the question of what those new process are, I think it is central to the first issue.

Mr Sedgwick—The particular detail about particular tenderers and—

Mr BEDDALL—No, I am not talking about that. I am talking about generic start-up business.

Mr Sedgwick—There was nothing in the RFT that prevented a start-up business. Indeed, I believe you would rarely want to prevent a start-up business from competing in a tender. Otherwise, you do not get new blood into the arrangements. If we were going to worry about start-ups, then we would not have done some of the changes that have occurred in the delivery of labour market programs over the last 10 to 15 years.

Mr BEDDALL—No. My point is, the failure rate of start-up businesses, in any field, is about 70 per cent. So I would suspect that there was a weighting factor in the tender process.

Mr Sedgwick—I do not want to be too specific about this because we need to protect the integrity of our assessment systems next time round. But in our financial viability checks, we drew on empirical data and some work that has been done by a world represented organisation—I have forgotten the name of the organisation—that deals with this kind of issue, to flag the kinds of indicators which would suggest a risk of failure or not.

Our financial viability processes drew on the information that is available in the accounting profession to assist us to recognise the early symptoms. None of this is perfect. There is always the possibility that, in a market where consumer choice is dominant, people will find that the going is tougher than they thought. But I can give you an assurance that, to the extent that you can do it in a systematic way, we did it in this process.

Mr BEDDALL—One of the things you said before, and I am coming back to your own evidence, is that you did not take into account the price that they tendered at, because that was assumed to be a business decision they had made because of this business expertise. My concern is that if a number of start-up businesses have tendered and the price they tendered at is not a factor in their getting the contract, then you are opening yourself up to failure.

Mr Sedgwick—No. Any tenderer, no matter what price they contracted at, will need to follow strategies in the way that they service clients and in the way that they manage their own costs, which will ensure that they can be viable at whatever price they tendered at. In the assessments that we made of financial viability for job matching—FLEX 1—which is an outcome payment, if they do not deliver then they do not get paid. The financial risk to the Commonwealth is very small in the case of FLEX 1.

Mr BEDDALL—But the risk to the client base is large.

Mr Sedgwick—Let us go back to SPCL: the SPCL question was basically about financial risk to the Commonwealth. The financial risk to the Commonwealth in the case of a FLEX 1—whether it is a start-up or an old company does not matter—is relatively low. We believe the market risk to the client is being addressed in the extent of competition and the depth of the market that has been put up and in the incentives which an individual provider has to actually perform.

There is quite strong competition in all of the markets, in all of the five services, quite strong competition. If it does turn out that an individual is not performing, then there are others in the market who can take their place. There are mechanisms in our contractual relationships that allow us to monitor the market and to review the level of business that we would be prepared to accept.

Mr BEDDALL—In the case of SPCL, I happened to hear a recent interview on

Brisbane radio where one of your clients had then been through three training programs. She was an SPCL client; she was passed on to another training program; and then passed on to another training program—all three of those providers were offering the same sorts of job opportunities, and each one of them failed. This is a woman in her mid-40s. At some stage she is looking for outcomes. I notice that the audit report says that it was good because people got training. But what is the objective? I thought the objective was to put people into employment.

Mr Sedgwick—Yes, that is precisely the government's rationale for the new market. The government believed it was too easy for an outcome to be defined as training. Under the TEP program an outcome could be defined as training. One of the novelties, one of the attractions, one of the reasons that some of the individuals involved may have been interested in pursuing the SPCL proposition was that they were proposing not only a training opportunity but also a job. The original approach was: 'Give us the subsidies to train the people and we will take them on a cruise ship.'

Mr BEDDALL—But then in phase 2 of that—and your officers would certainly know—weren't these people passed on to another cruise line which then failed, some of them at least?

Mr Campbell—I think you are referring to an employer called Richells shipping line who was attempting to establish a ferry service between Sydney and Melbourne. Late last year, some 15 or 16 of the SPCL trainees were referred to the Richells shipping line and I think about 11 or 13 of those went to Sydney for a short period of time. Yes, your comment is correct.

Mr BEDDALL—What happened to the Richells shipping line?

Mr Campbell—I am not up to date with the current arrangements. But at the time this occurred I think there were some charges laid against the principal of the shipping line. However, let me make this point: what occurred with regard to the Richells shipping line was referrals of job seekers to job vacancies. There was no program money involved. There was no training money or any subsequent money involved.

CHAIR—Do you have a question on the same point?

Mrs STONE—It is not on the same point.

Senator HOGG—I want to follow on the same point. The outcome was to be employment, but there was no employment at the end of the SPCL contract because of the failure of the company; yet it was described by Mr Sedgwick as being a significant outcome. To me there was no significant outcome at all. The significant outcome was that people who were long-term unemployed did not have a job materialise that was promised to them through this training process. What did DEETYA do to follow up these people

after the process had collapsed?

Ms Butler—It is true that none of the trainees got work with SPCL because the company withdrew from the market, although there was the expectation until the very last that those opportunities would be available to them. The CES immediately instituted a concentrated program of assistance to the job seekers who were disadvantaged. They did a concentrated vacancy search to try to generate jobs and have extra vacancies notified, particularly in the areas in which those trainees had received training. So it was not unexpected that some companies like Richells should come forward and seek trainees who were likely—

Senator HOGG—Of the 300, how many were placed?

Ms Butler—As at 21 April, some 201 trainees have been placed in employment and some 31 are no longer on the CES's books. Of those placements, 111 of them are in full-time employment, 20 people were placed in short-term jobs—that is not inconsistent with the hospitality market—and a further 70 are in casual or permanent part-time employment.

Mr Sedgwick—Can I take you back to paragraph 36 of page xvii of the report which makes the point:

Notwithstanding the above concerns—

and we all share them—

the Department has provided substantial and significant training, at a now accredited and industry accepted level, to more than 300 long-term unemployed persons. This is a valuable outcome of the project, even though well short of the outcome expected by either the participants or the department.

Let us be in no doubt that we wanted—and we would ultimately judge as a success—circumstances in which the bulk of people would have got the job that had been offered on the cruise line. Nonetheless, 300 people who were long-term unemployed did get an accredited training outcome which was consistent with the TEP guidelines. It is not everything but at least it is something.

Mr BEDDALL—But it was not even an accredited training program until after they completed, was it?

Mr Sedgwick—The training that they undertook comprised a large collection of accredited modules of training. There were two, from recollection.

Mr BEDDALL—I read somewhere in the audit report—they may remember, and maybe I read it wrong—that it was not until afterwards that it became an accredited course.

Mr Sedgwick—I will come to that. They were undertaking accredited modules from other accredited training programs. In order to have the entire course accredited as a course, as cruise ship hospitality level 2, there were some steps that needed to be gone through with the accrediting bodies. You are quite correct that the steps to accredit the course were not completed until after the training had been completed. Nonetheless, the training that was being undertaken was in accredited modules of courses all the way through. I have forgotten which party, but one of the parties had represented to us that this would be an accredited course. We were very pleased when that commitment was honoured.

Mrs STONE—You have obviously responded to recommendation No. 2—that DEETYA staff involved in the preparation of contracts and contract management will be provided with adequate training and guidance. Obviously you know exactly which staff were involved with this Queensland problem. Have they been specifically targeted with this training? Are they still in fact in positions of responsibility vis-a-vis this sort of assessment of future providers of training? What has been the outcome for the specific staff who handled this problem that we are talking about?

Mr Sedgwick—I would like to try to protect the identity of individuals if I can.

Mrs STONE—I am not asking for their identity; I am asking what has been the outcome for them. Have they been targeted with training and counselling? Are they still in positions of responsibility in relation to these sorts of future projects?

Mr Sedgwick—There are a couple of points to make here. The labour market programs of the future will be delivered through nationally managed tender arrangements. There are only three ongoing labour market programs of the old kind. They are the ones I referred to earlier—that is, AMEP, RAP and the Aboriginal employment strategies program. Until very recently when we had concluded our internal examination of the individual accountabilities of those involved, we had limited the delegations that were available, particularly in regard to the key people involved. The individuals concerned, apart from one who is no longer with us, have all received counselling. I can tell you that this is seared on their souls. They fully understand the gravity of what has happened here. One of them is undertaking a project management course in his own time, actually, but they certainly have been formally counselled. In one or two cases, more action than that has been taken as well.

Mr GRIFFIN—On that issue, you mentioned earlier that a fourth officer had in fact moved departments, I gather.

Mr Sedgwick—He is now outside Public Service act coverage.

Mr GRIFFIN—Completely?

Mr Sedgwick—Yes.

Mr GRIFFIN—So there is no scope to deal officially with him?

Mr Sedgwick—No. The recommendation in that case was counselling. I have it in mind to have a conversation with this person, but it would not be formal counselling.

Mrs STONE—My concern is that the professional skills and ability to work in a more competent way in the future are enhanced through what we do now with them in terms of both professional development and training. I am not talking about revenge but about assisting them. What you are saying is that those who are left in the department are receiving training or counselling or are no longer in those areas of responsibility.

Mr Sedgwick—All of the above.

Mr BEDDALL—My understanding on it, and I am not an expert, is that if you are going into a training program—that is, SPCL—you cannot get Commonwealth assistance unless it is an approved training course and the modules and everything are approved. Is that right?

Ms Butler—No, that is not necessarily the case.

Mr BEDDALL—What about Austudy and those sorts of things? I thought there had to be a tick.

Ms Butler—It depends under which program the assistance is being provided. To receive Austudy, for example, it has to be a course that is approved. Under a number of the labour market programs that we have run, people have been providing services to a project design under, for example, work for the dole where a project is specified and the activities are specified. That is not a training course, but there is an agreed provision of activities.

Under the training for employment program, which was the program that related to SPCL, there is a recommendation that, as far as possible, the training undertaken and training purchased be recognised training accredited with the appropriate training authorities. That is not universally the case because there are a number of jobs for which training will be useful in assisting people to get employment but there is no accredited training available. To be exclusive would in fact limit severely the job opportunities that we are able to offer to long-term unemployed and disadvantaged people. So it would come back on the advantage of the job seeker if we were to make that strict.

Mr BEDDALL—In the category of lessons learnt from SPCL and now with the brave new world of outsourcing of these sorts of activities, is there a move by the department to try to get a firmer arrangement than best intent in relation to this training?

When the department had control, it did not work that well and now the department has relinquished control of some of these programs, not completely, but in a more liberal way.

Ms Butler—I guess we are addressing one particular case where there was a severe failure of the arrangements. There were many courses under the labour market programs where people had successful outcomes and gained employment as a result of training undertaken.

Mr BEDDALL—These things are only any good if you learn from them.

Ms Butler—They certainly are but in the market the arrangements are that job network members will be funded to provide individually tailored assistance to meet the needs of the particular job seeker and to make the most, if you like, of the opportunities that are available in the local labour market. While the government's objectives in terms of a trained and skilled work force will certainly be supported and pursued through job network, we would again not wish to be prescriptive to a point that it prevented job network members providing assistance and training, whether it is accredited or not, which will help a person get employment.

Mr BEDDALL—But you obviously want value for money. One of the assessments we have made here is that one of the criterion for these programs being provided by these new private sector providers is cost. If there is a differential in the quality of training, that would affect cost, would it not?

Ms Butler—Yes.

Mr BEDDALL—What I am saying is that the quality of the service provided also has to be a factor, not just cost.

Ms Butler—It most certainly does.

Mr BEDDALL—Are you moving to a more formal overview of the type of training provided?

Ms Butler—The type of training provided under job network will be a decision for the provider. You must understand that the labour market programs, as we have known them, as the secretary has said, will cease. So it is the provider's decision in working with the job seeker as to what is appropriate to that job seeker's needs and what will produce the best outcome for the job seeker in their labour market.

Mr BEDDALL—But you are paying for it, aren't you?

Ms Butler—Yes, we are paying for it in outcomes. The payments to job network members will be made when they secure eligible job seekers a job. It comes back to the

decision of the provider as to what is the best training to provide to secure an eligible person a sustainable job.

CHAIR—Can I change direction, because we are going to run out of time. One of the things which I think the committee is concerned about is this issue of financial accountability and advanced payment. In addition to the advanced payment problem that was part of this particular contract, has your department put in place controls or mechanisms to try to prevent the 30 April syndrome as well, where contractors tend to be overpaid in order to get rid of department money ahead of a new financial year? There are two issues in the one question.

Mr Sedgwick—Could I start with the advance payment in the context of the TEP program, or programs more generally? The guidelines were quite clear on that point and the guidelines said that an advance payment could only be made in exceptional circumstances. One of the things that was done subsequent to SPCL was certainly to leave that exceptional circumstances rule, but also to restrict the amount of advance payment that could be made, even in those exceptional circumstances, to 50 per cent or $500,000—whichever is less. We also instituted a requirement that any proposal over $1 million had to be referred to the national office.

To the extent that there is continuing scope for that kind of activity in the arrangements that apply from Friday onwards, it is very small. It has been heavily constrained. There are circumstances in which an advance payment makes sense, particularly if there are start-up costs that need to be met, but they should be the exception rather than the rule.

In terms of the end-of-year spend-up, which I think is what you were referring to, like all other agencies, we are required to comply with the Finance Minister's Orders—what used to be called Finance directions—and they require that any advance payment of that kind has to constitute value for money, including appropriate recognition of the time value of money. Those guidelines are in place across our organisation as well as anyone else's.

CHAIR—As a private sector contractor in a minor sense to the Commonwealth but in a major sense to the state of Victoria for many years, June was always a time when the education department got on the phone, through the architect or directly, and said, 'For heaven's sake, Mr Charles, please make sure you put in a big progress claim this month because we have to get rid of the money.'

Mr GRIFFIN—We should be investigating you!

CHAIR—They always got their buildings—I do not need to be investigated!

Mr Sedgwick—The running cost guidelines that we work with attempt to minimise

the incentives to make payments like that by allowing agencies to carry over up to 10 per cent of their running cost allocation between years.

CHAIR—Is that new?

Mr Sedgwick—No. Some 15 years ago there was a big competition at the end of the year to spend up because your appropriation lapsed on 30 June. Progressively over that time, the amount that could be carried over has increased. I think it was three per cent for a while, and a few years ago it went to six per cent, and then it went to 10 per cent. The idea was to stop silly things happening at the end of the year.

Risk aversion is alive and well in the Public Service as well as anywhere else, and one of the things that I have discovered in this organisation, in Finance and, I suspect, in just about every other organisation around the place, is that a lot of managers do not want to run out of money. They prefer not to have to borrow, and so they tend to plan discretionary expenditures for the last quarter when they know whether they have the money to pay for it.

When I used to wear another hat, I used to say, 'Be sensible even with the flow of expenditure through the course of the year.' But I can well understand why people would not want to put themselves in the position where they had an unexpected bill at the end of the year that they could not pay for. There are discretionary items of expenditure that get done in the last quarter simply because that is a sensible management of funds over the course of the year.

CHAIR—Mr McPhee, can you comment on those issues?

Mr McPhee—I would agree with Steve, in the sense that there are some discretionary expenditures held over until agencies get a feel for the total agency budget. Also, there is the issue within agencies about whether they get the guaranteed carryover themselves or in their regional area. The issues that we are dealing with very much are concerned with running costs as opposed to program moneys. There is another issue relating to program moneys. The carryover arrangements generally do not apply to those so it is a different issue. The program moneys are the big area where the funds are, not necessarily the running costs.

Mr Sedgwick—That is more likely to be the case that you instanced, where somebody said to you that there is money about to lapse.

CHAIR—I have an AAP wire service report that indicates:

The man who won a government contract to provide a job-seeking service despite not having an office or staff has reportedly subcontracted the work to another company.

It was reported that a spokesman for your department told the paper that it had approved subcontracting for Employment Interactive and Hospitality Horizons. It said that Job Futures, a consortium of about 25 community and religious groups, would take over as the subcontractor for the companies and Job Futures would pay the original contractors. Is it not true that allowing subcontracting to occur under those circumstances will allow profits to be made at the expense of service provision?

Mr Sedgwick—I guess I do not see it that way.

CHAIR—If the original company that you let the contract to is now going to make a profit by subcontracting it and the subcontractor also has to make a profit, isn't service provision going to be the loser in the end?

Mr Sedgwick—There are a couple of things on that. One is that the RFT allowed subcontracting and our contractual arrangements with providers allow them to subcontract with our approval. That is the first point. So there were no deals for Mr Roude or anybody else.

CHAIR—I did not imply that.

Mr GRIFFIN—But there is scope for that to occur. That is what I would argue. If you have a process whereby you have a tendering and contracting—

CHAIR—Let him answer the first question first.

Mr GRIFFIN—I think it relates to that, though. When you have a tendering and contracting process, the department and the government basically decide on the 300 or so based on a range of good reasons—for example, financial, and I am not questioning the intent. Having got that, don't companies like this then have a form of monopoly, in that they have a component of what is there and then, when it comes to the question of looking at subcontracting, they have got control? Other agencies or tenderers who missed out but who still want to stay in the game effectively have to work through those organisations that have been successful. Doesn't that, in effect, lead to a situation where there can be real question marks raised?

Mr Sedgwick—I would come at it the other way—what are the job seekers and the employers getting? The way these arrangements are set up—particularly for FLEX 1—is that they are price competitive, which is where one of these characters, whose name we will not mention, made his cash. It is a price competitive process. To the extent that anyone is going to pad their costs—by setting up elaborate subcontracting arrangements, for example—they are going to have to make a quid against other people who are not. There is a natural discipline in the market that says that you cannot set up Amway and expect to make a quid in the job matching market when you have free and open competition in a blind tender where you have to set your price without knowing others' prices.

The second point relates to servicing the needs of clients. We fully understand that there will be circumstances where the most efficient way to get the full range of services that are needed is to subcontract, and the arrangements comprehend that. The arrangements also give us the flexibility, so if a provider comes to us and says, 'I can't service the needs of the client,' for whatever reason, we have options available to us, which include a subcontracting arrangement if we are happy with it, an assignment of the contract—where somebody else stands in the shoes of the contractor and takes on all of their obligations—or the termination of the contract. We will make a value for money, best interests of the client, judgment in each of those circumstances and the RFT will allow that.

Mr GRIFFIN—If I am a contractor who has been successful in that first stage and I then decide to do some subcontracting from there, what requirement is there for me to tell the department what I intend to subcontract? Do I need to tell the department at the beginning of the process when I am first applying for a contract or at the end of the process, after I have been awarded the contract and I am in the situation where I am looking at delivering the services?

Mr Sedgwick—The tenderers had the capacity to tell us in their RFT what subcontracting arrangements—

Mr GRIFFIN—The capacity or the requirement to? Must they tell you or is it up to them? What do they have to tell you?

Mr Campbell—In the RFT, there was provision that, if an organisation was going to subcontract a substantial part of the business and not simply purchase services—because organisations will always have to purchase services—then they had to tell us as part of their tender.

Mr GRIFFIN—Define 'substantial'.

Mr Campbell—It is case by case but, for example, if an organisation had a NEIS contract in a region and they wished to subcontract in one or two locations, we would argue that that was substantial. You have to look at it on a case by case basis.

Those who proposed to subcontract had to tell us at the time of putting their tender in. So when the contracts then went out, that subcontracting arrangement had to be considered as part of the assessment of the tender and that subcontracting arrangement would then have been part of the contract. Given that many organisations did not get a contract for everything they bid for but they got parts thereof—because demand was very great—we said to other organisations, 'If as a result of this, you wish to subcontract a substantial part or a whole part of your business, you can come back and seek our approval.' A very small number of organisations have done that since the end of January. As the secretary says, we do it on a case by case basis, taking into account the organisa-

tion subcontracting, its consistency with the tender they put in with regard to meeting their strategies and indeed the organisation they are going to be subcontracting to.

Mr Sedgwick—We have to have the flexibility to do that, because not everybody got in the tender what they wanted. We had to allow people the capacity to come back and tell us what their business response would be in circumstances in which we gave them business that was in their range but may not have been at the top of their range.

Mr GRIFFIN—But if a guy with no office, no staff and no phone line gets a contract—and you may not be able to answer this at this stage and I understand if that is the case—one would suggest that he is probably going to go well past substantial on the question of subcontracting. You wonder how he got through that process.

Mr Sedgwick—Not necessarily. Let us say that, hypothetically, somebody in those circumstances actually had quite substantial experience in the business, then you might well believe they had the capacity as the prime source. In the course of examining their bid, we also would have looked at their financial basis. We would have had a look at what kind of financial backing they had to support an operation. The fact that they may subsequently come back and say, 'I want to do it another way,' is comprehended by the arrangements and, of itself, does not necessarily mean a thing.

Mr Campbell—If I could add one more point in the hypotheticals, it was also of relevance what services the hypothetical tender would have been going to be contracted for, because there is a very big difference between the money at risk from the Commonwealth with regard to FLEX 3 rather than for FLEX 1.

Mrs STONE—After 1 May all of the new job network is supposed to be in place according to their tender. How soon after that are you going to monitor who, in fact, has delivered and has in place the services as agreed?

Mr Sedgwick—We have quite a degree of interest in what is on the ground and we will be monitoring it quite closely.

Mrs STONE—I ask this because—in my electorate office, for example—I am trying to do that right now, in anticipation of 1 May; and it is extraordinarily difficult, let me tell you, to get information.

Mr Sedgwick—Okay.

CHAIR—When the national office identified risks with SPCL, why did you not then institute your risk management procedures? Why was there inaction when the problems were identified?

Mr Sedgwick—I am not sure I follow the question. National office became

aware—

CHAIR—The problems occurred in Queensland, right?

Mr Sedgwick—Yes.

CHAIR—But once you knew there was a problem, why didn't the overarching national risk management procedures come into effect? How on earth did they subcontract that thing—shift it—without a contract, without getting legal advice? That is beyond me, too. I asked you that before.

Mr Sedgwick—Yes. It is probably beyond most of us, but, in terms of the substance of your question, which I think was the follow-up, national office became aware of this after the contract had been signed; in fact, I think it was even after the training had been started.

Mr Campbell—Yes; 17 and 18 June.

Mr Sedgwick—National office was involved right at the very start—by taking somebody from William Angliss to Queensland and setting up the original process, and then they bowed out. The next involvement of national office was after the contract had been signed. The issue there was to ensure that we had reasonable monitoring of the flow of funds from SPCL through to William Angliss, keeping a close eye on the training that was being provided by William Angliss. Essentially, from our side, we had gone past the point where there was value to the Commonwealth in terminating the contract. The value to the Commonwealth lay in getting the training and getting the funds passed through from SPCL to William Angliss.

It is interesting that when the approach came to change the head contractor to SPCL, the arrangement that was agreed was that William Angliss would be a subcontractor; but William Angliss did not have a contract. That commercial arrangement was allowed to go forward and we were simply dealing with an arrangement, after that, when we were trying to get the training and ensure the bona fides of SPCL. We kept hounding them to come up with proof that there was actually a cruise ship. Until the Friday—5 September, I think—before there was meant to be a meeting between SPCL and the trainees to tell them where to report for work, and even beyond that point, SPCL was representing to us that a job would be in fact provided. It was only just before the people actually came together, on the following Monday or Tuesday—the 10th—that they were told, 'I'm sorry, but there is no job.'

So our role, having got a contract that was at least delivering training, was to try to make sure that that actually happened. It was only at the final death, when SPCL failed to deliver either the ship or the jobs, that things finally terminated.

Mr GRIFFIN—I know you cannot answer specific questions on Hospitality Horizons at this stage, but it would be very handy for the committee if, at a time when matters can be discussed, you could write to us and explain how that situation occurred—around the question of the new improved guidelines and why in fact it is all okay, if it is.

Mr Sedgwick—Is your question in relation to how Hospitality Horizons got the contract?

Mr GRIFFIN—I know you cannot go into detail about it but, from what is on the public record, it appears that, firstly, they got a contract and, secondly, that there are significant questions that need to be asked about the question of how they made it through the process. From what you said earlier, I gather that you do not think you can comment on that in specifics at the moment.

Mr Sedgwick—Let us deal with another hypothetical. It is possible that in our financial viability assessments there were some issues raised about the liquidity of a company, for example, and that before a contract was issued we required additional information which would enable us to be satisfied that there was not in fact an issue remaining to be addressed, and that substantial evidence came forward at that time.

CHAIR—We are going to have to finish. We will break for lunch and reconvene to talk about Collins class submarines.

Proceedings suspended from 1.01 p.m. to 2.19 p.m.

ASKER, Commodore Eoin Michael, Director-General, Undersea Warfare Systems, Defence Acquisition Organisation, Department of Defence, Canberra, Australian Capital Territory 2600

BARTER, Captain Tim James, Submarine Project Manager, Defence Acquisition Organisation, Department of Defence, Canberra, Australian Capital Territory 2600

HYMAN, Mr John Alexander, Commercial Director, Undersea Warfare Systems, Department of Defence, Canberra, Australian Capital Territory 2600

McPHERSON, Mrs Merrilyn, Acting Deputy Secretary, Acquisition, Defence Acquisition Organisation, Department of Defence, Canberra, Australian Capital Territory

MUIR, Mr James Gregory, Director, Acquisition Review, Defence Acquisition Organisation, Department of Defence, Canberra, Australian Capital Territory

OXENBOULD, Rear Admiral Chris, Deputy Chief of Navy, Navy Headquarters, Royal Australian Navy, A-4-18, Russell Offices, Russell, Australian Capital Territory

PURCELL, Rear Admiral Peter Terence, Head, Systems Acquisition (Maritime and Ground) Defence Acquisition Organisation, CP 2-6-15, Campbell Park Offices, Russell, Australian Capital Territory

WATTERS, Mr Gilbert Michael, Acting First Assistant Secretary, Capital Equipment Program, Defence Acquisition Organisation, Russell, Australian Capital Territory

BARRETT, Mr Patrick Joseph, Auditor-General, Australian National Audit Office, 19 National Circuit, Barton, Australian Capital Territory 2600

McNALLY, Mr Raymond Gordon, Director, Performance Audit, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory 2601

MINCHIN, Mr Tony, Executive Director, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory 2601

SEYMOUR, Mr Roger, Consultant, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory

YANDELL, Mr Thomas Charles Nicol, Consultant, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory 2601

CHAIR—Welcome. We now come to the final session of today's public hearing. This afternoon, we will be taking evidence on *Audit Report No. 34 1997-98: New*

submarine project. The committee has received one submission from the Department of Defence in relation to audit report No. 34. I remind witnesses that the hearings today are legal proceedings of the parliament and warrant the same respect as proceedings of the House itself. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of parliament. The evidence given today will be recorded by Hansard and will attract parliamentary privilege.

I refer any members of the press who are present to a committee statement about the broadcasting of proceedings. In particular, I draw the media's attention to the need to report fairly and accurately the proceedings of the committee. Copies of the committee's statement are available from the secretariat staff.

From the committee's perspective, the main purpose of this session is to examine some of the key issues identified in audit report No. 34. The issues the committee will pursue include sharing of contract risk, risk management practices, contract management and control, and the commercial orientation of the project office. With that background, I would like to provide an opportunity for brief opening addresses from Defence and from the ANAO. Does Mrs McPherson have a brief opening statement?

Mrs McPherson—Yes, Mr Chairman. While Defence accepts most of the ANAO recommendations as contributing to the ongoing improvement in Defence's management of major acquisitions, the committee might note that many of the recommendations are current Defence policy and have been or are being implemented in some form. The report discusses a range of problems which have been experienced in the project to date and Defence acknowledges these.

I would like to emphasise that the project is one of the most complex ever undertaken in Australia. Construction commenced at two greenfield sites in parallel, with the design and development systems running in parallel. The inherent complexities in such a large project, the like of which has not been attempted in Australia before, inevitably means that problems will arise, difficult decisions have to be made and appropriate changes implemented. Defence acknowledges that the ANAO has had a very difficult task in attempting to review such a complex project which is at the leading edge of technology.

Unfortunately, in our view, the report focuses on problems encountered during the development and construction of the submarines rather than on what has been done to manage and overcome the problems while maintaining progress. The problems identified by the ANAO were well known to the project team with appropriate remedial action either complete or in progress.

We have always acknowledged that the submarine project posed significant risk, as does any acquisition of this complexity, cost and duration. We also acknowledge that there is some remaining risk in completing the project, but we believe that the risk is now much reduced and under effective management.

We have made the hard decisions in the interest of all parties, given the circumstances at the time. We remain confident that the submarines will achieve the capabilities specified in the contract and will be delivered within the current approved financial provision for the project. The project cost has not increased in real terms but remains within its original budget of $5.05 billion despite its developmental nature, long duration and the low levels of contingency included in the original project approval.

The media attention on the ANAO report has been unfortunate but not unexpected, and much of the commentary has been factually misleading. The Collins has successfully fired the mark 48 torpedo, and Defence is not considering cancelling the tactical data handling system although, as with most software systems, it will evolve and new and upgraded technology will be incorporated progressively.

Both the report and the media have focused on the fact that 95 per cent of the contract funds have been paid to ASC but that only two submarines have been delivered. The funds still to be paid to ASC are an important, but not the only, indication of ASC's ability to complete the project. ASC's audited accounts were reviewed during 1997 by two independent groups of chartered accountants, and both accept the director's report that ASC has sufficient financial viability to complete the project.

The department continues to monitor ASC's capability and capacity to conclude the project, as it has done since the contract was awarded in 1987.Progress is measured against some 2,700 work packages, and the aggregated progress to complete is some 95 per cent, as indicated in our submission. Two submarines have now been delivered to navy, a further two have been launched and the final two are at a very advanced stage of construction.

Defence largely agrees with the recommendations of the audit report; however, there are a number of issues that we still do not totally agree with. These have been indicated in our submission in more detail.

In conclusion, yes, there have been technical problems. We never expected to have a first of class submarine to be problem free. Indeed, the absence of technical problems would have indicated that we had not been ambitious enough in our specifications and would have delivered capability with dated technology. Contrary to the ANAO review, I believe that the project office has been effectively managing this very complex project, and my colleagues and I welcome the opportunity to answer your questions this afternoon.

I would like to add one thing before passing over to my colleagues to take questions of detail relating to the submarine project. If your questioning leads into areas that we can only answer in camera, I would ask that we do that at the end of the session, or at least to ensure that we go into in camera only once.

CHAIR—But we do not have any. Mr Barrett, would you like to make a brief

opening statement?

Mr Barrett—Thank you. The audit objective was to assess project management by the department's project office in the light of accepted better practice project management techniques. Importantly, it aimed to derive lessons to be learned and recommendations that could be applied to the project and to similar Defence projects now and in the future.

The project contained some significant achievements, given that the production program commenced at separate sites in 1987 and ran in parallel, as is indicated, with design and system development. In many ways, the project demonstrates the capacity of Australian industry to produce to world class standards. Nevertheless, the submarines do have unresolved problems relating to design and system reliability which, in part, may be expected with a large and complex first of class submarine.

The major concern has been the high level of expenditure against project funding and the apparent outstanding commitments still to be met, as has been indicated. We do not have explanations for this. Numerous defects discovered late in the construction and trials period indicate persistent problems with quality management, inspections tests and the trials themselves. Some problems result from a combination of Defence's lack of contractual leverage and also, in our view, the project office' lack of determined, commercially focused follow-up of project risks identified early in the design and construction phase to minimise later lack of performance. The project office seemed to achieve little in practical terms from representations concerning the need to improve the quality of some of the Collins imported hull sections and imported seam welded pipes now installed throughout the submarines.

The submarine's combat system software, as we understand it, still remains incomplete. We understand that some software based systems are performing as intended but are under continuing review, as has just been indicated. There is a strong argument for such reviews to continue, particularly in relation to safety critical or mission critical software functions. A major problem has been with the integration of the various systems.

Importantly, in our view, as part of the $56 million performance guarantee considerations, the Commonwealth would benefit from an independent team's examination of the submarine's design and design control. Again, in our view, Defence needs assurance that the submarine's design and the design documentation are under appropriate management control and that all technical performance specification objectives have been met. This issue should be addressed in any risk management assessment, even at this relatively late stage.

It is essential that project risks be managed sensibly and responsibly in the interests of all parties. This should be done in a strongly disciplined and systematic fashion throughout the project so that there are no surprises. Project management has to reflect the integration of risk control and quality outcomes. This demands mutual understanding and commitment of all parties to ensure successful integration, which has been

achieved through a real sense of partnership that recognises both individual and collective responsibilities.

In preparing the audit report, we sought to balance Defence concerns about the security of naval information with accountability for expenditure of significant amounts of public funds. Our report made 12 recommendations designed to improve project management on the new submarine project and other major defence projects. Defence agreed or agreed in principle to eight. Comments have been made about a lot of these issues already being put in place. The recommendations were reconsidered extensively in light of Defence's comments but, in the end, they reflect the views that we gained throughout the audit.

When the audit report was tabled, the minister welcomed the constructive findings and said the report contained some valuable lessons that will be used in the management of all defence projects. Tony Minchin and Ray McNally were the senior audit staff involved in the audit. Also present today are two of the technical consultants on the audit, Mr Charles Yandell and Mr Roger Seymour.

CHAIR—Thank you for that, Mr Barrett. ANAO recommendation No. 3 reads:

The ANAO recommends that future major Defence contracts provide the opportunity for direct access by the ANAO to records of transactions of contractors or major subcontractors which support the expenditure of Commonwealth funds.

Could Defence please tell me why you have not agreed to that recommendation.

Mr Watters—The basic reason we do not agree with that recommendation is that we believe that, by auditing Defence, the National Audit Office has access to adequate documents and information to form a view on the Commonwealth's interests in the management of any major defence contract.

CHAIR—If I as a contractor received a progress payment for a portion of the system—a portion of hardware or whatever—and I am not required to prove to Defence, therefore to the audit office who has the overlooking responsibility to the parliament for the expenditure of Commonwealth funds, how can I be assured that that portion of that hardware in fact had been produced?

Mr Watters—I am not sure that I understand precisely the nature of your question.

CHAIR—Let us put it in bricks and mortar then. If a subcontractor through the Australian Submarine Corporation makes a claim for a progress payment for a seamless welded pipe, and they say, 'We have a piece of paper to prove that it is in store,' it is now the Commonwealth's property, but Mr Barrett does not have the opportunity to chase

that paper trail or to go and look at the piece of seamless welded pipe to prove that it in fact exists.

Mr Watters—We have to distinguish here between the role of government and the role of the private sector. When dealing with particular companies, they are responsible to a board of shareholders who are traditionally entitled to have their own auditors look over their books and the way they do business. I think what you are suggesting to me is that in future the Australian National Audit Office should have some right to audit the endeavours of private organisations. I find that quite a shift in terms of the role of the National Audit Office. In fact, I believe that would be such a shift in its role that, if that is the desire of parliament, they should have included that provision in the audit bill which recently went through the parliament.

Mr GRIFFIN—Can we get a comment from Mr Barrett on that?

CHAIR—I will let Mr Barrett respond to that but, before I do, it is this committee's understanding that the United States Department of Defense has such provisions as the Auditor-General has recommended in recommendation No. 3.

Mr Watters—I think it is a matter for the parliament to consider in relation to the role of the audit office rather than a matter for Defence to consider through its contracts. If the parliament wishes the National Audit Office to audit the books of private contractors, then that is something which should be written into the audit act. I do not think it is something that is appropriately addressed through contracts which Defence writes with contractors.

Mr Barrett—The new Auditor-General Act includes a provision which allows me and my office to seek information in relation to Commonwealth expenditure from private sector suppliers. What it does not do is go the next step and allow access to premises. When this issue was raised, the suggestion was that the provision in the act was sufficient, because if we were to ask information then the onus would be on the relevant agency to make sure that that information was provided. The normal requirement and expectation would be that the contractual arrangements would allow the agency to do so. There are quite a number of contracts which do allow this and a number of contracts which do not.

When this was discussed with the then Department of Finance, it was suggested that, in order to overcome the concerns that were being expressed in that respect, we develop standard access clauses which would then be put into the purchasing guidelines. I would then make those available to chief executives of all government bodies, which I subsequently did, so that these standard access clauses would be incorporated into the standard contracts arrangements. This was with the endorsement both of the Minister for Finance and the Department of Finance as it was then.

As a pragmatic view, there would be very few instances where we would need to

have physical access to client's premises. But it is our experience that when an audit question is asked there are normally about 20 other questions that follow. It is in the interests of both the auditee, the supplier and the audit office to overcome and deal with these questions in a timely fashion to get the information needed as quickly and as simply as possible. Having access to records in this case would have facilitated that considerably. I would argue that, in line with the agreement that I have specified, I am not suggesting anything more than that Defence uses the standard access clauses that have been sent to its secretary.

Mr GRIFFIN—Have you had a response from the defence secretary about that issue?

Mr Barrett—No.

Mr GRIFFIN—How long ago was the standard clause provided to the secretaries?

Mr Barrett—It was about the middle of last year.

Mr GRIFFIN—So nearly 12 months ago, and you have not had a response.

Mr Barrett—I did not necessarily seek a response from the agencies concerned. It was a request with attachments setting standard access clauses. I have actually had responses from some secretaries to indicate that such clauses would be included.

Mr GRIFFIN—Have you had anyone come back to you and say no?

Mr Barrett—No.

Mr GRIFFIN—I take it from what you have said, Mr Watters, that basically Defence's position is at odds with the other departments that have responded?

Mr Watters—I am not sure what response other departments have provided.

Mr GRIFFIN—Okay, I will put it another way. Given your response with respect to the act needing adjustment—which I take to be Defence's official response to recommendation No. 3, which in effect deals with this issue—it would appear that Defence's position is that you do not agree with it.

Mr Watters—No, I do not agree with it and our position is as set out in our submission to you.

Mr BEDDALL—Can I make a point about that? We got your submission this morning. I realise you sent it yesterday but, if you want us to take note of a submission, it is too late for us to receive it the day before a public hearing.

I want some clarification. We have heard this rosy thing of 95 per cent delivered, 95 per cent paid for. I just want some real clarification about the submarine you do have in terms of the navy. Do I now understand that the first Collins class submarine, HMAS *Collins*, is now fully operational and a commissioned ship within the Australian navy and that it has no further requirements for expenditure? Do I understand that it is an absolutely delivered submarine and the next ones are going to flow through and we are off and running?

Rear Adm. Oxenbould—The situation with *Collins* and with *Farncomb* is that both submarines have been provisionally accepted by the navy. Both submarines have been commissioned into service but they are not considered fully operational yet. There is still some more work to be done on them.

Mr BEDDALL—Can I go back to Defence then—95 per cent delivered, 95 per cent paid for. What do you interpret 'provisionally accepted' to mean? If I can refer to a previous inquiry we did on JORN, we heard that everything was okay and then it ended up not being okay. What I am trying to find out is, if it is going to be delivered on target and on budget, can we get it on the public record that it is absolutely correct and that it will be delivered within the budget provided?

Mr Watters—I am not too sure too many parallels can be drawn between the JORN contract and the submarine project. I think you have to look at each project separately in terms of what is achieved. I think the question of what provisionally accepted means is—

Rear Adm. Purcell—I can probably give some clarification on that. In response to your simple question about whether it is going to come in on time, the answer is no, and the audit report discusses the fact that the schedules are delayed. Is it going to come in on cost? The best evidence to date indicates that it will come in on cost, and that evidence is derived from several angles. The first is a pure accounting angle—independent advice in that domain. The second is a review of cost and work to be done, and that also leads us to the conclusion that it should come in on time. The third is performance—that is, is it going to come in meeting our performance characteristics? Our expectation at this time is yes, but we make that expectation in the full knowledge that this is an ab initio design and we have yet to discover things about it.

In terms of 'provisionally accepted', what that means to the navy is that the navy is now prepared to take that submarine and drive it for us, and it has sufficient capability to continue with the trials program that is the next step in its evolution. It does not mean it is operational and ready to go to war or any of those sorts of dimensions. It is suitable to do the activities that we want from the submarine and that the navy wants from the submarine in its next iteration.

CHAIR—So if we had a war, you would not send it to sea?

Rear Adm. Purcell—That is quite a different question.

Senator HOGG—How long before it ceases being provisionally accepted?

Rear Adm. Purcell—It will not be fully accepted until it has complied with the requirements of the contract.

Mr GRIFFIN—What is your view on time lines for that?

Rear Adm. Purcell—We are talking about March 2000 for the final delivery of software that completes the contractual deliveries. The navy may take six to 12 months from that date to put it through its paces.

Mr GEORGIOU—That is for Collins 1 or for the whole lot?

Rear Adm. Purcell—This is for Collins 1 but, once the first submarine is accepted, the rest flow.

Mr GEORGIOU—So Collins 1 will not be fully operational, in your best estimates, until 2000?

Rear Adm. Purcell—It will not be fully accepted into service until the end of 2000.

Mr GEORGIOU—The end of 2000?

Rear Adm. Oxenbould—That is compliant with the contract. We are aiming to have an operationally acceptable capability before then. We are aiming to have that by early next year.

CHAIR—What would you do with the subs if we went to war?

Rear Adm. Oxenbould—It would clearly depend upon the risk which was willing to be accepted. We believe that by early next year—and we have milestones in place to achieve this—the submarines will have an operational capability where we would be able to deploy them.

Mr GRIFFIN—That is an operational capability but full capability by 2000.

Rear Adm. Oxenbould—Yes, the capability as contracted would be achieved at a later date.

Mr GRIFFIN—And that is in line with the contract as it was or as it is now? I want to be clear because it was mentioned that time lines have blown out a bit. I just want

to get that clear on the record as to what the difference is.

Rear Adm. Purcell—The reference to contract I am making is the performance that we are requiring at contract. I am not talking about what is a contracted delivery date. That has moved several times as a result of delays allowed in contract amendment and it is still being negotiated at the moment with respect to some additional changes we want in the contract.

Mr GEORGIOU—The original intention was that Collins should come on stream and replace Oberon, because we are going to be talking a lot about money, coming in on cost, et cetera. We had a particular capacity, given Oberon was supposed to be supplanted by Collins. Has that happened? To put it more crudely, how many Oberons have we taken off and have they been replaced by Collins?

Rear Adm. Oxenbould—Four Oberon class have been decommissioned. We have two Oberon class in commission at the moment—HMAS *Onslow* and HMAS *Otama*. Those two submarines are due to pay-off and go out of service in the early part of next year, in February and May next year. That is the milestone that we have set at the moment and we have a degree of confidence in achieving that Collins will be able to assume that capability. So we should be able to maintain a minimum level of capability of around two operational class submarines.

Mr GEORGIOU—How much has the delay in Collins impacted on our submarine capacity? This is from a layman. If the changeover was supposed to go hand in hand, and we have had a significant delay even on Collins 1—it will not be fully operational until the end of 2000—what has been the substantive impact on our submarine capacity?

Rear Adm. Oxenbould—With the six Oberon class submarines, we were able to maintain an operational fleet of four. Four would be worked up and able to be deployed on operations. With the delay in the Collins coming into service, that has reduced that capability to two.

Mr GEORGIOU—That is just two Oberon because the Collins really are not functional?

Rear Adm. Oxenbould—Yes. If we stuck by the original plan, we would have had a build-up in the Collins class and we would have had an operational Collins class by now and that would have been able to take up the capability which was lost through the Oberons paying off. However, in the current strategic circumstances, it is considered acceptable with the operational force of two submarines.

Mr BEDDALL—In round figures, the cost is $5 billion. Do you think Defence may have got a better outcome in terms of delivery if their liabilities against the contractor had not been so small? I understand the two liabilities were $15 million and $56 million

in a total of $5 billion. That seems a very small penalty imposed on a contractor. Why is it so small and why was it capped at $2½ million per submarine for liquidation damages?

Cdre Asker—The submarine contract is a negotiated contract. There are two parties to it. It is a very large contract. It is $5 billion, as Mr Beddall said. No matter what sort of lever you try to negotiate with a contract of that size, it is going to appear small. So in terms of the performance guarantee of $56 million and in terms of the liquidated damages provision of a maximum of $15 million, they appear to be extremely small. If we negotiated a higher level of liquidated damages or performance guarantee, one must ask who will pay for it. We, the Commonwealth, will pay for it. So we will pay for it one way or another.

We did have those penalties in there, those incentives for performance but, as I said before, it is a negotiated outcome, there were two parties to it—the Commonwealth and the contractor—and we had the best advice available at the time in terms of setting that quanta.

Mr BEDDALL—But there wasn't only one tenderer, was there?

Cdre Asker—There were two tenderers and we negotiated with both tenderers, and the better deal was the one that was struck with ASC.

CHAIR—Do other major defence establishments around the world impose liquidated damages and also have performance clauses?

Cdre Asker—It is usual with most other governments in terms of their acquisitions to have those penalties, those levers in place. The magnitudes vary, of course.

Mr GEORGIOU—Your point is that you could not get any more because Defence would end up paying?

Cdre Asker—The contract price would have risen.

Mr GEORGIOU—Yes. And then you said that nothing has been lost. The elapse of time has cost substantial risk in terms of indemnities which, if you quantify it, is in the order of $20 million to $50 million—the $30 million that Defence estimates would have been the cost of running the insurance contract out for full term. Compared to even that number, $30 million in terms of lateness and performance seems puny.

Cdre Asker—I am a little bit confused about what you are saying. If you are inferring that the transfer from commercial insurance to Commonwealth indemnity has cost the Commonwealth money—

Mr GEORGIOU—You claim to have saved $30 million just by not covering the

increase in time which the insurance would have had to run. I am saying that compared to even that amount, which is just insurance, $30 million in terms of liquidated damages in total seems puny.

Cdre Asker—I think that is a matter for judgment.

Mr Watters—I think it is a question of this issue of risk management that we spoke about earlier. As we said, there are two parties to the contract and how the risk is divided between those parties ultimately is reflected in the price of the contract. You can insure against all sorts of outcomes through your contract, but at the end of the day, if you are requiring the contractor to take on more risk, then you are going to pay for it. That does not move us away from the position that in some particular case or other there might be a view that damages are too small or too great. I think the answer is that we get to a negotiated outcome.

Mrs STONE—Following a similar line of questioning, the ANAO report actually suggests that the project office has done very little to put commercial pressure on the contractors to remedy problems embodying significant areas of risk to the Commonwealth. It refers to things like the pipe welds, fire hazard cabling and so on. Do you agree with the ANAO's assessment there? Has that got something to do with this cap on penalties that was referred to in the question from Mr Beddall a moment ago? How do you respond to the suggestion that you have not put sufficient commercial pressure on the contractors where there were substantial problems?

Rear Adm. Purcell—I would like to respond to that. I think you really have to ask our contractor and their major subcontractors what sort of pressure they feel they are under. I think they would all come back and explain to you that they are under enormous pressure. It is a question of how you apply that pressure. We are applying it against the delivery of the products that we have contracted for. It is certainly now costing some of those subcontractors their own moneys to ensure that they deliver the product that we have contracted for.

Mrs STONE—What sort of pressures are the contractors under? Are they withholding payment, requiring further assessment of the progress—what sorts of pressures are you applying?

Rear Adm. Purcell—The fundamental pressure that we apply is that we do not take delivery of product until it complies with our requirements; and until we take delivery of product we do not pay. Although we have paid 95 per cent of the project costs at this stage, most of the subsequent payments are now frozen and, particularly where contractors are in a cost overrun situation to deliver the product they are contracted to deliver, they are having to meet those costs.

Mrs STONE—It is apparently the practice in the US and the UK to have each

submarine's suitability for acceptance by the navy checked out by an independent expert body. We have talked about subcontractors and contractors being under substantial commercial pressure. Is the Australian Navy going to have an independent assessment before it accepts the submarine as suitable for its purpose?

Rear Adm. Purcell—Yes, indeed. We run an independent assessment organisation which reports to Rear Admiral Oxenbould, in fact.

Mrs STONE—There will be an independent assessment?

Rear Adm. Purcell—Yes.

Mr BEDDALL—I have a question for Mr Barrett, although I do not know whether you did an assessment. I am not very good at mathematics, but I think $56 million is about 0.1 per cent of the project cost; that is the penalty that is available. Would that be an international benchmark?

Mr Barrett—We could not give you a definitive answer today but we will follow it up. I can only go on the basis of my commercial experience elsewhere and certainly, that would not be anywhere near benchmark, even given the conditions that were explained. In fact, it would be really very nominal—almost, not worth having; neither an incentive nor a disincentive, for that matter.

CHAIR—I have a broad question I think the committee would like to ask. As I understand it, ANAO has been critical of Defence for some extended period of time with respect to its project management and systems engineering capability. Indeed, it has raised some questions about the professionalism and centralisation of its purchasing procedures and purchasing officers. Would Defence like to tell this committee what you are now doing that is different from what you were doing two, five or 10 years ago, which would help satisfy both this committee's concerns, as expressed in its recent report on JORN, and continuing concerns being expressed by the ANAO?

Mr Watters—I think that is a very big question and—

CHAIR—You betcha.

Mr Watters—There are many ways in which you can look at various aspects of our organisation and current practice today and compare it with what we were doing at the time of signing the submarine contract 13 years ago. I believe that we have a very robust approach within the organisation to the improvement of our project management performance. You may be aware that we have had some very major organisational changes as a result of the defence efficiency review and the defence reform program. We are now organised very differently from 13 years ago. We are now organised along technology lines and we are now a genuine acquisition organisation, if I can use that term.

We spend a lot of time trying to improve the skills and abilities of those people within our organisation who are responsible for contracts; in fact, we have some statistics here which talk about the skills of our staff. And if you look at all of our projects, a quick survey that we have done suggests that 71 per cent of our project managers have technical or other professional qualifications and that the average time that a project manager has been in a job is about 6½ years. When you look at the time in their current position, about a third of our project managers have been in their current job for more than two years. A fifth of our project directors/managers have greater than 10 years experience in project management.

So we are an organisation that is trying to improve the skills and talents of people in the organisation. We have embarked on an aggressive program of recruiting graduates into our organisation and training them in technical, legal and commercial skills. We are not an organisation that, by any means, is sitting on its hands. I believe that many aspects of our project management are, in fact, leading practice. If you look at the sort of benchmarking that was done by the Industry Commission back in 1994, they found that our performance was very good compared to similar organisations in Western democracies. If you look at many of the initiatives that are occurring in smart procurement in the UK, many of the initiatives there are practice that has been in place in the Defence Acquisition Organisation now for quite some time.

So I think we are looking at an organisation that is constantly trying to invigorate its approach to contracting. We do have a standard and predictable way of doing business through our policies and our procedures. We have a standard contracting document called DEFPUR 101 which provides the basis, or the initial negotiating position, for all our contracts. Our policies are now well-practised and well documented throughout the organisation.

At the same time, we are looking at new ways of doing business. We are constantly trying to look at the time it takes for us to get to contract, and we have in place in the organisation a business process re-engineering project which is trialling some innovative ways of doing business. So I believe that the Defence Acquisition Organisation has made some great strides since 13 years ago in terms of the way we do business and our effectiveness and efficiency.

Mr GRIFFIN—I would like to get a comment from the ANAO. It is a very wide question and it is a difficult one to answer from either end. Can I get a comment from your organisation on that general question of perceptions in terms of your dealings with Defence with respect to changes.

Mr Barrett—In my personal experience over the years, there is no question that, in the areas of acquisition, facilities management, et cetera—along with other areas of the Public Service—modern approaches have been put in place by Defence. It is a very significant organisation with significant assets and significant facilities management

requirements. Nevertheless, as with all public sector organisations, and indeed much more in the private sector, in recent years there has been a very large focus on the better management of risks in projects, and that is not just the capabilities in relation to risks that are insurable. In fact, the risk management is pervasive and has become an integral part of good corporate governance and an integral part of control structures that modern corporations have been putting in place.

The essential lessons that have been learned are that it is what you do not know that actually bamboozles you. The only way of trying to get a hold on what you do not know is to have a very systematic approach, to bring in the right kinds of experts in a timely way and to take action earlier rather than later. These are common lessons that we all have to learn. In essence, these are the kinds of things that we were trying to test with projects like JORN and the submarines project with Defence as to whether there were lessons to be learned in the new approaches that had been established with more systematic approaches to risk management. I think Defence would agree that they, like the rest of us, are still learning and still putting in place those techniques.

Really what we are saying is that 'a stitch in time' is still valid. If we do re-evaluate and do systematic examination and bring in appropriate processes of monitoring and review on a regular basis and not simply take for granted the things that are occurring which will sometimes get caught up latterly in a project stage, which tends to cost times what it would initially cost if it were addressed at the time, in that case, we have some real progress to make. I think that is the issue as we see it.

Mr GRIFFIN—On the question of the four recommendations that were not agreed to—we went through recommendation No. 3 at the start—I would not mind just going through those four recommendations quickly to basically be clear on what has happened. I have the Defence submission here which has that comment, but I have not had a chance to digest that yet because we got it quite late.The next one was recommendation No. 4 which said:

The ANAO recommends that Defence's annual Cost and Schedule Control System surveillance audit at ASC be increased in frequency to twice each year and also include the Project's Contract Management and Control System.

I would like a quick comment from Defence and then a comment from ANAO on that issue, and to then go on to the other two.

Mr Watters—I think that question requires quite a detailed understanding of the way in which we pay for contracts, and this relates to another recommendation—recommendation No. 5—which talks about the physical sampling of claims that come into the department.

Mr GRIFFIN—You can handle them both together if you like.

Mr Watters—This really goes to the question of what visibility we have of

contracts and subcontracts, which goes back to the role of the National Audit Office. The first question asked today went to the visibility the Defence organisation has of what is going on within the contract and within subcontracts within that contract. There is very good visibility of what goes in those contracts, and I think we should go into some length to explain that to you.

It really does indicate to me that there is adequate evidence within the Defence Organisation that could be made available to the National Audit Office should they so desire to get it that way. But I will hand over to Jim Muir, who is our expert on cost schedule control systems, who can take up these two recommendations that we have decided not to accept.

Mr GRIFFIN—To put that on the record, recommendation No. 5 reads:

The ANAO recommends that Defence review a large proportion of ASC's work package progress claims in order to make a better assessment of overall progress.

Mr Muir—The submarine project was one of the first in which the Department of Defence applied cost schedule control systems as a contractual requirement with the contractor, but, at the stage at which the submarine project was when that recommendation came down essentially from this committee as a result of report No. 243 in the mid-1980s, the submarine project was already fairly well structured in terms of its content. The project itself and the technical content of the project were defined with a system other than a cost schedule control system. That system was called CMACS. Essentially, the two systems are very similar in that each system aims to break down the project into a large number of small pieces so that it can be clearly seen when each of those small pieces is completed. The progress can then be added so that you can see what percentage completed the whole project is.

With the submarine project, we had both requirements applying to this contract. We had CMACS as a contract definition system on which the technical content of the program was defined and upon which basis payment would be made. We also had cost schedule control systems applied as an overall discipline within which CMACS could then run. The cost schedule control system was applied a little bit late because of the accidents of timing for this particular project. On subsequent projects, we have not applied systems like CMACS but have relied upon the earned value system or the cost schedule control system to do both of those things for us. We have evolved a number of different approaches to payment, what we now call payment based on earned value, which is the output of the cost schedule control system.

Within the submarine project, CMACS is the system used for invoicing. The fact that we have paid 95 per cent of the contract price comes out of CMACS rather than out of the earned value system, but the earned value system is run in parallel with that. Surveillance on the cost schedule control system is to see that the ASC maintains the basic

disciplines of project management that underlie their approach and that feed into CMACS to provide invoicing. I am no expert on CMACS because I do not work on the particular project. I would have to refer to John Hyman to give you more detail on that, but the cost schedule control system, in this case, is not used directly for invoicing. So the relevance of auditing or doing surveillance on the cost schedule control system is only to ensure that ASC has the basic disciplines in place; it is not directly tied to the payments that are being made.

The question as to how often it should be under surveillance is a matter for judgment. In this case, because we are not paying based directly on the cost schedule control system data, it is not important that we look at that so often because we have surveillance occurring on a regular basis on the CMAC system on which the invoices are made. With ASC being the first major contractor that had a cost schedule control system requirement, we were at the stage of breaking new ground with industry in Australia.

There was a lot of resistance from industry to this new approach being implemented by the Department of Defence. They were saying things to us like, 'We've never done this before. Why do we have to do it now? This is intrusive to us in our commercial approach to the contract. It is all very well for the Americans because they apply cost schedule control systems in totally different environments from what we do. They apply cost schedule control systems in a cost-plus environment where they have access to all the ins and outs of contractor costs anyway because they are paying based on costs rather than paying based on price. So we are in a different ballpark.'

A lot of negotiation had to go on very early in the piece with ASC in terms of what visibility we had into the records of their actual costs of running the contract. When we validated the Australian Submarine Corporation as the first contractor to have a validated cost schedule control system in Australia, there was a very tricky situation of setting ground rules that we could then build on for the rest of industry in Australia.

Having got ASC validated, we then had to ensure that that system was maintained. The frequency of once a year surveillance was established, based on a negotiated position between Defence and ASC and acknowledging the fact that CMACS was also in place and was under surveillance at the same time—so we had two looks, if you like, at similar aspects of data.

CHAIR—Mr Muir, does your system also encompass a test every month, or at whatever progress claim frequency exists, not just on work that is done but on the work yet to be done to complete the submarine? When you have spent 120 per cent of the project's funds and you still only have 50 per cent of a submarine, you have a problem, don't you? The control system that monitors how much money is to be spent does not work very well.

Mrs STONE—And if you say that commercial pressures are being put upon the

contractors via the subcontractors, how come that proportion of the dollars have gone out for that sort of product delivery?

Mr Muir—When we look at detailed information within the cost schedule control system, it includes estimates to complete the project. Recently, I was at ASC on the last surveillance that was conducted on their cost schedule control system and went into some detail in looking at their estimated cost to complete the contract, comparing that with the work that had been done to date and so on and various other aspects of the financial picture. Certainly, the cost schedule control system does provide that sort of data. That is quite separate from the picture that occurs in CMACS and the invoicing and the payments which are made on CMACS. Again, I would have to refer to the submarine project to answer that question with regard to CMACS.

Mr BEDDALL—Does the estimated cost to complete add up to the original budgeted cost?

CHAIR—That is the question, isn't it?

Mr BEDDALL—Does the money out-spent and the estimated cost to complete come in under or on budget?

Mr Muir—That question is, I think, commercially sensitive to Australian Submarine Corporation and we may need to discuss it in camera.

Mr BEDDALL—We have been told that it is on budget.

Mr Muir—I can certainly answer that question, but—

Mr GRIFFIN—Before you jump on to the next question, on recommendation No. 5—the question of reviewing a large proportion of ASC's work packages—at the moment I understand that 15 per cent is actually reviewed. Is that correct?

Mr Muir—Again, I will have to refer to—

Mr GRIFFIN—Could you handle that question in there as well as to whether that is sufficient, given that ANAO has raised the question about whether that should be a larger percentage.

Mr Muir—Certainly, yes.

Mr Hyman—In summary, our response is that additional surveillance of the CS^2 system will add nothing so far as visibility of progress is concerned, because that is not what that system is designed for. Just to give you some idea of what the system is, CMACS is a total of some 2,700 packages, and they are then subdivided into activities as

necessary. Some of the packages may have only one or two, and some of them may have 20 or 30. Then, as appropriate, those activities can be further subdivided. So you have a very large number of activities and each of those has a weight, which is the proportion of the total work under the contract to be performed. Those proportions were set, many of them at contract award, and others are set progressively before the work commences.

CHAIR—Do they total 100 per cent?

Mr Hyman—Yes. A reader of the report we are reviewing could be led to believe that our 95 per cent comes from the amount of money paid. That is a simplistic view. The process under CMACS is that the contractor submits to us a claim which is an aggregate of the actual physical progress made against each of these activities, and he can claim a percentage of a sub-activity which is a percentage of the total, so we are getting to very small numbers.

Nonetheless he goes through that process and aggregates what he claims is the physical progress. He must certify to the project office that that physical progress has been completed. For that he relies on his own audit of his own work and his own audit of his subcontracted work. I would point out that there is some advantage to the contractor in being very conservative as far as his certification of the subcontracted work is concerned, because once that is paid for he loses his ability to get that product.

So he submits that claim to us, which is a claim of the physical progress which has been made, and we then sample or audit or verify that claim. In so doing, traditionally, we have audited about 15 per cent of the packages. But we do not say, 'Here is the claim, fine him 15 per cent and go and do them.' The process has been to look at the progress which is claimed and look for packages of interest. It may be new work which is being commenced, a new activity, or a new package which is being opened. Alternatively, it could be because the package is getting close to completion. It also could be because we have not looked at that package for a while; we have not looked at that subcontractor for a while; the subcontractor may be new to the program; or it may be because last time we looked at him his claim was incorrect and so on—all of these factors are taken into account. That leads us to do about 15 per cent of the packages.

Mr GRIFFIN—That is per annum, is it?

Mr Hyman—No, per month. This process occurs every month. Before I forget, the CMAC system is under constant surveillance, because it is how we pay the contractor, through this process—not annually or six-monthly.

Mr BEDDALL—Have you answered my question on whether the cost to complete and the cost expended adds up to 100 per cent?

CHAIR—Or does it add up to 120 per cent?

Mr Hyman—I think Mr Muir addressed part of that question. A CS^2 system will do that better. The essential difference between the two systems is that CMACS is reporting the actual work completed against progress but not against the contractor's costs; whereas the CS^2 system will give those reports to the customer as well.

Mr BEDDALL—My question was: the last time you checked—anyone in Defence—does the cost expended plus the cost to complete equal 100 per cent?

Mr Hyman—In our view, yes, absolutely, leaving aside any rework which may be necessary. It must do so because we will not certify further progress unless the package is complete. We cannot get beyond 100 per cent.

Mr GEORGIOU—There are no overruns.

CHAIR—I do not think the committee has had an answer to that question.

Mr GRIFFIN—We were told by the department that—

Mr Hyman—The answer is yes, we are satisfied on the basis of external audit which is conducted of the contractor's estimates to complete, our own estimates to complete which we make from the CMAC system by looking at the packages that are not yet complete and how much overrun there is on that and by looking at the amount of payments still to be made under the contract, and comparing that to average claims at the moment. The amount still to be paid, looking at the amounts which are being paid presently—of course, the annual amount being claimed is decreasing as we move further down—will sustain the operation for the three years until 2001, which is after the scheduled delivery.

I must say that, within that, there will be some work which the contractor will be required to do which is a rework, so he cannot claim additional progress. We will not be paying him for that work. That is to come from his own resources. But the answer to your question is: out of the Commonwealth money for what the Commonwealth is required to fund to complete the project, yes, our estimate is that does equal 100 per cent.

CHAIR—Does the ANAO have a comment on those comments?

Mr McNally—The comment that underpins our recommendations 4 and 5 is the fact that we have so many packages either being reopened or remaining open and a lot of rework being done on those packages, it indicates to us that perhaps the overall funding profile for the project is under a lot of stress. That is why we recommended the review of those progress cost and schedule management systems, so that the Commonwealth can be sure that the contractor will not run into trouble in completing the project.

Mr GRIFFIN—Just on that question—and bear with me because I am not quite

sure what I am looking at here—for example, on the question of reopening packages, the way I am thinking of it at the moment is that a package is worth X value. It may be valued at, say, half a per cent of the overall cost of the project. The contractors notify work done on a percentage basis in terms of that half a per cent. So they come and say, 'We have done 25 per cent of that and claim payment of 25 per cent of the half a per cent.' Is that basically how it happens?

Mr Hyman—Yes.

Mr GRIFFIN—So that happens with the payments up until they have completed. Once a contractor has claimed 100 per cent of that particular package, then they cannot claim any more on that package—

Mr Hyman—Correct.

Mr GRIFFIN—Is it a situation where, if they have claimed 100 per cent on that particular aspect of the package, the package should be completed or is it a question of there being overruns which may occur on the basis that they have miscalculated themselves; is that right?

Mr Hyman—The answer is both. We will not certify until we are satisfied that the work is complete. If I can give you an example: part of the work is to fit tiles to the hull of the submarine, and that is a package of work. The contractor starts that and makes progressive claims. He may claim for this month that the job is 57 per cent complete. We could agree with that quite simply by observation and say, 'Look, it may be 58, it may be 56, but 57 is not a bad figure'—

Mr GRIFFIN—Just on that point though, 15 per cent of whatever is claimed in a month is what you will actually look at?

Mr Hyman—Of the packages.

Mr GRIFFIN—Of the overall packages?

Mr Hyman—Yes, generally—not exactly 15 per cent but statistically it is worked out at about 15 per cent.

Mr GRIFFIN—But ballpark?

Mr Hyman—Yes. It may be that we agree on that 57 per cent, which could be 60 per cent, 50 per cent or whatever. But he may find in the next month that some of the tiles that he has applied have to be redone. He will do that work but he cannot claim any more progress until he makes any more real progress, and that could happen when we have paid out a package. We have done all the tests that are necessary under that package,

all of the package scope. He has satisfied all of those things and we have said, 'Yes, that is okay'—

Mr GRIFFIN—Is there any penalty for him if he has claimed the full value of the package and then found he has not completed the package?

Mr Hyman—No, there is no penalty. There cannot be a penalty under a contract.

Mr GRIFFIN—Ray, you had an example to give?

Mr McNally—In terms of the Collins, we know that Collins is listed here as being 98 per cent complete but we also know that there is quite a lot of rework being done on Collins. That has to be funded somewhere. It has to be funded by ASC or subcontractors. The issue that underpinned our recommendations 4 and 5 is that we need to understand how the cost and schedule profile was reacting to those reworks on Collins and the other submarines.

Mr Hyman—I felt we had spent almost two years to give you that understanding. The process that I have just outlined I think answers your original question, Mr Chairman, when we were looking at access by the ANAO: how do we know that the pipe that they say they have done is done? It is through the process that I have just outlined. It may be that that particular pipe is a package we never get to, but that would be most unlikely. We think that the 15 per cent sample is adequate, bearing in mind that, if we are not satisfied, we can make it for a month higher. We can do a 100 per cent audit and, if necessary, we could do that and provide that information for the ANAO if the real question is looking at the amount of progress. We do not have a right under the contract to access the contractor's costs details, which is a separate issue.

CHAIR—Will you assure the committee that the pipes will be rectified under the construction project budget and that Defence will not outlay additional Commonwealth funds to have the pipes rectified as a maintenance item?

Capt. Barter—Yes.

CHAIR—Thank you.

Mr GRIFFIN—Ray, you are saying that, from ANAO's point of view, the situation is establishing clarity as to what in fact is the case not only from Defence's point of view in terms of expenditure but also where ASC is at in the overall project. Is that because of the concern that there may be additional costs sought from the Commonwealth or the question of when a capability is going to be available?

Mr McNally—No, the cost to complete the project is a concern for the Common-

wealth and ASC.

Mr GRIFFIN—From Defence's point of view, there are two concerns here: there is a question of time lines in terms of capability realised; and there is a question of cost. If they are saying that effectively there is a ceiling on that cost from the Commonwealth's point of view, then there is a question of whether in fact there is an additional cost—and that relates to ASC or subcontractors; is that right?

Mr McNally—Yes, that is right.

Mr GRIFFIN—So that is a little bit different.

Mr McNally—Our concern is that we need ASC to remain viable and we need to be assured of that. That is the bottom line here.

Mr GRIFFIN—Yes, because if ASC were in trouble then there would be an impact on the Commonwealth.

Mr McNally—We need ASC to maintain those submarines through life.

Mr GRIFFIN—Can I get a comment from Defence on that?

Mr Muir—We have looked at that aspect of the estimate to complete and whether it is a reasonable figure, firstly, in terms of how it was constructed and, secondly, in terms of the number of payments left under the contract, and so on. We have assured ourselves, in looking at that, that ASC is in a reasonable position to complete the contract. As I mentioned, the figures are commercially sensitive. I would be prepared to give them in camera, but not in public.

Mr GRIFFIN—Sure. You were able to establish that. Has ANAO been able to look at those issues to be able to establish that from their point of view as auditor for the Commonwealth? That comes back to the earlier issue about what it has access to.

Mr Muir—This exercise conducted by ourselves has only been done very recently, after the end of the ANAO audit.

Mr GRIFFIN—I am happy that Defence is happy about the way things are going, but I am going to be happier if I am confident the ANAO agree with that and have had access to the information to agree on that.

Mr GEORGIOU—Are ANAO going to get access to your reviews which were completed recently, since ANAO completed their review?

CHAIR—In other words, can Mr Barrett audit your audit?

Mr GEORGIOU—Are you going to give ANAO access to your independent reviews that give you such confidence that there will be no additional moneys needed to complete this project?

Mr Watters—ANAO have access to documents in the Defence Organisation.

Mr GEORGIOU—You have had access to them? You have reviewed them?

Mr McNally—This review, CS^2, was only done recently; is that correct?

Mr Muir—That is correct.

Mr GRIFFIN—You have not seen it?

Mr McNally—No, I have not seen it.

Mr GEORGIOU—Well, go for it and reassure yourselves. Could I get back to expressions of confidence. Part of my problem is that we have had expressions of confidence about this project throughout. We have had the portfolio budget statements where everything was going well, except that buried further down the text it is not going so well. We have had statements about the combat system, that that is going to be okay. We have had Mr Ohff saying, 'The submarine will be fully operational from a combat system point of view in 1998.' 'You can be categorically sure of that?' That was to Mr Ohff. 'Categorical, categorical.' There have been so many expressions of timing and systems confidence that simply have not come true. Does Defence get a bit shaky at times?

Mr Hyman—I think we have done everything we can with this recent exercise.

Mr GEORGIOU—Let us go to the combat systems. Where are we on the integrated combat software?

Rear Adm. Purcell—Perhaps I can give you a perspective on the Defence position here. We have been reporting difficulties with the combat system for at least five years now. It has been in the public domain. The world has been aware that, in the early 1990s, we became aware of a problem with that combat system.

Mr GEORGIOU—Paragraph 8.24 on page 100 says:

The difficulties were reported to be of a timing nature and were expected to take some weeks to resolve.

That was 1993. Five years later, we are still waiting.

Rear Adm. Purcell—You will find that quite recently after that, probably within a year, the difficulties of delivering the combat system on time were most certainly disclosed to the public. The project director can give us the exact timing because we entered into a contract amendment with the Australian Submarine Corporation to introduce phased deliveries of the software program. As soon as it became clear that we were not going to get the whole thing in one big hit, we then said, 'If you can give it to us in meaningful pieces, we can get on with our work and you can get on with delivering the rest of it to us.'

Mr GEORGIOU—My point was that, when those difficulties were discovered, it was believed that they would be resolved within weeks. Five years later, they still have not been resolved.

Rear Adm. Purcell—I will ask the project director to advise us of exactly when that was first made public.

Cdre Asker—If I can lead this off, I think you will find that the ANAO report is fairly selective in terms of identifying this particular report in 1993. I have no doubt that in the lead-up to March 1993 there were many other reports indicating problems with integration and the development of software. At about that time, or probably a little later in 1993, it became very apparent to the contractor of the day that the combat system was considerably more complex and challenging than he originally considered. It was agreed with the Commonwealth that there would be a re-baselining and sorting out of that combat system subcontract. ASC was involved in this. I guess what we are seeing in 8.24 is one of the first indications of a very large problem that manifested itself in various contract changes leading to the current software development, which was the development of a system, 1.5.5D6, and another system, Release 2, being developed in parallel.

Mr GEORGIOU—But it was supposed to go through Release 2 when it started functioning. There was not supposed to be a 1.5 or a 1.5.5D6. We were supposed to go from one functionality—

Cdre Asker—What you say is entirely correct.

Mr GEORGIOU—But that was supposed to be in 1995.

Cdre Asker—Correct.

Mr GEORGIOU—Now we have a situation where we are looking towards the year 2000 and we have paid a substantial amount of money—95 per cent of the contract—to have half the submarine capacity that we intended to have over a period of years. Is that unreasonable?

Cdre Asker—It is not unreasonable at all.

Mr GEORGIOU—So we outlay money to get a submarine capacity. We have half the submarine capacity that we intended to have and we have outlaid 95 per cent of a contract on the system and the combat system is still not working.

Cdre Asker—I do not know about half the capacity. I think it is misleading.

Mr GEORGIOU—The response was that we were supposed to have four, but we have two. That was the response.

Cdre Asker—Two as in submarine numbers? Is that what you are talking about?

Mr GRIFFIN—I can drag you back on time lines in terms of what actually occurred. I think I am about the only member of the committee that was on the PAC at the time of the earlier review we made, which was 1994 and early 1995. So it was the best part of 12 months since the audit report came down at that stage. It is testing the old grey cells a bit, but my recollection at the time was that it was mentioned in passing that there were a few software problems. Some 12 months after the review from the audit office, the circumstances were that we were being told, 'It's under control. It's going to be all right. It's not going to take long.'

I thought I got the suggestion before that you were saying it had become fairly obvious fairly quickly after that in fact that there were major problems and action was then taken. During that period of some 18 months after the report when we were looking into it, that was not what was said to us that I can recall at the time.

Cdre Asker—You are testing my grey cells as well. I will refer you to my submarine project manager who is probably closer to it than I am.

Capt. Barter—I am afraid I was not around at the time of the previous report, nor in 1993. I do feel that this comment is perhaps being taken a little out of context. I am not too sure that we would have been saying that we were talking about correcting a problem to achieve a Release 2 within weeks. That said, we did underestimate some of the problems. We have underestimated some of the problems with the software development along the way. We are not unique in that aspect. It gets down to the way the technology has evolved over the 13 years that we have been developing software.

The process that we set out was the process that was the then process of developing software, which was more akin to developing hardware. In that, you went through detailed design reviews and you then went into building and you set a whole stack of software engineers building code. Then you brought it together and a miracle occurred and it all worked. With hardware, that is a much easier thing to do. To draw an analogy, when building a house you can go along and first of all see the plans, then see the bricks being put there and the foundations going in. We all have a lot of experience in assessing what a house looks like and what the construction techniques are and you can make a good

assessment and say, 'Well, we're about 95 per cent complete. All we've got to do now is paint the house and we'll be done.'

With software, it is harder. You can get very good designs down on paper. You can get a lot of preparations done but even to this day we are totally reliant on the artisan software developer and, to a large extent in this particular case, we are off in the land of the unknown. We were trying to build something which would be at the forefront of technology. When we brought all the bits together, some worked and some did not. Some have caused us a lot of pain and they have cost the contractor a lot of money. I think we now have a very good understanding of where we are. To some extent we would like to go back and rewrite history and apply some of the new techniques we have learnt, but we have a good understanding of the scope of the problem. Our current estimates are that we will bring this together by the year 2000.

Mr GRIFFIN—The concern we have though, essentially—and I do not wish to harp on it; others have said it but I will say it bluntly—is that we have had a situation with major Defence projects on a number of occasions now where they are state of the art and very complex. But the fact of the matter is that we have on most occasions been led to believe that certain things were happening, were near completion and were costing X which then turned out later on, for a range of reasons, not to be the case. So when you guys say, 'Trust me,' I get a little pang in my back and I think, 'Here we go again.' I may be wrong. I hope I am, but when I also hear ANAO say, 'We're not sure we're getting all the information we need to be able to make the sorts of judgments that we have to make,' we are getting 'trust me' again, and it worries me. It worries me deeply.

Capt. Barter—I think you are asking two questions.

Mr GRIFFIN—I am making a statement really.

Capt. Barter—But you spoke about physical progress and we have spoken about the pipe example. In that case, I feel highly confident, and I think the ANAO should feel highly confident and I think you should feel highly confident, that our assessment of the progress against building a pipe, the physical building of a submarine, is a pretty good estimate at where we are at because we can go down and verify it. Software is a lot harder and we have got it wrong. There are a number of strategies that we have adopted in Defence now to bring this under control. I think we are leading the way, and we outlined a few to the ANAO.

The techniques were not around at the time we started this software development. The techniques are still evolving to this day. It might be in two years time we will all be saying that they were the wrong techniques, but the current trends are object oriented coding, evolutionary acquisition of software, which is something that Defence is doing a lot of work on, and open systems is a current vogue term.

Mr GEORGIOU—So what degree of certainty is there that it will be fully operational, to all intentions, at the end of 2000?

Rear Adm. Purcell—You cannot put a degree of certainty on it. What Defence is trying to do—if we have not achieved that, then I am sorry that we have not, but we would like to achieve it—is to get across to you our best estimates in terms of schedules, in terms of cost, in terms of performance and to get across to you what we are basing those estimates on. In all three of those domains, we acknowledge that there are still risks. We have talked about the cost risk. As far as the contract is concerned, the thing will come in on price because that is what the contract dictates. Whether the contractor has to pick up a whole bunch of costs beyond that or not, we do not really know. What we do know is based on independent accounting advice that the company is viable. Based on our assessments of the work to be done for us, he will make it within the cost envelope, but there will be no flowback of cost to the Commonwealth. That is our best advice. That is the basis of it. I cannot put a probability figure on it.

CHAIR—I want to further explore the software issue. Captain Barter, can you assure the committee that, unlike JORN, the transfusers, transmitters and receivers on the radar systems, the velocity systems and everything you have that feeds into the weapon control system, are operational and that that works but that what is missing is a software that works with the screen to integrate all those into one to tell you when you have a problem and allow a single command to fire something?

Capt. Barter—I cannot give you a 100 per cent guarantee on that because of the integrated nature of the system. But the testing we have done and that we have been able to do of the stand-alone functionality shows that, yes, those systems work.

CHAIR—Because you do not have hardware system problems.

Capt. Barter—That is correct.

CHAIR—It is totally a software computer problem in terms of commanding the weapons signals from receiving signals in from transmitters or transducers.

Capt. Barter—The system is a highly integrated system. Our current, if you like, mitigation strategy is to bring as much of the sensor information into stand-alone functionality as possible. Through those, with the trials we have done, all those sensors are working generally well.

CHAIR—And so they should. Because it is all proven technology.

Capt. Barter—Well—

CHAIR—Isn't it?

Capt. Barter—No.

Mr BEDDALL—Just to pick the point up from the chairman, if you are redesigning the software, will you have to redesign some of the hardware?

Capt. Barter—I think there is very little probability that we will have to further upgrade the processors. The software is like in a computer. You are running on a 486 and you upgrade to a Pentium. We have already made quite a substantial upgrade in our processor capacity and we do not think there is a great deal of risk now that we have not got sufficient processing capability. With that proviso over the hardware, we will not have to change hardware to take on the software upgrades we have to do.

Mrs STONE—Can I follow a slightly different line. One of the objectives of JORN was to develop a domestic defence industry capability. In this project, too, there is a very strong emphasis on the local, indigenous defence force building capability and so on. Are you content with the way your own Australian project or your contributors are being able to meet the needs of the project? Are there any problems with the way we have had local content defined in the various contracts? Have there been some overseas workers working and contributing under those so-called Australian content requirements? There have been some accusations in the ANAO report that there are problems in that area—that local content should have been there, but it was overseas content and so on.

Cdre Asker—The submarine project was the first of what we call the macro projects that Defence undertook within Australia. We have over 200 Australian subcontractors and contractors involved. The local content level or Australian industry involvement level is currently running at about 72 per cent, exceeding the contract requirement of 70 per cent. There are other requirements that affect the combat system and I am pleased to say that, in general, those requirements are also being met. They are on track. Many of these firms had not been exposed to manufacturing equipment or systems for Defence previously, so there was a considerable learning curve and I am also pleased to say that most of the Australian firms responded well and got up that learning curve very quickly.

In terms of developing an Australian submarine support capability, I believe we have been quite successful there. I guess the next trick is to ensure that those companies we have started up and educated continue to support the submarine force in the future.

With respect to your remarks about overseas companies, I do not believe there was any dishonest intention by overseas companies in terms of placing work with Australian companies and then moving it offshore and disguising it. I am not aware of any evidence of that occurring. In terms of the quality of work that has been done overseas, we have had arrangements in place with government organisations in the UK, Sweden and other countries to undertake quality assurance activities on our behalf to ensure that the equipment and systems produced there have been up to the mark. Additionally, we have had representatives visit from time to time to conduct audits on those overseas authorities.

At times, I must say, we have found them lacking—in which case, we have instituted rework and overcome those problems as far as we have been aware of them. I think I have answered your question. Is there something I have not answered?

Mrs STONE—ANAO was suggesting that there was a problem with the original contract's local content definitions—I do not know whether Mr McNally wants to comment on that. They suggested that, while there was supposed to be local content, work was undertaken overseas despite the requirement of the contract for local content. The suggestion is that there may have been too loose a definition of what constituted local content. Would the ANAO like to pick up on that and explain further what they saw as the problem, or are you saying that you have not perceived that?

Cdre Asker—If I could just respond: the contract was negotiated back in 1987 and, in terms of contemporary definitions, local content, as it was described in the contract at that time, was possibly the only existing definition. Whether Mr McNally has another definition, a superior definition, I do not know.

Mr McNally—The issue we identified in chapter 10 was that, even though Defence was able to demonstrate in expenditure terms that the Australian industry involvement met the target levels, we were not quite sure how Defence actually measured technology transfer and verified that the technology and the competencies that are required to support the submarine through life have been developed in Australia. That is an area which is very difficult to measure. We took a couple of examples in paragraphs 10.10 and 10.11, which suggested to us that perhaps there was some lack of technology transfer in certain areas. Because of the nature of the audit, we could not exhaustively check those issues and we simply left the technology transfer question as a possible indicator that that is an issue that should be considered for the future.

Rear Adm. Purcell—We agree that it is an issue that we need to consider for the future. In the past we measured performance quantitatively—by how many dollars we spent. Defence has now done a lot of work on what it defines as the defence needs of industry—those elements of industry that we really should be shaping to ensure defence self-reliance—and we are now capturing that in our more recent contracts so that when we talk about AII, we are not only talking about the quanitative aspects but we are also talking about the qualitative aspects.

VICE-CHAIR—Can you give us some examples of more recent contracts?

Rear Adm. Purcell—The Minehunter Coastal, for instance.

Mr BEDDALL—I did a series of inquiries into the North West Shelf, which one of the competitors described as very much like a submarine standing up. One of the points they made was that quite often there is a lot of emphasis on the contract price but not on the ongoing maintenance and servicing of an industry. Quite often that is the same value.

Are you confident that the vast majority of that will be done here? Obviously, from a Defence point of view, you do not want to be reliant on parts of your submarines coming from somewhere else in a time of conflict.

Rear Adm. Purcell—The point you make is very valid, and we are confident that the great bulk of submarine support will come out of Australia. Quite obviously, where equipments have been sourced from overseas, those equipments will probably end up going overseas for repair and refit. The submarine itself, its complex integration, the project management of the whole process of refits, is an Australian skill that is there and we would hope to draw-down on that for the life of the submarines.

Mr GEORGIOU—I would like to chase up two things that have been irritating me. The first one is the Commonwealth allowance to the ASC's insurance broker which, in a sum of about $5 billion, is only a miserable $2.4 million. I cannot understand why that amount, on the evidence put forward by ANAO, was diverted to the insurance broker when the insurance went to an indemnity. I have read the Defence response, and I am puzzled by it. Who authorised it? Why was the $2.4 million diverted and why was there a broken paper trail, according to ANAO?

Mr Watters—I am not sure that the word 'diverted' is appropriate.

Mr GEORGIOU—Allocated, given, bartered.

Mr Hyman—We believe 'paid under the contract'. The situation was that under the contract the all-risks insurance for the submarines was provisionally priced. That means that the scope of the insurance and the amount of money to be paid under the contract was not finalised so that if more money was required, more money went in. Part of that scope was for the advice. The contract also required the contractor to arrange the commercial insurance. Part of the money payable under the contract was for the services he required to do that and for the management services that he required for insurance. That is not remarkable if we understand that all his other management work is funded—they are his staff. But this was an agent to which he was entitled under the contract.

Mr GEORGIOU—The insurance agent was anticipating commissions; the insurance contract was terminated; there was a rebate. Why was the insurance broker paid $2.4 million against the advice of Defence's adviser on insurance?

Mr Hyman—Defence's adviser on insurance was one adviser, and he was not asked to advise on that particular issue. He was our adviser who assisted—

Mr GEORGIOU—So you did that gratuitously? You said, 'Don't pay it; you don't need to?'

Mr Hyman—Yes, but he was not aware of the contract provisions under which the

arrangements were made. The ANAO in an earlier version of its report acknowledged that this payment for brokerage was due under the contract.

Mr GEORGIOU—Can I have ANAO's comment please? You have accepted something and then put something contrary in your report.

Mr McNally—This is the report.

Mr GRIFFIN—Was there an earlier draft which had that in it? If so, why?

Mr McNally—There may have been an issues paper, but it was only very early.

Mr Hyman—No, it was the October—

CHAIR—The committee hearings will not be formal hearings of the parliament if the two of you answer each other's questions. You have to go through the chair.

Mr Hyman—The point I am trying to make is that the fact that the payments were due under the contract we saw as not being an issue. Close reading of the contract will demonstrate that. I understood from an earlier version which was presented to us as the final draft—the one that was to be tabled—that there was this comment in a part of the report. We drew attention to that and indicated that therefore some of the objections which were raised later in the report seemed to be contradictory. We hoped that that may have caused the objections to be removed. It did not have that effect. What was removed was the expression that it was seen to be due under the contract. So that was Defence's position on the matter.

It is relevant to point out that this change on insurance was one thing that Defence had been seeking virtually since contract award. It is the only matter on which there had been litigation between the two parties. Insurance was only one part of the amendment under which this payment was made. We were seeking to change from commercial insurance to the indemnity. We saw that as a cost-effective way to go. In order to get that contract amendment agreed to by the other party, because we cannot act unilaterally, he required us to fund his insurance adviser for the remainder of the contract. It was not simply because he required us to do that but because we felt that it was reasonable under the contract that the amount was agreed. The original amount sought was I think $3.7 million. It was negotiated down to what we felt was a reasonable figure.

Mr GEORGIOU—I am confused and I need clarification. Your initial statement was that the contract would require this payout—not that it was reasonable or unreasonable or anything else, but the contract itself required the payout.

Mr Hyman—No. I will clarify—I may have misled you if I said that. The original contract never envisaged the circumstances that were in this contract amendment. It talked

about a fee to the contractor so that he had adequate expert advice to do the services which were then contracted—that is, to arrange commercial insurance through the market and manage that.

Mr GEORGIOU—But if we terminated the commercial insurance then—

Mr Hyman—Correct. But, by doing that, we did not terminate his need or his reasonable entitlement to the same level of advice on what was now a Commonwealth indemnity which previously was commercial insurance.

Mr GEORGIOU—We paid the bloke originally to buy commercial insurance to cover the submarine project. We then changed to an indemnity under which the Commonwealth would pick up the indemnity. We then pay the ASC so he can get the best advice to maximise the benefit of the indemnity against the Commonwealth. And that is reasonable?

Mr Hyman—I do not think it is unreasonable. The other party is entitled to advice to minimise or manage his risk, whether that insurance has been provided through a Commonwealth indemnity or through a commercial insurance arrangement.

Mr GEORGIOU—Is there a piece of advice on this to Defence saying, 'We are obliged to pay this under the contract,' or 'We believe that this is reasonable for the following reasons'? One of the things that struck me in reading this is that the paper trail is very broken. The one piece of advice that is put out is that this was made despite advice from Defence advisers that said this should be paid for by the ASC not the Commonwealth and that the broker's loss of commission on terminated insurance was just part of the business.

Mr Hyman—I cannot tell you whether or not there is a specific piece of legal advice on this issue. We do not refer all of the matters which we are going to alter in the contract for legal advice, only those which we think justify that. I have tried to indicate that other people who have looked at the contract have arrived at the same conclusion.

Mr GEORGIOU—My problem is that, knowing a tiny bit about bureaucracy, you have specific advice that you are not to pay it; and you pay it without getting specific written advice to justify the rejection of your adviser's best judgment.

Mr Hyman—It is also not unusual that you will get conflicting advice. Our adviser in London was particularly retained to provide an overview of the Commonwealth's interest on what the contractor was doing in arranging insurance through that market. We had no experience or expertise there. He was retained for that. He was not our general contracts adviser on the terms of the contract.

Mr GEORGIOU—So your general contracts adviser gave you written advice to

override your previous advice, saying, 'This is rubbish, ignore it.'

Mr Hyman—No, our general contracts advisers were the project's staff who, if they had felt there was a need for clarification, would have referred the matter for expert advice. But they felt that it was not necessary.

Mr GEORGIOU—Can I ask either Mr Minchin or Mr McNally to comment on this situation.

Mr Minchin—We stand by what we said in the report. To clarify the situation, it might be best if we let you have a copy of the documentation that we have.

Mr GEORGIOU—Is that documentation complete?

Mr Minchin—It is from the incomplete files in Defence. It is the best we have.

Mr GEORGIOU—Are there complete files in Defence that let you chase this through?

Mr Hyman—The ANAO has access to all the documents that we have and the documents which formed our judgment.

Mr GEORGIOU—Does that mean there is a document saying, 'Pay this because it is required.' Paragraph 3.40 states:

> In the absence of complete records, the dimensions of the arrangements are unclear, as indeed are the benefits to the Commonwealth . . . On the face of it . . . raising the question of the legal authority for such a payment.

As I said, compared with $5 billion it is a small number, but $2.4 million looks like a lot to the punters.

CHAIR—Does ANAO have a comment to make?

Mr Barrett—I actually asked this question of my audit manager. The response was that we were not really in a position to answer the question. I asked the question as to whether there was any evidence that that $2.4 million was paid into consolidated revenue or paid direct to the South Australian broker. In other words, was it a payment that was diverted as opposed to the normal arrangements you would expect when, if you cancel a policy, you get back the amount outstanding? The other was a separate transaction.

I was interested to know whether that transaction and the assumed liability by Defence to the South Australian broker was then a financial arrangement between Defence and the South Australian broker. It seemed to me rather odd to have a diversion from the

London principal direct to the South Australian broker as a payment. Preferably, from the Commonwealth's point of view, we would expect such transactions to be separated; we would not have those sorts of set-off arrangements for accountability purposes. The answer to your question is that we were not able to get sufficient evidence to clarify the matter to the satisfaction of the committee.

CHAIR—That is because no paper in fact exists.

Mr Barrett—There is a draft contract, as I understand it, and that is the only piece of paper that we managed to find.

Mr GEORGIOU—How can we clarify this? As I said, in the context of 95 per cent of $5 billion being paid it is not big, but administration is some of the small things.

Mr Hyman—I have nothing to add, Mr Chairman. We still do not believe that the arrangement was exceptionable. We have made all our records available to the ANAO.

Mr GEORGIOU—Mr Barrett, can you think about this and come back to us on it? You say that the paper trail is partial; they say it is all kosher. They get advice that they should not do it from their adviser and then they do it. But there are apparently no further bits of documentation or authorisation.

CHAIR—It would be helpful if you could attempt to clarify this issue to satisfy the committee so that we do not have to prolong our investigations, quite frankly. I think it is a reasonable request from the committee.

Mr Hyman—Yes.

Mrs STONE—Could I ask a question about intellectual property. I presume there has been intellectual property generated through this project. What steps have you taken to identify and protect that intellectual property, especially if there is commercial advantage to be taken perhaps later on? Can you tell us what measures you have taken in terms of protecting the Commonwealth's intellectual property in particular?

Mr Hyman—Under the contract, the Commonwealth does not own the intellectual property, it is licensed to use it. That is what we call foreground or any intellectual property which is generated by the performance of the work. Generally within a project, intellectual property which the Commonwealth owns under contracts that we write or entitlements which we have to it is logged under a procedure that we have. So far as the submarine contract is concerned, the Commonwealth is entitled to a fee from the contractor or subcontractors for any of the foreground which they use for other customers.

Mrs STONE—Has the project generated any of that foreground, as you have called it, at this stage that has then been used?

Mr Hyman—No, we do not. Because we do not own the intellectual property, and the contract did not provide that, we do not have a register of what intellectual property may attract that fee. What we have relied upon is what we have described as the good faith of contractors to advise us when they are going to use intellectual property and when they have the obligation to us under the contract.

Mrs STONE—Do you see that as adequate or appropriate in this day and age?

Mr Hyman—Yes. If we did not, we would seek to do otherwise. But under this contract that is the way it has operated. The resources required to maintain a register of all of the intellectual property which may be foreground and which could be used otherwise would be very, very large. We do not believe that the arrangement of those resources would be cost-effective.

Given the rate at which technology changes, we do not expect that a lot of this will be used elsewhere but, if it is, given the size of the submarine community and the good faith of the commercial enterprises involved, we do expect that we will be notified. There have been, to our knowledge, two examples of intended use of intellectual property which is foreground to this contract. On both occasions, we were advised by the contractor.

Mrs STONE—Could I ask Mr Seymour or Mr Yandell, in your international experience, what is the way the UK, for example, typically handles its intellectual property development in a project like this? Is that the usual sort of arrangement that you would expect to see?

Mr Seymour—Generally speaking, yes; I have no difficulty with it.

Mr Yandell—A lot of it is based on goodwill. The person who has the information expects that you will support him in the use of it. He does not expect you to steal it from him. That is where the hell of it comes in. You are taking away his livelihood.

CHAIR—You are saying it is a contract on trust.

Mr Yandell—Virtually. We tried this in Cockatoo but we had no success.

Mr GEORGIOU—Mr Barrett, two of your consultants were excluded from the inspection, as I understand it, of the ASC premises—or something on the ASC premises. Can you tell us what they were about to do and can you tell us whether or not you regard the potential conflict of interest as justifying a refusal of access?

Mr Barrett—Personally, I certainly do not agree with the conflict of interest point. Where people are appointed legitimately under the Audit Act and assume the very stringent obligations under that act, it seems to me that, particularly in an area where there are very few people who have any expertise, one is drawing a very long bow indeed to be

talking about potential conflicts of interest. But I would ask the audit manager to explain the substantive issue.

Mr McNally—The issue with regard to paragraph 4.24 was to actually check the CMACS progress claim chain, from the actual production of some incremental variation to a work package right through the documentation, and link that with the final claim for payment. Because submarine construction is a fairly highly technical process, we engaged technical consultants to help us with this—especially on that issue. Mr Yandell here—who has about 50 years experience in submarine construction—was engaged on the audit to actually assist me to look at progress claims and Australian industry involvement. His access to specific sections of submarines 04 and 06 was denied, because he had had a previous employment position in ASC. Now, at the time, we did not accept the claim that he had a conflict of interest, and we still do not.

CHAIR—Mr Barrett, in your experience, is it normal practice for a major contractor of this nature to refuse the owner of the property—that is, the purchaser—access to goods which have been paid for?

Mr Barrett—Certainly not in any commercial operations that I have had experience with, and certainly that would not have applied in Defence's case where they have had Defence assets in private sector premises; they would never have been denied access to those assets and inspection, et cetera. I think common sense has got to prevail here, Mr Chairman, to a considerable extent; and that is why we did not make a issue of it, at the end of the day. Also, there was the uncertainty about authority, that we spoke about earlier, regarding access to premises from the audit point of view. Now if there was an earnest of intent and good faith, and the issue was only about conflict of interest, then I think we could have had a reasonable discussion and settled that issue.

Mr GEORGIOU—Mr Watters, have you got any problems with this denial of access? I know you are not the one denying it.

Mr Watters—I think it is a matter you really need to take up with the Submarine Corporation.

Mr GEORGIOU—So, essentially, Defence says, 'It's not our business.' That is your position? It is not really your—

Mr Watters—We did not deny access. It was the ASC that denied access.

Mr GEORGIOU—But you say that it has nothing to do with us, that it has to do with them.

Mr Watters—I think the question should be addressed to the ASC.

Mr GEORGIOU—But the question is also worth while addressing to the Department of Defence. It actually is committing quite a substantial amount of money to build submarines.

Mr Hyman—I think part of our response to that would relate to the activities which were advised to be undertaken during that visit. CMACS audit was an activity, as I explained at some length before, that we felt we could do as completely, if necessary to 100 per cent of every package in the contract, if we had the resources to do it. Our response would be that we feel we were able to perform that task and satisfy ourselves that the Commonwealth interest was protected.

Mr GEORGIOU—Isn't that a bit different from audit satisfying itself that the function is being performed? The reason why we have auditors is that people who run statutory authorities say, 'I'm doing it.' and they say, 'No, we will still have a look.' They defer to them. It is in the Commonwealth's interest that there be an autonomous or independent agent inspecting things that we think are hunky-dory. Every so often we come across things that we did not think we would come across. Your argument is essentially that they do not need to do it because we do it.

Mr Watters—I think the relationship between the Commonwealth and the ASC is as determined by the contract. If you see a role for the audit office outside that contract I think it is an issue that needs to be pursued under some mechanism other than the contract.

Mr GEORGIOU—But your perspective is that it is up to the contractor, and Mr Hyman's perspective is that that need not go forth because we have already done it. There is a rather different perspective on it.

Mr Watters—I think in terms of the way in which audits are conducted in the defence organisation there are in fact two audit organisations. We have an Inspector-General's division, which does quite a bit of auditing of major capital projects. We have, if you like, an external agency—the National Audit Office. It is not uncommon for the Inspector-General's division to look at the way the Defence Acquisition Organisation does business. We have also instituted within the acquisition organisation an acquisition review program, which takes a very high level review of contracts that are in progress. I think there is probably adequate oversight at the moment of the way in which the acquisition organisation does business.

Mr GEORGIOU—The difference is, however, that the Auditor-General does have a responsibility to report to the parliament in public reports, which is not something that lies with the other authorities.

Mr Watters—Sure.

Mr Hyman—Just to make sure that it is not seen that we are trying to keep a separation, certainly we cooperated and facilitated visits by the ANAO to the Submarine Corporation. I believe that they were conducted and were successful. It was a later visit, without speaking for the Submarine Corporation, which involved consultants of a particular sort which caused the objection.

CHAIR—Mr Watters, in a former life I was briefly a contractor to the Commonwealth and substantially a contractor to the state government of Victoria. To the best of my recollection—and I am not sure I still have contract documents left to go back and look at—those contracts required me, firstly, to prove to the paying authority that I had paid subcontractors for work which I had claimed and, secondly, if necessary, to provide physical access to the goods on the subcontractors' premises or my own premises. It seems that those sorts of provisions were absent from this contract. If you were to write this up as a new contract today, would you include them?

Mr Watters—I think the answer is contained in our response to—

CHAIR—I have not read your response because it did not come in until last night and I was on an aeroplane.

Mr Hyman—These provisions are in the contract. That access is given. There is a list of activities, one of which is to verify the progress claimed and for cost investigation purposes for any new work under the contract.

CHAIR—How can that be if, as the Commonwealth's representative, the auditor is denied access?

Mr Hyman—Again, I cannot speak for the corporation. But perhaps because our project staff are involved in that process month by month and complete that task it could be seen that the access for that activity—that is, the verification of progress—has been completed.

CHAIR—It takes us back again, Mr Watters, to the question that I asked at the beginning of this round table and your denial of the Auditor-General's recommendation No. 3. If your contract says that the Department of Defence, project office, whatever, is to have access to goods that have been paid for by the Commonwealth, claimed to have been paid for legitimately by the Commonwealth, then why not allow the Auditor-General, as representative of the parliament, to have the same access to those goods to prove to the satisfaction of the parliament and the Commonwealth government that the goods have been properly paid for and are physically intact and are and remain the property of the Commonwealth?

Mr Watters—I think the reality is that the Department of Defence, who manages the contract, does have access to those records and the National Audit Office does have

access to those records through the Department of Defence. I am not sure that there is a necessity, as a result of that, for the National Audit Office to actually audit the books of a contractor. As I said before, the contractor is generally a private sector organisation reporting to a board of directors that has a right to appoint auditors to that organisation.

CHAIR—Let us go back to money. One other thing this committee concentrated on this morning in respect of two other departments was the issue of the jam tin culture where departments seem to try to get rid of all the money that is in the jam tin for a particular project or a particular purchase order or under a particular budget allocation prior to 30 June so that they do not lose it in future budget allocations. Notwithstanding what we have heard about progress payments and the testing against percentage completion and theoretical testing against cost yet to complete, can you tell us honestly that the department has not tried to spend funds which were allocated in advance of when very possibly they were truly due to the contractor?

Mr Watters—That goes to the way in which we manage funds within the Defence Acquisition Organisation. Each year we spend approximately $2.2 billion on major capital projects. At the moment we have about 200 phases of various projects. The way in which we manage those funds is that we manage them through a central pool of funds. Each year we do two exercises which look at what each of the projects is bidding, and we revise those bids as the year progresses. We then try to juggle the slippages against those projects that are achieving. Hopefully, at the end of the day we manage that $2.2 billion within the budget year. There are, however, provisions that allow us to roll over some of those funds, if they are not spent, up to a certain limit. So I think there is no necessity to spend the last cent by 30 June, if that is what you are implying by your question.

CHAIR—So you are telling me that that culture of 30 June no longer exists in the Department of Defence?

Mr Watters—We do have a budget to spend each year and 30 June is the end of the financial year. I think we are less obsessive about that with the changes to the way in which financial administration in the Commonwealth is now managed than we were in the past.

CHAIR—Let me up the ante a bit then. Can you assure the committee that funds are not expended in advance of value earned?

Mr Watters—Typically, the way we pay projects is to provide some mobilisation payment at the commencement of the project and then pay either against milestones or earned value. At the end of the project, we try to retain funds, which gives us some leverage over the project. Basically, what we try to do—and it is quite hard to do on occasions—is make that contractor's cash as neutral as possible. In other words, we do not have the contractor either positively buoyant for excessive periods of time or negatively buoyant. We try to pay against physical progress as the project proceeds.

Mr GEORGIOU—I want to go back to one question about the consequences of delay. This is not a precise rendition of what you said, but you said submarine effectiveness was not at an optimum level but there was an acceptable element of risk. I am not trying to misquote you, but I cannot precisely recall your words.

Rear Adm. Oxenbould—I said that in our strategic circumstances, the availability of two operational submarines is adequate.

Mr GEORGIOU—From a strategic perspective, what are the substantive non-monetary costs of this delay?

Rear Adm. Oxenbould—It is the training opportunities. The submarine arm that we do have is relatively small—it is about 600 or 700 people in total. One of the critical things within that submarine arm is a training pipeline, where we have young people who are joining the submarine arm and they have to complete part of their training at sea. When we have only got two submarines operating that makes it very critical. When you compound that with two different classes of submarines—both the Oberon and the Collins class in different training regimes—that adds a further complexity to it. However, we are able to use the *Collins* and the *Farncomb* now to conduct trials and to participate in exercises. We are able to achieve a level of training value, but not the full level of training that we might like to in the full range of capabilities of that submarine.

Mr GEORGIOU—So it is fair to say that you are, to a degree, concerned about this delay? It is not just, 'We are getting the best possible submarine so it is fine.' The JORN comment is, 'I would rather trade-off time and get something fantastic.' You are rather less laid back about this.

Rear Adm. Oxenbould—I can assure you that we are concerned about any potential delays. We are concerned in regard to submarine capability. We are concerned in maintaining the viability of our submarine arm and we are concerned about the ability to participate and train our own forces in anti-submarine warfare. We are putting a great deal of staff effort towards making sure we manage whatever risk exists there as well as we can.

CHAIR—Mr Watters, earlier in these discussions, the Auditor-General said—and I will paraphrase because I did not write it down exactly—that he was confident that Defence would agree that it still had a way to go in obtaining best practice in project management. At the time I wanted to ask you about that but one of my colleagues had a more urgent question. Do you agree with Mr Barrett on that point?

Mr Watters—I think we will always have a way to go in improving our performance. We are very interested in criticism that does lead us to that end. I think the organisation that we have now has some real strengths, and perhaps I could outline to you what I would regard as leading practice within the Defence Acquisition Organisation in the

management of government projects.

The first issue I would like to talk about in that context is probity and ethics. In the Defence Acquisition Organisation we have got an organisation that places a very high value on ethical behaviour and probity. We have a Defence source selection board which recommends decisions to a delegate and that Defence source selection board, if you like, is at arms-length from the projects, so there is quite a lot of transparency in terms of the way in which we make decisions about who gets particular contracts.

We also spend a lot of time, a lot of research and a lot of documentation recommending source evaluation. We spend a lot of time poring over tenders and coming up with very well-researched recommendations which go to the Defence Source Selection Board. I think one of the other strengths is the predicability and consistency with which we do business. There are very few Defence Acquisition Organisation projects that are cancelled after approval. Believe me, if you do get into a contract and decide that you want to cancel the contract you are in for very big costs indeed.

I do not know whether you are aware of this, but in recent times I have seen a report of a legal case which resulted from the cancellation of a Pentagon project for a navy stealth plane back in the early 1990s. The award of damages in that case—subject to appeal, of course—is over $2 billion in damages against the Pentagon. So, generally, when we get to contract we proceed with business.

The other thing that I think is a real strength of our project is that we have a one-shot approach. There are no best and final offers. People are invited to put their offer on the table. It is then considered. We do not get into any messy haggling after that first shot, best shot is put on the table. I think we have a very consistent and predictable way of doing business.

The other thing we have developed in the years since the submarine contract was done is a whole array of innovative contracting techniques. Payment against a combination of earned value and milestones is typically the way we do business. We have tailored price arrangements—fixed price, variable price with exchange and price adjustments—and that is all about risk sharing with our contractors. We are experimenting increasingly with evolutionary acquisition of software intensive systems. Compared with some other countries with which we like to compare ourselves, we put a lot more reliance on market forces. We place great store on open and effective competition and trying to get best value for the Commonwealth.

We could also claim some pride in the state-of-the-art approach that we have to contract development. As I mentioned before in answer to a question, we have a standard contract form called DEFPUR 101. It is our standard terms and conditions for the way we do business. We constantly update that and we constantly discuss it with industry and revise it. We also have new ways of meeting our requirements. If you look at the lead-in

fighter contract in recent times, it was quite innovative in terms of trying to specify the numbers of aircraft that we wanted. Basically, we left it up to the contractors to tell us how many aircraft they would provide to deliver a level of service to us.

We have increasingly put invitations to review and comment on draft solicitation documents to industry. In certain circumstances, we like to get industry to comment on our tenders before they actually get out on the street and a response is required. Increasingly, we have looked at contracting for the through-life support of a piece of equipment at the same time as we buy it. So we sign the original equipment contract and the through-life support contract at the same time.

We are doing a lot more work in terms of earlier consideration of acquisition issues within the defence organisation. As a result of the changes that came in the defence reform program, we have much more involvement of the acquisition organisation in the very early decisions that are made about particular capabilities. The Deputy Secretary, Acquisition is now on the Defence Capabilities Committee.

We have industry involvement at the early stages of a project and project definition studies, which are typically funded, and we put out on the streets a public pink book which is our unapproved capital program so industry knows what is coming down the stream in broad and general terms. In recent times we have been looking at putting a DSTO representative within the Capital Equipment Program Division to try to increase the level of interaction between the scientific and the acquisition communities.

In terms of finance, we have very strong centralised funds control. We mentioned that in an answer to an earlier question. We have state-of-the-art corporate and project finance systems trying to introduce a standard way of accounting across the Defence Acquisition Organisation, and we are hoping to get that project finalised by the end of this year. We are looking to ways in which we change our accounting processes as a result of the introduction of accrual accounting within the Commonwealth public sector. We also have a strong emphasis within our acquisition decision making on the full cost of ownership—what it is going to cost over the life cycle. We are in the process of getting a report from the Australian National Audit Office which will allow us to improve that process.

We have a very rigid set of delegated authorities when it comes to finances within the Acquisition Organisation, which are totally consistent with the FMA Act, and DAO is becoming increasingly an output-focused organisation. We have some very innovative things happening in our industry policy and we are looking forward to the statement from the Minister for Defence Industry, Science and Personnel in the next few months. We are experimenting with capability and technology demonstrators, which look at the feasibility of using certain technologies earlier in the process, to minimise the risks that are associated with those technologies.

We have seen, in our industry policy, major restructuring away from the government ownership that we saw in the 1970s and 1980s. The only remnants of government ownership these days are the Australian Defence Industries, which is soon to be privatised, and the Australian Submarine Corporation, which is also to be sold in the near future.

In recent years we have introduced a very comprehensive system of project reporting within the Defence Acquisition Organisation. It is not yet completed, but we have done a lot of work on getting visibility of what is going on in our contracts—after we get to contract. We have introduced, as I mentioned earlier, a Defence Acquisition Review Board, which is part of our mechanism for corporate governance. It gives us very high level visibility of what is going on in our projects. I think one of our other strengths is the new organisation which has come out of the defence reform program. As I said, we have got a technology or an industry focus, which makes it much better for industry to do business with us. Now all our helicopters are bought in the same area of the department, as opposed to the situation prior to the defence efficiency review where they were bought in separate divisions. We have got very good ties to the scientific, logistics and requirement communities, and we have delegated authority for managing projects MATRIX A through D, which pushes decision-making down to levels consistent with authority throughout the organisation.

As I mentioned before, we are focusing on continuous improvement in the way that we do business. We have established policy and support centres within the organisation so that we now have centres of expertise, if you like, which look at contracting, finance, earned value and a whole array of things which are central to the way that we do business. We are continuing to review and promulgate, in our policy, the lessons that we learn from contracts and from procedures such as this, so that we can adopt best practice. We have a capital equipment procurement manual, which is now on-line throughout the organisation. It is continuously updated to reflect lessons learnt.

Staff training and development are two things we should be very proud of in the organisation. We have set up a human resources policy and support centre to manage the human resources of the organisation. We are leading the way for the Commonwealth in terms of training people for project management and procurement competencies. And I think there is an increasing emphasis within the Defence Acquisition Organisation on staffing the organisation with acquisition professionals. I mentioned some of these statistics to you before. We have very well-trained staff who are increasingly expert in acquisition matters. We are also looking at new ways of contracting-in expertise, given the staffing pressures we are under. Where we do not have staff in-house, we are looking at increasingly more flexible arrangements for bringing that expertise into the organisation on contract.

We have an excellent program of corporate governance. We have got an audit and evaluation steering group. We have got a defence acquisition review board, an acquisition program executive and a Defence Source Selection Board, which I mentioned earlier—all

part of our corporate governance. We have a DAO strategic plan, a human resources plan, an EEO program implementation plan and an audit plan. We take these things very seriously as part of the way in which we run the organisation.

I think that gives you a fair feel for the way in which I believe the Defence Acquisition Organisation displays leading practice in project management. But we are always looking at new ways and better ways of doing business and we do have a project called business process re-engineering which is trialling new ways of project management.

I would like to mention a few of the things we are looking at there. One is a project management methodology which will become standardised across the organisation if the trial proves successful. That is called PRINCE 2. We are looking at quality management systems within our own organisation. We require quality management from our contractors. We are looking at the way in which we might adopt quality management in-house, and we are also looking at the way in which we report performance both at the project level and for the organisation as a whole. So with that, we have a fairly comprehensive catalogue of the way in which we have been trying to improve business and trying to improve our outcomes within the Defence Acquisition Organisation.

CHAIR—Thank you for that. I understand that a project like Collins class submarines would have a project office staffed by both department personnel and navy personnel. Is that correct?

Rear Adm. Purcell—That is correct. But, in reality, both of those types of people report to the Defence Acquisition Organisation under the new arrangements.

CHAIR—Are the naval personnel still moved around from post to post and job to job, or do they tend to go into that project management office and stick with it?

Rear Adm. Purcell—They are under navy control with respect to posting but, because of their speciality, they tend to spend a long time in project offices.

Mrs STONE—You said before that they had been, on average, two years in a job. What would be the average cycling on from one of those positions?

Rear Adm. Purcell—Most of the uniform people would have been in their project jobs for probably five to six years. That would be the average. That would fit in with the other average for our civilian counterparts.

Mr GEORGIOU—What is your best estimate for the delivery of fully compliant submarines—that is, all systems go, all weapons go, integrated weapons system, the lot? What is your best estimate?

Rear Adm. Purcell—The best estimate we have at this stage is probably the end

of the year 2000. That would be a submarine accepted into naval service.

Mr GEORGIOU—You have led me to one last question. A year ago, what was your best estimate?

Rear Adm. Purcell—It would have been about the end of the year 2000.

Mrs STONE—And to accept that submarine—after you have had an independent review of its fully integrated service set of systems, so to speak.

Rear Adm. Purcell—That is this process of being accepted into naval service. It is when the customer, who is about as independent as you can get because he bears no relationship with the organisation, tells us what is wrong with the deal we are offering him.

Mrs STONE—Can I go back to one question regarding liability? In December 1996, the ASC made 46 claims under the indemnity that we were discussing earlier, and 23 of those were denied. How many dollars were involved in those 46 claims?

Mr Hyman—If you can bear with me for one moment, somewhere amongst all of my paperwork, I will find the information.

Mrs STONE—Exactly half of them were denied. It would be interesting if you could comment on why that was so.

Mr Hyman—I will answer that part because I do not need a paper for that. It was for a variety of reasons. The project has engaged a claims manager, a professional insurer, to manage the claims for us. It is on his advice as to whether or not claims are paid. Generally, the claims were denied because there was insufficient evidence provided by a contractor to substantiate the claims. In some cases, it was because the event had occurred some time before he reported the claim. On some occasions, he had gone ahead and made the repairs himself and then submitted the claim, so there was no evidence to support the fact that payments were due under the indemnity.

I cannot answer your first question in full. The table that I have does not have values, but I can tell you that there is a total of 61 claims to date.

Mrs STONE—There are 61 now?

Mr Hyman—Yes.

CHAIR—To make it easy for you, can you provide that evidence to the committee please?

Mr Hyman—Yes, I can.

CHAIR—Mr Barrett, I have allowed Mr Watters a fair go in marketing new Defence organisation and policy. Is there a final statement that you or the rest of the ANAO team would like to make before I call it quits?

Mr Barrett—I would like to make a few points. What we are seeing in the Public Service as a whole, particularly in a very large department like Defence, is a change in culture within organisations so as to be much more commercially focused. Therefore, the whole approach to project management is now oriented towards a proper assessment, prioritisation, review and monitoring of risks in those projects. Learning from commercially oriented practices, we need to have very firm and systematic approaches right from the outset if we are to be successful. We have to deal with commercial providers in a commercial manner, and they expect us to do so. Otherwise, we are certainly going to be at the wrong end of the stick.

Recommendations 4 and 5 are really about prudent management and risk assessment. We are not here to tell Defence how to manage or how to do risk assessments. What we are saying is that, in very complex projects with degrees of uncertainty, there are situations where they have almost blue-sky technology in some areas, where they need to put in place appropriate strategies and to be prepared to be flexible as they go through the various project stages—not take things for granted and certainly not value opportunity costs at zero.

I have a lot of sympathy for the approaches taken which we have heard about here today. I certainly endorse the high value being placed on probity, ethics and arms-length arrangements, but, at the same time, we have to be practitioners and we have to be very good. Where we have very large, complex projects, we have to be excellent. That is what we are trying to encourage.

CHAIR—Is it the wish of the committee that the documents entitled 'State of the service report: APS employment data presented by PSMPC, No. 1', 'The permanent staff by agency according to percentage of EEO data not supplied as at 31 December 1997, presented by PSMPC', and 'Employment services tender, remarks to Senate estimates by Mr Sedgwick', be included in the committee's records as exhibits? There being no objection, it is so ordered.

Resolved (on motion by **Mrs Stone**):

That this committee authorises publication, including publication on the parliamentary database, of the proof transcript of the evidence given before it at public hearing this day.

CHAIR—Thank you for your attendance today and for your frank, comprehensive response to our questions.

Committee adjourned at 4.44 p.m.