



COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

**Reference: Review of Auditor-General's reports, first quarter 2000-01**

FRIDAY, 2 MARCH 2001

CANBERRA

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**JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT**

**Friday, 2 March 2001**

**Members:** Mr Charles (*Chair*), Mr Cox (*Deputy Chair*), Senators Coonan, Crowley, Gibson, Hogg, Muray and Watson and Mr Andrews, Mr Cox, Mr Georgiou, Ms Gillard, Mr Lindsay, Mr St Clair, Mr Somlyay, Mr Tanner and Mr Kelvin Thomson

**Senators and members in attendance:** Senator Murray and Mr Charles, Mr Cox, Mr Georgiou and Ms Gillard

**Terms of reference for the inquiry:**

Review of Auditor-General's reports, first quarter 2000-01.

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**Committee met at 9.42 a.m.**

**CARLTON, Mr Timothy, General Manager, Business Strategy, Australian Quarantine and Inspection Service**

**CLARKE, Mr Tom, Senior Director, Performance Audit Services, Australian National Audit Office**

**GREENSLADE, Mr Alan, Executive Director, Performance Audit Services, Australian National Audit Office**

**McPHEE, Mr Ian, Deputy Auditor-General, Australian National Audit Office**

**MACDONALD, Mr Brian, Executive Manager, Meat Inspection and Food Services, Australian Quarantine and Inspection Service**

**STANTON, Ms Meryl Annette, Executive Director, Australian Quarantine and Inspection Service**

**CHAIRMAN**—Welcome. I declare open today's public hearing, which is the first in a series of hearings to examine reports tabled by the Auditor-General in the financial year 2000-01. This morning we will be taking evidence on two audit reports: Audit Report No. 10, *AQIS Cost-Recovery Systems* and Audit Report No. 11, *Knowledge System Equipment Acquisition Projects in Defence*. The committee has received submissions from AQIS in relation to Audit Report No. 10 and from the Department of Defence in relation to Audit Report No. 11.

We will be running today's session for each report in a roundtable format. I ask participants to strictly observe a number of procedural rules. First, only members of the committee can put questions to witnesses if this hearing is to constitute formal proceedings of the parliament and attract parliamentary privilege. If other participants wish to raise an issue for discussion, I 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 directly to respond to each other. Second, given the length of the program, statements and comments by witnesses should be relevant and succinct. Third, I remind witnesses 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. 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 the secretariat staff.

The audit report being considered in this first segment is Audit Report No. 10, *AQIS Cost-Recovery Systems*. Ms Stanton, do you wish to make a brief opening statement to the committee before we proceed with questions?

**Ms STANTON**—Thank you. I would like to make an opening statement, which I will keep brief and succinct. Firstly, I want to paint a picture of what it is that AQIS does and the environment in which it operates, because it is important for this audit. AQIS is an operational

agency; it no longer undertakes what might be called policy functions such as import risk assessments. Our two major functions are to stop pests and diseases entering Australia through our regional quarantine and import clearance operations and to facilitate exports from Australia through our export certification arrangements to ensure that Australian products meet the standards required by overseas importers. We have some 1,700 staff in over 150 locations around Australia, including in remote and regional locations such as the Torres Strait, Cairns, Townsville and Broome.

We operate very much in partnership with industry in fulfilling our functions. We have fully recovered our costs from industry parties on a program basis for most of our activities since 1993. We have a broad network of services in a wide variety of locations and we work closely with industry in determining and implementing our fee structures. Some of these fee structures are more complex than we might like but they fulfil the needs of the particular industry group—there are 14 of these—and we make sure they are contemporary, reviewing fees every couple of years. Last year, we recovered \$137 million in industry fees to cover the costs of our operations. A fundamental principle under which we operate is that there be no cross-subsidisation between industry groups. Both the government and industry expect this of us.

Turning to the current audit report we are here to discuss, in general we have found this to be a useful exercise to check that our cost recovery policies and processes are robust. The ANAO concluded that overall our cost recovery systems are mature and stable. Further, they concluded that, with minor exceptions, AQIS systems seek to identify the full accrued cost of each recoverable program. Notwithstanding this, the audit found some weaknesses in our processes which need improvement. As a consequence, it made six recommendations to increase the effectiveness and efficiency of cost recovery in AQIS. I will not go through the first five of these, which we found very constructive, have agreed with and are well down the path in implementing. Those details are outlined in our submission, to which we also attached the outcome of implementing recommendation 1—our fees and charging policy. This policy has now been widely promulgated, including being placed on our web site. However, I will briefly comment on the sixth recommendation with which we did have some difficulty. Actually, it would be more accurate to say that we do not disagree with the recommendation as it is worded but it was felt that, in responding to the recommendation, to accept it as worded would be to accept the more detailed model suggested by the supporting text. This is where our reservations lay in terms of possibly moving away from our current consultative approach with industry.

We believe that our current cost recovery structures are efficient and effective for most industry groups. Some industries are still sensitive about paying fees at all, and it is important that we work in partnership with them as to how they want their fees to be structured. Some industries, for example, are more exposed to volatile and environmental conditions than are others. To take cost recovery practices to lower levels within all industry groups—for example, to a service by service level or to a location by location basis, as is suggested by the audit—would, we believe, not only raise our administrative costs but also have other less tangible costs in terms of complexity and transparency, which in turn can lead to further increases in administrative costs.

These increased costs would then need to be passed to industry. As is explained in our submission, we have moved further down this path in some cases where it is agreed to be appropriate, but our management judgment is that we have industry support for our current cost

recovery regimes and most industry groups would react adversely to moving universally down that path.

In the context of this review, continuous improvement has involved a long process from partial cost recovery to full cost recovery, to full cost recovery by program, to accrual accounting, implementation of the recommendations of the Nairn review on quarantine and now substantial changes to our approach through the introduction of co-regulation in many of our programs. This last development, like those before it, impacts on fee structures because AQIS moves out of some fee-for-service areas and becomes more the standard setter and the auditor. We are committed to continued refinement and improvement of all our functions, including those related to setting and recovering fees within the cost recovery framework the government has set. This ANAO audit has helped us in that regard. That concludes my opening remarks.

**CHAIRMAN**—Mr McPhee, do you have a brief opening statement?

**Mr McPHEE**—Ms Stanton has summarised the audit report fairly well. The thrust of the report is very much about encouraging AQIS to further improve their management information for decision making. It is encouraging to hear Ms Stanton refer to their desire to continuously improve their administration.

**CHAIRMAN**—Ms Stanton, it is my understanding that, while you agree with the general thrust of the first five recommendations contained in the ANAO performance audit report, you have expressed some concern to the ANAO that the report generally lacks balance in its presentation and contains inaccuracies and inconsistencies which may lead to a distorted view of the efficiency and effectiveness of AQIS cost recovery systems. Would you like to speak to that? Those are pretty overt statements. We are not used to having agencies disagree with the Audit Office on such a public basis.

**Ms STANTON**—Mr McPhee and I discussed this a couple of months ago and again very recently. We would say that this was not necessarily the happiest audit process that ever took place. There are issues from both the ANAO and the AQIS side that led to that situation. It is true to say that there are parts of the text of this audit report, as opposed to the recommendations, where we still feel there was a lack of balance and some inconsistencies, and we have given some examples of that. Having said that, we are keen to move forward. We have stated that we believe that is the situation, but we are very keen to move forward now and to concentrate on implementing the recommendations. I have said in my opening statement that I believe that the audit report has been very helpful to us. Even in setting our new fees and charging policy it was a very useful document and a very useful exercise to go through. In summary, it was certainly felt at the time the audit was concluded that certain points we had been making had not perhaps been taken sufficiently into account.

**CHAIRMAN**—To explain briefly to you why you are here today, in fact it was on 28 May 1999 that we had a public hearing to discuss costing and services of various agencies. AQIS appeared and reported to us that AQIS had been moving towards being a full cost recovery agency for your service delivery activities. I asked a number of rather pertinent questions about your mechanisms for measuring cost. The answers I got seemed to imply that you really knew what you were doing and that your level of sophistication was sufficient that your clients were happy with the cost recovery procedures, but I was not necessarily convinced from that hearing

that in fact your cost measurement systems would equate in any favourable comparison with most of industry, so the committee asked ANAO to do this audit. We did that on behalf of the parliament. They agreed and did the audit. In this report, my colleague Mr Cox reminds me, at 7.5 it is reported that 69 per cent of clients consider AQIS charges are too high. That does not particularly surprise me because I ran into some problems with AQIS charging earlier in my time in this place.

What I am concerned about, Ms Stanton, is the fact that you do not have a time measurement system and you do not have a chart of accounts cost centre system set up that will allow you to measure programs and the actual cost of programs and activities within those programs. You come to some ambit agreement with client agencies that this is what you will charge on an hourly basis but you have no way of measuring the actual cost versus the standard cost, generating variances and either managing your business more efficiently by knowing what it costs you to do all this work or to accurately charge your clients without cross-subsidising them. I do not understand why you are so totally opposed to agreeing with audit's recommendation that you go to a more substantive cost measuring system. I would be very pleased to hear your words as to why you are resisting that.

**Ms STANTON**—I will make a general statement on this. It may be that Mr Macdonald and/or Mr Carlton will also want to comment on it. First of all, I would say that we do have cost measurement systems.

**CHAIRMAN**—Do you have time sheets?

**Ms STANTON**—We do not have time sheets.

**CHAIRMAN**—Then you do not have a cost measurement system.

**Ms STANTON**—I believe that we have cost measurement systems that are those that are necessary. They may not be ideal. I will move on to say why it is that we have reservations about moving down very tight time charging processes. Before I do, though, as we have indicated in our submission, we are currently reviewing this as the ANAO suggested. We have asked KPMG to look for us at what the possibilities are for our moving down a more sophisticated time measurement system. They have recently done a similar exercise in Customs. Given the similarities of our businesses we believe that they have some expertise in this area. We are waiting on the KPMG report, which we should have within a couple of weeks.

In terms of the nature of the charges and whether or not they are full activity based costing, no, they are not. It is clear that they are not done on a full activity based basis. In other organisations that I have been involved with I have been involved in activity based costing. The costing procedures that we have are based on broader analysis of time spent, usually over a fortnight.

It is important to remember that this is important from a cost subsidisation point of view where we have individuals who are working across different programs and across different groups. That, in fact, only relates to about 15 per cent of our staff, but we do need to look in more detail at that. I mentioned to you how decentralised we are as an organisation, with staff in the Torres Strait and Broome, and a lot of them are operating virtually as sole operators. We



have to have a system that is not only transparent and understandable to industry but transparent and understandable to our staff. We also need to understand how it would help us to go down to a very fine level of activity based costing.

Our judgment is that, at the stage we are at in our continuum from no cost recovery through to full cost recovery and the continuous improvement which I talked about in my opening statement, while we need to keep pushing and we need to become more sophisticated, we are at the stage at the moment that is about what both our staff and our industry partners can bear. Certainly, industry is very reluctant to make the system more complex. They say they do not need it, and they are very concerned to keep their charges low. They are concerned that it will add to their charges. That is a general statement about it.

**CHAIRMAN**—I have some difficulty understanding why putting in place and implementing an accurate cost measuring system is going to cost more money. It seems to me, if you were in industry and you were a business and you had competitors, by now you would probably be broke because you do not know any activity costs and those activities for which you undercharge might well exceed those for which you overcharge and would put you at great risk in the marketplace. I just cannot imagine that you could exist as a private sector organisation with the way that you are measuring costs, or attempting to measure costs, at the moment.

**Ms STANTON**—The other thing I would say is that there have been other reviews of this which indicate that our cost measurement systems are, in the opinion of others, quite robust. We have recently done a review of our horticultural exports program where that was certainly an outcome from a consultant on that basis. I will pass to Mr Macdonald, who has a lot of experience in this particular area.

**Mr MACDONALD**—We do have fairly comprehensive cost measuring procedures in AQIS. Sometimes they are not used to match fees up to those costs but that is because industry has decided they want a simple system that is uniform across Australia, and we have negotiated that. If I could take a couple of examples which are significant components of AQIS's revenue base: we collect about \$140 million in fees in one way or another from industry for the services we provide. The meat program makes up about \$55 million of that and we have divided that program into five cost centres: meat inspectors, veterinarians, our senior auditing veterinarians, overtime and our export documentation system. We have set fees for each of those groups which recover the cost, except for a margin which the government and industry agreed in a formal agreement they would do to reduce the registration charge.

We have a registration charge which covers the cost of maintaining the structure of the program and then we have fee-for-service arrangements which reflect the cost of all the others. However, we do not go below the inspector level because we have different costs for different forms of employee. For example, we have contractors whom we pay \$28 an hour, whatever time they work, and we have employees who are subjected to the certified agreement that we have signed with them. If we were to have a system that reflected that level of detail, that would be enormously complex because it varies on a day-to-day basis across the meat program. We think we have gone down as far as we can in assigning the costs to each of the services that we deliver to industry.

On the import clearance program, we have also divided that program into five component parts agreed with industry: entry permits and the cost of running that program is \$1.8 million and we collect \$1.3 million in the fees and charges we assign to that; the cost of the air cargo risk management procedures is \$1.7 million and we collect \$1.7 million in revenue; sea cargo—that is dealing with containers—is \$6.5 million in costs and \$6.7 million in revenue; entry management costs us \$10 million and we are collecting \$12.2 million, but the difference between the two—

**Mr GEORGIU**—That is a profit centre.

**Mr MACDONALD**—That is a profit centre but it is not quite a profit centre; it is an agreement with industry that we will charge more than the cost of providing that service to build up capital so that we can finance a re-engineering of our AIMS entry control system. It is an agreement with industry so that, rather than putting in a depreciation charge and then spreading it across our industry, over the years they agreed that they would finance it up front. That looks like a profit centre but there is a reason for it. Finally, inspection treatment, which is the fee-for-service activity, costs us \$16.8 million and we collect revenue of \$16.5 million. So there is a very close alignment in those broad groups.

**CHAIRMAN**—You think you are very good, but ANAO thinks you are not. They say that they are unable to assess with any confidence how well your fees and charges reflect the actual costs incurred—full stop! So you have an outside agency which is impartial. The judge, if you will, came in and had a look and yet you say, ‘Oh no, you’ve got it wrong. We’ve been around for a long time. We know what we’re doing and we’re right.’ That is the way your response to the report reads to me.

**Mr MACDONALD**—I think that reflects Ms Stanton’s comments about questions at the margin. We are talking about degrees of interpretation here. These are agreed figures with industry as well. On the import clearance industry—

**CHAIRMAN**—That is not the issue. What you have agreed is not the issue. The issue is whether or not you can accurately measure your costs and therefore manage your own business as well as apportion costs to industry for cost recovery accurately. You say you can; ANAO says you cannot. If we were to make a significant recommendation in this regard I suppose you would tell us that we did not know what we were talking about either. Would that be right, Mr Macdonald?

**Mr MACDONALD**—I do not think you could draw that conclusion, Mr Chairman.

**CHAIRMAN**—We might find out.

**Mr GEORGIU**—This report seems to have created quite a bit of angst.

**CHAIRMAN**—It sure has.

**Mr GEORGIU**—Having had a look at the comments by AQIS on the report, with one exception it seems to me that the things are nitpicking. I refer you to an example in your submission which is of concern. You say:

In Chapter 3, the ANAO used an example of AQIS further refining its overhead allocation methodology ... to be an indicator that cross-subsidisation between programs must therefore have existed in the years prior to that change.

You object to this and you say that AQIS sees this as being a further refinement of your processes. Is that the first reason why you are complaining about the report? Does that have a great deal of substance?

**Ms STANTON**—As I indicated, I believe—and Mr McPhee and I have discussed this—that it is time to move on from that. Your statement is correct.

**Mr GEORGIU**—You are an authority and you say, ‘We are really irritated by this report.’ Point 1 of irritation is something that to the naked eye has no merit or substance.

**Ms STANTON**—For the AQIS staff involved at the time, it did have substance.

**Mr GEORGIU**—Can you address it here today rather than somebody getting irritated with the ANAO? Somebody once threw an auditor from the Auditor-General’s out of an organisation, so I know how irritated people can get.

**Ms STANTON**—The basic issue is that there was a feeling that the considerable effort that had been put in over the years and our regime of continuous improvement had not been recognised. I really think that sums it up in relation to all those points.

**Mr GEORGIU**—Let us say you were just irritated and you blew your stack.

**Ms STANTON**—I think it was a lack of recognition of effort.

**Mr GEORGIU**—How does ANAO respond to the AQIS point of how come things are so bad now when, in 1998, you found that they were so good? That seems to me to be a pertinent point.

**Mr McPHEE**—The 1998 audit was an audit of 10 or 11 agencies which looked more at the higher level arrangements for cost recovery and fundamentally focused on cost recovery at program levels. That report was a more broader brush review than this in-depth review.

**Mr GEORGIU**—A bit like AQIS’s costings?

**Mr McPHEE**—I think we would both agree with AQIS that they do a pretty good job on the cost recovery at the program level. The debate is very much about the service level and costing at the particular service or fee level. The focus of the two audits was quite different. This one was as a result of the committee asking us to have a thorough look at AQIS’s performance, and that is what we have done.

**Mr GEORGIU**—I do not remember the cost recovery systems report, but in the ranking at that level of generality—the broad brush level—where did AQIS fall? Was it lots better or lots worse?

**Mr McPHEE**—There is a two-part response to that. The report that we provided was a generic report. It did not comment on the performance of particular agencies. We provided each agency—

**Mr GEORGIU**—It was not global—no names, no pack drill. It says:

AQIS has developed satisfactory procedures—

**Mr McPHEE**—Yes. That was the second part of the response that I was about to get to. In compiling the report, we provided each agency with a management letter which set out how we saw the particular organisation. It was in that context that we sent that letter to AQIS. I would need to go back, but my assessment would have been that at that level AQIS were probably in the stronger half than the weaker half.

**Mr GEORGIU**—Thank you.

**CHAIRMAN**—If I could read you a bit out of our report on this issue it might be constructive. We stated:

The audit showed that most agencies were still in the initial phase of developing costing systems as measured against a three phase model. None of the agencies used costing information as a key part of overall decision making. The management of cash revenues and expenditure was the primary focus of financial control.

That is historic, and we all understand that. We continued:

The Auditor-General noted the transition to the more mature phases will be facilitated by:

an increased understanding in the value and uses of cost information;

the implementation of sophisticated cost systems; and

an effective costing framework, including an appropriate environment, an effective approach and informed application.

We absolutely agreed with all of that and went on to say:

The committee notes that significant cultural change is required to support the reform of public sector financial management.

I am not sure that the response to this audit indicates that this agency has got that message.

**Ms STANTON**—I think we do have the message, Mr Chairman. In the period since that audit, for instance, in some of our programs we have introduced more sophisticated systems than we had at that time. The issue is how we have introduced them and on what basis we have introduced them. Again, Mr Macdonald can give some examples, but it is a matter of having, where it is appropriate, gone down to get information at quite a detailed level but not on a strict activity based costing level. That would give us information, for instance, on cost by location, that we would not see that we would then use. In that particular example, we have a policy of not charging differentially between locations. There have been some examples in that period

where we have introduced far more detailed systems than we had at the time of the previous comment.

**Mr MACDONALD**—As Ms Stanton said, we have been refining our systems. We do maintain detailed cost structures and we record information on that base, and we do use that to make judgements about what appropriate prices are. The meat program did it some time ago. More recently we are doing it with our seaports program. I will cite that as an example. Ninety-four per cent of the revenue and the activity in that program comes from three activities. There is critique for inspection, which is where AQIS goes onto a vessel and inspects it for whatever we are looking for—it might be cockroaches or forms of contamination if it is a cargo ship. That is done with an inspection. There is critique without inspection where we know the company has a good record, and there is a QA system operating. We do that off the papers. And then there is a thing called a de-rat certificate, which is a certificate that AQIS issues at the request of companies. International shipping requires companies to have a valid de-ratted certificate. Those three activities comprise 94 per cent of our activity. We charge \$475, \$120 and \$475 respectively for those programs.

The other balance of the revenue collection is from fee-for-service, which is \$120 per half-hour. We know that \$120 per half-hour is well above the price of providing labour. We know it is around \$60 because we have the data to show that. So we are going with industry; we are reducing that price to \$60, and we are doing an analysis on the workload that we get from our costing data against those three functions. If it says that the de-ratting exercise—which is a total survey of the ship, looking for rats—costs more than \$475, then we will adjust the fee with the agreement of industry. So it is a constant process of looking at our fee structures. As Ms Stanton said, the programs are subject to structural change on an ongoing basis as well, so it just does not sit still. None of our programs are sitting still in terms of their structure.

**CHAIRMAN**—But, as an example, if you have an abattoir export meat inspector in Victoria and one in New South Wales, and if you actually set up a time measurement system and a proper costing system, and you found that it cost twice as much per hour to provide that service in New South Wales as it did in Victoria, wouldn't that tell management that something was wrong in New South Wales and you had best go about finding out what it was to fix it?

**Mr MACDONALD**—Yes, it does, and we have done that. That is precisely what we did when we reformed the meat program. We looked at our cost structures. We could work out what the input was in terms of the inspection effort. We could measure the inspection effort. There was the number of inspectors, the throughput, the kill statistics in the establishment, which we record. So we had workload. And we did determine against a staffing formula that places were overstaffed. We reduced staffing according to that formula and brought them all back to a constant. That means that now the cost of providing an inspector in Bourke, New South Wales, is exactly the same as the cost of providing the inspector in Mount Gambier, South Australia, because we have the one underpinning cost structure. The only variation is caused by the throughput of the establishment. If their chain speeds go up then we have to apply more inspectors. It is a step function in the staffing formula, and that does cause some differences at the margin, but they are marginal only, and to build a system that comprehended that would be almost impossible to manage.

**Mr GEORGIU**—So you have this level of costing across your organisation?

**Mr MACDONALD**—Yes.

**Mr GEORGIU**—It seems to me that you are putting forward two propositions; no more information could be in the least bit helpful to us as managers—

**Mr MACDONALD**—No.

**Mr GEORGIU**—Then I have misunderstood you.

**Ms STANTON**—I certainly would not be saying that. I also need to say in relation to your first comment, Mr Georgio, that some of our programs are better developed than others. The meat program has been at this longer than the other programs. There is improvement to be made in all programs, including the meat program. Over time that is what we are doing. Some programs need to be brought forward more quickly than that. I think that in each and every program there are things we can learn and things that we can keep improving. I have no doubt about that. The issue is one of pace and one of ensuring that both our resources and the resources of industry are balanced in moving forward along that path. But there is improvement to be made in all of them.

**Mr GEORGIU**—Every time somebody mentions an improvement you whack us across the head with industry and say, ‘This has all been agreed with industry.’

**Ms STANTON**—I would prefer to think that we did not attempt to whack you across the head with that. What we are trying to make clear is that we are perhaps in a different situation where the whole of the government’s policy is about moving forward together with industry, in partnership with industry. It is about the concept of co-regulation moving forward so that there is more industry responsibility for some of these issues. AQIS is more a standard setter and auditor. It is a matter of moving forward in the context that Mr Macdonald put, which was of structural adjustment as well as concentrating on our fee structures. They have to be consistent with what else is happening.

**Mr GEORGIU**—Every time a point is made you say ‘Industry wouldn’t wear it’ or ‘We have reached an agreement.’ That seems to me to be a shield. Can I pose a hypothetical question? Where would you be moving if industry said, ‘Fix whatever you have to fix’?

**Ms STANTON**—I commented in my opening statement that I thought some of our fee structures were more complex than they needed to be. Clearly, based on sophisticated information, I would sooner have a situation where I did not have nearly 500 different fees to administer across a number of industries. Consolidation of some of those aspects would be something that I would have a vision for, but we move down that road as best we can.

**Mr GEORGIU**—Yes, but not all that quickly. I am genuinely not being critical. I am just saying that it seems that you are basically happy with what you have got, you feel under-appreciated by audit and you have a relationship with industry which actually lets you screen out some of the impulses towards change. That is what I am hearing.

**Ms STANTON**—I am concerned if you are still hearing the last point you made from me. I have been in this position for four months and I certainly think there are changes to be made. I am not satisfied that we have a good enough system.

**Mr GEORGIU**—What is your priority change and when are you going to achieve it, in your vision?

**Ms STANTON**—My priorities are to look at those programs where I believe there is still improvement to be made because they are trailing behind. There are a couple of those.

**Mr GEORGIU**—Can you specify them please?

**Ms STANTON**—Horticulture has been a good example. That review is nearing completion now. We are hoping that we will have a new fee structure for horticulture in the near future which will be more transparent, more equitable, and so on. The vision beyond that really is a matter of, once we believe that these programs are pretty much up to speed in terms of their basic costing information and so on, trying to work towards a simpler set of fees—which I do not for a minute believe means that you do not need more detailed information; you do. The more detailed the information, the better able you are to set a simpler fee structure in the end.

**Ms GILLARD**—I wanted to raise two issues. One arises from an experience I had in my electorate where a business was going bankrupt and a significant issue in the sale became the quantum of unpaid fees to AQIS which had been allowed to accumulate over a period of years into a very extraordinary figure. Because of the inability of AQIS to waive those fees, and the unwillingness of the potential purchaser to take on that liability, the sale ultimately did not proceed, with the result that the business closed and some jobs were lost in my electorate. I would be interested, given that we are talking about fee recovery and all of that, in what steps you are taking to ensure that fees that are owed to you by industry are promptly paid and that that situation is not allowed to arise again.

**Ms STANTON**—Thank you for reminding me of that point because that is something else that, in my short time with AQIS, I have also noted. As we are changing fee structures in particular programs, one of the things we are considering is how we can move—with new technology and so on, such as it is—to more up-front fees so that you do not get in a situation where you are into debt recovery. As to debt recovery itself, which does happen from time to time, I am also looking at those processes because, to put it in a positive way, I think we can do better at drawing attention to debt early and not continuing to provide service which increases the debt. There is an issue there, of course, because you are then withdrawing service, but I think we can be more rigorous about that, and that is something we are looking at at the moment.

**Ms GILLARD**—What sort of quantum of outstanding debts—say a debt more than 12 months old—would AQIS have at the moment?

**Ms STANTON**—I do not have that figure with me.

**Mr MACDONALD**—In the meat program, which I think is the program you are referring to, where that system of collecting debt from new occupiers is in place, our debt over 180 days—six months—is about \$600,000 at this point in time, and most of this is under management. It is

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x months—is about \$600,000 at this point in time, and most of this is under management. It is not debt that is just sitting there waiting to be written off; there is a management process applying to that debt. Total turnover in the program is about \$53 million to \$55 million at the moment.

**Ms GILLARD**—The example I gave was actually in the milk products and the dairy area. Another issue raised in the ANAO report was your philosophy on rebating and, if you are overrecovering, that you will adjust so that those moneys are returned to industry, but at various points of the report there is an issue raised about the timeliness with which that is happening. The ANAO says that, of the six programs that had revenue rebate balances at 30 June 1997, only grains had paid out rebates over the following two years. Can you perhaps explain to us what your approach is there, in terms of the timeliness and effectiveness of rebates if you have overrecovered from industry?

**Ms STANTON**—I am going to hand that question over to Mr Carlton.

**Mr CARLTON**—It is important to note—and I cannot remember what the figure was at the time of the audit, but I think it was about \$2 million sitting in that account—that, as at the end of January, that amount is down to \$151,000, so a lot of work has been done on that since the audit. The amounts in that are reasonably small. The largest amount is in the dairy program where there is \$69,000, fish has \$28,000 and international mail has \$54,000. Those revenue rebates, as far as I know, have been ceased in anticipation of some sort of surplus deficit being experienced in those programs with the intention of using those funds that are sitting there to offset a possible surplus in the current financial year.

**Ms GILLARD**—What about the animal quarantine stations program? We were told at the time of the audit that it had accumulated funds totalled at 46 per cent of the program's annual expenditure.

**Mr CARLTON**—At the end of the last financial year the accumulated surplus was \$360,000. The program is showing a small surplus at the moment of an additional \$82,000. The fees for the animal quarantine stations went to our business and financial committee just before Christmas. It was decided that, because the program has a possible major restructure which may take a fair bit of capital to fund, we should let that surplus deficit sit there at the moment to see more detail about what money is going to be required for any restructure.

**Ms GILLARD**—Across the programs would you agree with the proposition that you could be more timely in making decisions about rebating and that too much time has been allowed to go by in a number of these?

**Mr CARLTON**—At the time of the audit there was a lot of money sitting in that account. One of the reasons was a bookkeeping problem in that one of the larger programs which had a lot of that money had agreed for that money to be transferred into the income equalisation reserve. That had been agreed with industry but the accounting within AQIS had not caught up. Some of the others had been quite slow in going out. There has been a push since then to get the money out.

**CHAIRMAN**—In recommendation 2 you say:



... AQIS considers the cost-effectiveness of introducing a system to enable it to determine, and regularly review, the proportion of time spent by staff working on each program ...

In other words, time recording and time measurement. You responded:

AQIS considers that it already has a highly defensible cost-allocation system which it considers is supported by industry clients. The cost-effectiveness of introducing an alternate system will be reviewed in conjunction with industry.

In the beginning statement, Ms Stanton, I recall that you said something to the effect that AQIS remains unconvinced that a full costing system will be viable and that in fact it would be more expensive. Have you any basis for such a statement? Have you ever measured the cost of introducing and maintaining a highly sophisticated cost measuring system?

**Ms STANTON**—That is part of what we are asking KPMG to do for us. The internal calculations have been done and the internal considerations have led us to that, but I do not believe that they have been disciplined enough in their approach. Partly, that is what we are asking KPMG to look at for us.

**CHAIRMAN**—You do not have to defend every statement you made in response to audit's recommendation No. 1. Whoever wrote your submission to this committee was in a fairly aggressive state of mind when they wrote it. You do not have to live with that. Recently we had Defence, who had disagreed with the recommendation of ANAO, come back to us and say, 'We have re-thought that and we have decided we will do it now. It is under way.' Even the Prime Minister is allowed to change his mind.

**Ms GILLARD**—He does so frequently.

**Mr COX**—I was having a discussion with someone who had been involved in the export meat trade until relatively recently. He was a Russian and he made the observation that in Russia, if somebody came into your factory and charged fees as AQIS did, he would buy a bigger machine gun and chase them out. Have you done an international benchmarking study of your fees relative to the fees that are being charged in other places? By that I do not mean the Russian mafia.

**Ms STANTON**—We have not done international benchmarking on all of our programs. I would be surprised, though, if there was not some international comparison made on the issue of meat, given the attention that that has brought over the last couple of years. I will ask Mr Macdonald to comment.

**Mr MACDONALD**—Not a formal benchmarking exercise, but we do keep an eye on what happens with our trading competitors. In New Zealand, they full cost recover like they do in Australia, and the fees are pretty similar. They are direct competitors for Australia, Europe, north Asia, South-East Asia and the United States. The United States does not charge fees for standard inspection but they do charge fees for overtime and special requests that might be made. Their problem in the United States is that they are funded from the budget and the budget has been declining and they cannot resource their tasks. They are having a problem. In Europe, there is a directive in law that says how they will charge and what they will include in their cost base. It is an accrual based analysis. Under European law what they include in their cost base is

what we include. The fees end up being pretty similar for that reason, although, if you used the exchange rate, Australia would look a lot cheaper.

Our fee for an inspector for one year, for 50 weeks of the year, for eight hours a day, is \$71,000. That is quite a reasonable fee. It works out at about \$34 an hour, which is low if you benchmark that against a plumber or some other service provider. It is the actual cost of providing that person. It is made up of a base salary, the on-costs for superannuation and workers' compensation. Then it adds a provision for relief because people will take about six weeks leave during the course of the year—four weeks annual leave and maybe sick leave. It takes into account the on-costs that are personal overheads like payroll charges so the cost of doing the payroll is also added in. That is the system that we use, and it works out at about \$34 an hour. You need to compare that with other services that are provided in our community to give you a benchmark. We do know that industry have complained about the \$71,000, and they have compared that to salaries that they pay, but the \$71,000 is not a salary, it is the price we charge to provide a service eight hours a day for five days a week over 50 weeks of the year. It is a price; it is not the cost. When they have to put their own QA systems in place they say that is what it costs them, too, for their own staff.

**Mr COX**—You said that the Europeans were required by law to include the same things in their cost structure as you do.

**Mr MACDONALD**—Yes.

**Mr COX**—But do you know whether they are applying relatively more or less resources to it than we do per unit of output?

**Mr MACDONALD**—They provide much more than Australia. We have just received a draft review by the EU of our meat inspection system where they observed, in terms of staffing, that we run a pretty light system by comparison.

**Mr COX**—Do you have anecdotal or other evidence that one of the reasons the EU are running a heavier system is because they are effectively a non-tariff barrier?

**Mr MACDONALD**—There is a quota, and they have their own internal subsidy systems operating, of course, in Europe. They have an intensive agriculture system as well, compared to our extensive agriculture, so it is pretty difficult. Maybe you could do some sort of analysis along those lines, but we have not done that sort of analysis.

**Mr COX**—It might be worth doing from a wider policy perspective and it might be useful in other discussions if they are, in fact, trying to frustrate our exporters.

**Mr MACDONALD**—They do that by a quota. Australia has an absolute quota for sheep meat and red meat and there is a quota in dairy. That is how they control international trade and competition for their domestic producers.

**Mr COX**—If they are charging the importers of our product for quarantine services there, that is presumably adding to the—

**Mr MACDONALD**—No, they do not. I cannot be comprehensive about that. What I was talking about was the inspection function that they apply to their own production system. I was not talking about import clearance fees. I am not sure what the situation is in relation to import clearance fees.

**Mr COX**—So that would be another area that would possibly bear some study.

**CHAIRMAN**—In Chapter 2 it states:

... ANAO found that a number of cost-recovery practices have evolved within AQIS, many of which are undocumented.

Are you addressing that?

**Ms STANTON**—We have addressed that in two ways. First of all, the guidelines that already existed that were documented but that were not all in one place we have now documented. Each program has a specific document that relates to fees and charges in their particular program. Overarching that we have now produced a document that outlines our overall fees and charging policy. We now have a comprehensive set of documentation to which all our staff has access. Indeed, our overarching document which we attached to the submission is also available on the Internet. We believe now that we have a much better documented system and that that documentation has been distributed where it needs to be.

**CHAIRMAN**—In July 1998, in response to an ANAO audit on costing the services, you advise of your intention to issue an organisation-wide charging policy document. ANAO advised you have still not issued it and there is no clear timetable for its availability. Are you addressing that issue?

**Ms STANTON**—This is the document that is at attachment 8A of the submission. It has been issued.

**Mr COX**—Could I ask you a couple of questions about the glassy-winged sharpshooter, since Warren Truss very wisely announced this week that we were not going to be allowing the importation of any Californian table grapes?

**Ms STANTON**—This may be a matter for Biosecurity Australia, not the Australian Quarantine and Inspection Service. But ask the question and I will let you know if I can answer it.

**Mr COX**—It is a flying insect that is the victim of Pierce's disease. I was just wondering whether you any detected any in Australia.

**Ms STANTON**—I cannot answer the question. Certainly not recently. I do not know whether we have ever detected any in Australia.

**Mr GEORGIU**—What is it?

**Mr COX**—Pierce's disease is a virus that kills grapevines.

**Mr GEORGIU**—Are you declaring an interest?

**Mr COX**—I will declare an interest. I thought it was a very wise decision by the Minister for Agriculture. I applauded it. I am quite happy to put that on record.

**Mr GEORGIU**—That is the first compliment we have copped out of him in three years.

**CHAIRMAN**—My understanding is that AQIS has been involved in cost recovery for some 31 years. Has their progress been satisfactory?

**Mr McPHEE**—I guess it is a case of saying where they might go in the future. That is what our report was trying to get at. AQIS has to deal with a range of queries and sometimes complaints about fee levels, issues about the levels, inequities and some of the charges. Our view is that having a more refined costing system would be a very strong defence in discussions of that kind. It would also provide timely information—week-to-week, month-to-month—about the state of the costs, rather than on a review basis. It seems to be the predominant approach now, when there is a problem, periodically to have a review and to adjust the cost. We think there are a lot of advantages to AQIS. But obviously, as Meryl said, there is a range of issues that the organisation is facing. It is up to them to sort out the priorities.

**CHAIRMAN**—Do you have any information or do you have any views in ANAO on the cost of developing and maintaining a sophisticated cost measurement system versus the potential productivity and economic benefits to be derived from so doing?

**Mr GEORGIU**—That is a very good question.

**Mr McPHEE**—I refer the committee to a better practice guide we put out, which was called *Building a better financial management framework*, and a case study in that report, on page 42, concerns the Therapeutic Goods Administration. They charge fees for particular services and they wanted to see if they could get some value out of refining their costing information. They started off with a method by which they asked their staff to record how they spend their time against a set of predetermined activities for a set period of six to eight weeks. They did that on spreadsheets—a very low-cost approach to seeing what it provided them with and whether there were benefits in it. They have since moved to a commercially based off-the-shelf time recording costing system. I think that is a very sensible way to go, particularly if there are concerns or doubts in the organisation about the value of it. We are not just asking the organisation to spend a fortune on a very costly system but to try to explore a bit further the benefits of such an approach that the TGA used.

**CHAIRMAN**—Did it provide economic benefits?

**Mr McPHEE**—Yes. They were convinced there was value in it.

**CHAIRMAN**—Did they measure the improvement in value or the improvement in performance? Have they done so since they brought in the system? Is it simply anecdotal—‘Now that we have more information about how we operate, we think we operate better’—or can they measure improvement in performance?

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**Mr McPHEE**—What we reported here was that they found the resulting cost data to be robust and defensible. Fees and charges for 1998-99 were set to recover costs identified by the exercise, which is repeated periodically to ensure that revenue collection, fees and charges remain appropriate. They put in place arrangements to keep monitoring their collected costs against the fees they are charging and continuously monitoring.

**CHAIRMAN**—Do they use that in a management sense to improve the efficiency of their service provision?

**Mr McPHEE**—Exactly, and to inform their decisions about allocation of costs and resources.

**CHAIRMAN**—Does ANAO have any further comments?

**Mr McPHEE**—No. I think our report is quite clear.

**CHAIRMAN**—Does AQIS have any further comments?

**Ms STANTON**—No, thank you.

**CHAIRMAN**—Do my colleagues have any further comments?

**Mr GEORGIU**—I thought that was a very good question from the Chairman. Occasionally the level of the ANAO's recommendations are pitched at a very high level of generality. Might it not be worth while actually specifying, at a rather more specific but more modest level, what you really mean to get some fairly rudimentary systems in to see whether or not this would be helpful—

**Mr McPHEE**—Yes. I think we did try to pick that up in the text.

**Mr GEORGIU**—Yes, but the recommendation is at the grand level and it just means, 'Can you distribute the questionnaire to your staff and see whether or not that helps.' Maybe that would create greater relaxation in the authority, especially one that seems to be as sensitive as it has been in its response.

**Mr COX**—I just wanted to go back to the issue of charging the same fees whether you have an abattoir that is in the back of Bourke or Mount Gambier. Was that something that AQIS wanted, or was that something that the industry wanted?

**Mr MACDONALD**—It was a mixture of both. Industry wants a simple fee structure. We had some very significant discussions with industry in 1997 when we brought the current fee structure into place. They wanted simplicity and certainty. But we also felt that if we changed the way we structured our staffing, we could actually provide the service at the same cost, no matter where we were in Australia. We did that through negotiation with the union. We had a certified agreement and we established the right to employ casual labour. Up until that point, the cost of providing services in distant rural areas was greatly increased by the need to shift relief staff out there and pay them travel and mileage allowance. There were a lot of allowances

attached to it. With the introduction of casual employees, we were able to engage people who would live and work in those establishments. It has made the cost structure uniform across Australia because the staff are now all located in the place where the abattoir exists. That is why I said earlier that we have got this uniform structure.

**CHAIRMAN**—Thank you very much, both ANAO and AQIS.

[10.58 a.m.]

**McKENNA, Brigadier Timothy John, Director-General, Defence Knowledge Improvement Team, Department of Defence**

**McKINNIE, Ms Shireane Kay, Head, Electronic Systems Division, Department of Defence**

**MESSER, Ms Wendy, Director, Resource Management and Planning Section, Chief Finance Officer Group, Department of Defence**

**NICHOLSON, Air Vice Marshal Peter, Chief Knowledge Officer, Department of Defence**

**McNALLY, Mr Ray, Audit Manager, Performance Audit Services, Australian National Audit Office**

**McPHEE, Mr Ian, Deputy Auditor-General, Australian National Audit Office**

**MINCHIN, Mr Tony, Executive Director, Australian National Audit Office**

**CHAIRMAN**—Welcome. We now come to the second audit report to be examined at this morning's public hearing. 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. The audit report being considered in this session is Audit Report No. 11: *Knowledge system equipment acquisition projects in Defence*. Does Air Vice Marshal Nicholson have a brief opening statement?

**Air Vice Marshal NICHOLSON**—No, Mr Chairman. I will leave it at the submission that we have put to your committee, unless you require further elaboration.

**CHAIRMAN**—No, that is not necessary. Mr McPhee?

**Mr McPHEE**—Very briefly, this audit provides a high level review of the state of knowledge management in Defence and the issues to be addressed, and made seven recommendations supporting the current directions the department is taking. It must be said that this is a very significant task in terms of what the department has ahead of it in settling the governance arrangements and the architectural framework which best suit the defence environment and in their gaining acceptance of an approach which allows for greater systems integration without unnecessarily impairing the delivery of capability.

**CHAIRMAN**—Mr McPhee, on page 77 of your audit you reported that both of defence's internal audits were not referred to the defence audit program evaluation committee. How serious do you consider that omission?

**Mr McPHEE**—At the time, we certainly viewed it seriously. I understand that arrangements have changed in more recent times with the appointment of the new chairman of the audit committee. I might ask Mr Minchin to refer generally to the arrangements that the audit committee has in place.

**Mr MINCHIN**—It has been a concern that the audit committee has not applied its mind to both the reports of the audit office and the reports of this committee. That has now changed. In fact, the Inspector-General did inform an earlier hearing of this committee that they are paying closer attention to that. There is now an independent chairman of the audit committee and they have said they will be addressing our reports and your reports more closely in the future.

**CHAIRMAN**—Does Defence have any comments?

**Air Vice Marshal NICHOLSON**—No, only to reaffirm that the new arrangements of the Defence Audit Committee with an independent chairman are designed to overcome those criticisms.

**CHAIRMAN**—Can I say to you on an informal basis that this is an issue which does concern the committee in a generic, across the agency sense, I guess. We are now starting to focus our minds on it and are trying to figure out the best way of coming to grips with it. ANAO has its own set of problems—that is to say, it produces many performance audit reports and financial audit reports every year and makes recommendations. Departments respond to those formally in the documents themselves and they say, ‘Yes’, ‘No’ or whatever. Once you have said ‘No’, you have said ‘No’. As far as we are concerned, that is the end of the matter. But if you say ‘Yes’, I think ANAO, from their viewpoint, needs to know that ‘Yes’ actually translates into action. From our viewpoint, when we produce a report and we make recommendations that are accepted, we also need to know that action is being taken that introduces those. In a bureaucratic sense, it is a nightmare for us to try and follow up on all that without some assurance that, in fact, it is occurring.

**Mr McPHEE**—Many audit committees do, as a matter of course, get updates on progress against our recommendations and their own internal audit recommendations. So I think the best place to put the responsibility is on the audit committees to make sure things are happening. In most cases, once something has been completed, they drop it off their list. But they do keep monitoring it in most cases.

**Mr GEORGIU**—Could I just refer you to the Audit Office’s findings on the impact of deficiencies at page 78 and the tracking personnel movements, producing deployment planning sheets and tracking logistics in terms of the East Timor deployment. Can you tell us the magnitude of the problem?

**Air Vice Marshal NICHOLSON**—As they existed then, or now?

**Mr GEORGIU**—As they existed then.

**Air Vice Marshal NICHOLSON**—The magnitude of the problems were that many of those sorts of things could not be tracked electronically in the way they would be tracked in barracks



electronically. We are working to actually provide that sort of information for deployed forces through a concept which we are calling the defence management support environment.

**Mr GEORGIU**—Can you tell us what the consequences of not being able to track were?

**Air Vice Marshal NICHOLSON**—Inefficiency, more than anything else. It took longer to do things. There were no show-stopping operational aspects in those failures, because there were manual systems in place, and we put in place interim electronic systems for the operations. But we recognised that this should be a standing part of our business.

**Mr GEORGIU**—Are you happy with how things are progressing at the moment?

**Air Vice Marshal NICHOLSON**—Yes. We would all like them to be going much faster than they are, but they are progressing.

**Mr GEORGIU**—The audit report tends to draw a distinction between the management projects under your sponsorship and those that are not under your sponsorship. Could you tell us a little bit about the dilemmas in projects that are not under your sponsorship?

**Air Vice Marshal NICHOLSON**—The main problem is coherency between those systems—in particular, not being able to exchange information between the systems. We are working to overcome that now by, in the first place, recognising that administrative systems which we have in the past have considered to be non-operational are in fact integral to our operations, and that is this concept of the defence management support environment. The second way to do that is to put in place a very rigorous governance mechanism to make sure that all projects that come under this administrative rubric are in fact examined for their coherency within the environment.

**Mr GEORGIU**—When you say, ‘which fall under this rubric’ which ones are excluded?

**Air Vice Marshal NICHOLSON**—None are now.

**Mr GEORGIU**—So it is everything.

**Air Vice Marshal NICHOLSON**—Yes. We have got two levels: the first level is for major projects, those above a few hundred thousand to a million or so dollars, which will go formally as a project; and those that are minor projects, and we are doing a register, an audit, of all of those.

**Mr GEORGIU**—Are you having many difficulties cutting into the non-administrative military projects?

**Air Vice Marshal NICHOLSON**—No, they are the easier parts. It is the administrative—I hesitate to call them ‘civilians’—

**Mr GEORGIU**—That is no problem.

**Air Vice Marshal NICHOLSON**—that are the biggest problem.

**CHAIRMAN**—Why is that?

**Air Vice Marshal NICHOLSON**—Because they have been developed in a stovepipe to fulfil a particular function. For example, there is a system called ROMAN, which is designed for a financial system but not designed to exchange information necessarily with the personnel system, which is called PMKEYS. So a lot of our work at the moment is to in fact enable that to take place. Each of these projects was conceived to fulfil the information requirements of a particular business process, say personnel.

**Mr GEORGIU**—That is not my reading of the audit report—that in fact you are having more difficulties with the military projects than you were with the administrative projects. Can the Audit Office please correct me, because if I have misread the report I should actually focus a bit more.

**Mr McNALLY**—No, I do not think it is correct. The audit report does cover both military and business projects. We did say that the knowledge staff had most problems with the administrative projects, mainly because of the fact that they were developed for their own functional purposes and not for a purpose other than that function. The difficulties that the knowledge systems program had was to make sure that those administrative systems were designed in such a way that they were cohesive with the military systems.

**Mr GEORGIU**—Let me try again. Paragraph 4.7 on page 45 says:

... Knowledge staff are establishing the processes needed for effective program management of the projects that they sponsor. There were 50 such projects at the time of audit. Subject to some caveats ... processes to achieve good coherence between these projects are now being put in place.

In paragraph 4.8 it says:

The situation is much less clear for the many other projects, estimated to cost some \$4 billion, that will contribute to, or depend on, the Defence Information Environment. As mentioned in Chapter 1, these include the ... Airborne Early Warning and Control Project, ... an air defence acquisition.

I thought that you were drawing a distinction.

**Air Vice Marshal NICHOLSON**—Yes, between projects which are sponsored by me and projects which are sponsored in other parts of the department. Would you prefer for me to answer this?

**Mr GEORGIU**—Can you explain? I am not being rude.

**Mr McNALLY**—Yes. The difference, of course, is the sponsor of the projects.

**Mr GEORGIU**—Yes, that is precisely the point here.

**Mr McNALLY**—The sponsor has most say because they are mostly the customer of those projects during the development phase.

**Mr GEORGIU**—Yes, I do appreciate the difficulty.

**Mr McNALLY**—The words we used were that there is less visibility of those projects and the projects which were sponsored by the chief knowledge officer, which is a natural result of the fact that they have different sponsors, but I do not think that we said that that was a major problem. We said the major problem was with the administrative systems, the business systems.

**Mr GEORGIU**—I thought what you said in the report and earlier on was that that was a major focus that you regarded as having to have priority and not that the other issues were being effectively managed.

**Mr McNALLY**—At the time of the audit the major focus was on the military systems, but a secondary issue was those business systems. We had to cover both of them. The initial focus was on those military systems, and in covering those systems we had to make the observation that there were two subsets or two groups—those who were sponsored by the chief knowledge officer which were under fairly tight control and those which were in other areas of defence.

**Mr GEORGIU**—Sorry; I had a bone to pick.

**Air Vice Marshal NICHOLSON**—I can elaborate a little further. We have subsequently put in place, and it is now in advanced stages of draft, a new procedure which details how these projects, whoever they are sponsored by, are brought forward so that our government's mechanism can actually check that they accord with the architecture and are coherent. That draft system is now in place and working, so that even sponsors from outside my area—for example, AEW and C—are now being examined with the same sorts of criteria that are needed for knowledge systems.

**Mr GEORGIU**—If there is a conflict between yourself and another over a project of which you are not a sponsor, how is that resolved?

**Air Vice Marshal NICHOLSON**—Ultimately, in the Defence Capability Investment Committee, which is chaired by the Vice Chief of Defence Force.

**Mr GEORGIU**—Can you tell us how that works?

**Air Vice Marshal NICHOLSON**—There are two subcommittees. One is called the subcommittee of the DCIC, the Defence Capability Investment Committee, and that looks at capability systems. The other one is called the Defence Information Environment Committee and that looks at knowledge systems. If there is some conflict, it would be resolved at the Defence Capability Investment Committee, the chairman of which is the vice chief. The other main members are the Chief Finance Officer, the Deputy Secretary for Strategy and the Under-Secretary for Defence Materiel. There are a number of permanently invited members according to what the project is. For example, the Chief of Air Force would be there for Air Force related projects. That would be the forum at which that sort of conflict would be resolved.

**Mr GEORGIU**—Could you prevail over a resistant sponsoring division?

**Air Vice Marshal NICHOLSON**—That is very hypothetical. Since we have put in place this new architectural approach, that has not arisen. I think that is because all of the people involved recognise that the whole of the Defence information environment has to be coherent. So there has not been a head butt about it.

**Mr GEORGIU**—So there is broad consensus that no problems will emerge? That would be nice.

**Air Vice Marshal NICHOLSON**—I am sure problems will arise in the future, but at this stage, no.

**Mr GEORGIU**—In terms of the recommendation that there should be a more disciplined approach to the scrutiny of military projects which are not under your sponsorship, that is agreed. How is that proceeding?

**Air Vice Marshal NICHOLSON**—The checklist that we are using is the draft instruction that I spoke about, which indicates that compliance with the architectural frameworks that we are putting out is actually met.

**Mr GEORGIU**—How developed are the architectural frameworks?

**Air Vice Marshal NICHOLSON**—The highest, level 1, is virtually complete and we are now looking at specific areas. For example, one on surveillance will go before this committee structure in the next month or so.

**Mr GEORGIU**—So you start with the broadest level of generality and then specify to activities? You use surveillance. Is it specification to activities, functions or—

**Air Vice Marshal NICHOLSON**—A specific example would be that for maritime mobile communications the project which is looking at providing those communications for ships, aircraft and submarines and then to land is using the first cut of our architectural framework. It is being presented in architectural terms in the capability options document, which will go to these committees.

**Mr GEORGIU**—Somebody mentioned earlier this morning that the Chief of the Defence Staff could not send emails around the place to all his units. Is that so?

**Air Vice Marshal NICHOLSON**—The desktop applications do not go down to individual soldiers.

**Mr GEORGIU**—Where do they go down to?

**Air Vice Marshal NICHOLSON**—They go down to sub-unit level. The email environment is now pervasive down to unit and sub-unit level. Certainly each individual does not have a desktop.

**Brig. McKENNA**—It is pretty hard to prove that something does not exist. Absolutely everybody cannot get everything. But our best judgment at the moment is that it is improving and we are continuing to improve it.

**Mr GEORGIU**—Your first statement was a long way from improving and continuing to improve.

**Brig. McKENNA**—There may be one unit in the organisation where there are some difficulties but it is very hard to prove when someone has got a problem.

**Mr GEORGIU**—I appreciate that. So how are you improving?

**Mr COX**—The anecdote from this morning, I presume, was that Alan at some point in the recent reorganisation phase had wanted to communicate with everybody that the white paper was being released or that some restructuring was being done. He wanted to do that as efficiently as he could. He decided that the easiest way to do it was by email and somebody had obviously said to him, ‘Sorry, Secretary, you can’t.’

**Air Vice Marshal NICHOLSON**—I would like to make a clear and unequivocal statement. There is not now, and there never has been, the intention to be able to email every member of the Defence organisation. That has never been part of our objective. The idea is to get this electronic information to the level at which it needs to be used. I have characterised that generally as about sub-unit level—that is, for platoons.

**Mr COX**—I do not think we were suggesting that the email would go necessarily to every private. It was that there were some parts of the organisation where there were some—

**Mr GEORGIU**—Structural blockages.

**Mr COX**—Yes. I wondered—and I know it is a long time ago—whether, since we spent umpteen hundreds of millions of dollars on project design in the mid-1980s to try and have a higher degree of interconnectivity between Defence computing systems, the same issues that were outstanding then in terms of physical equipment and software being different all over the place are still outstanding; whether that is still the case.

**Air Vice Marshal NICHOLSON**—No. After the Defence Efficiency Review, one of the outcomes was to form the Defence Information Systems Group so that, rather than all parts of the organisation providing their own capabilities, they came under this single group. They have been working steadily to standardise all of the problems that design had in the 1980s. So it is a quite different situation. Since then, of course, the information technology revolution has advanced at mind-numbing speed. So it is a different situation altogether.

**CHAIRMAN**—Would you like to clarify that a bit? The words ‘it is a different situation’ do not tell me much.

**Air Vice Marshal NICHOLSON**—In the mid-1980s our computing environment was based on large mainframes. Now it is largely distributed on PCs and service. That is the technological difference.

**Mr GEORGIU**—Basically are you saying that, if somebody wants to communicate with the three arms down to a reasonably appropriate level, you just press the button and you go?

**Air Vice Marshal NICHOLSON**—Yes.

**Mr GEORGIU**—So you can prove that much?

**Brig. McKENNA**—Yes, we can prove that much.

**Mr GEORGIU**—I am not asking for perfection; I am just asking: are there any fundamental blockages that have not been removed?

**Air Vice Marshal NICHOLSON**—No. The system can always be improved.

**Mr GEORGIU**—Can I rephrase that question. What blockages once existed and have they now been removed?

**Air Vice Marshal NICHOLSON**—One blockage in the past was bandwidth. We have a project to improve the wide area communications network within Australia, to steadily—month on month really—improve the bandwidth that is available; that is, the amount of information that can be passed down. That is less of an impediment now than it was last year or the year before.

**Mr GEORGIU**—What was the consequence of that impediment?

**Air Vice Marshal NICHOLSON**—For example, that emails might take longer to arrive than they do today.

**Mr GEORGIU**—So it is just speed?

**Air Vice Marshal NICHOLSON**—It is speed and quantity. For example, emails with attachments—a Word document, an Excel spreadsheet or whatever—would take considerably longer to arrive than they do today. Next month and next year, it will be faster.

**Mr GEORGIU**—Do ANAO have any insight into blockages that are more significant than just speed of transmission?

**Mr McNALLY**—No, we do not. When this audit was being progressed there was another review into Defence's administrative systems looking at those types of issues. We made a decision not to review that review because it started and finished after ours. So there was no point in us—

**Mr GEORGIU**—Have you had access to the review subsequently?

**Mr McNALLY**—No, I have not.

**Mr GEORGIU**—What did the review show?

**Air Vice Marshal NICHOLSON**—It has led to a whole range of requirements—for example, as I mentioned, the improvement in the Defence wide area network capability and replacement of components around that, and a need to modernise some components for security, bandwidth and speed and all of those sorts of things. Those results are being fed directly into projects to improve the overall capability.

**Mr GEORGIU**—What were the fundamental issues that that raised—or weren't there any?

**Air Vice Marshal NICHOLSON**—The main one was the inability of specific functional areas to transmit information from one area to another—for example, from the financial system to the personnel system or the logistics support system.

**Mr GEORGIU**—Can you explain that a bit further?

**Air Vice Marshal NICHOLSON**—The way the financial data was presented in the personnel system was different from the way the financial information was presented in the financial system, and similarly with the logistic support system. One of the recent decisions has been that the financial system—chart of accounts is the technical term for it—will be applied across all of these systems. They are actually working as we speak to change the personnel system so that its chart of accounts is the same as the financial system's.

**CHAIRMAN**—I should hope so.

**Mr McPHEE**—On pages 76 and 77 of our report we actually include an address by Dr Allan Hawke—I would have to say it is fairly lighthearted—about Defence's systems. He talks about the email in the second paragraph on page 77. Further down, he says:

... we've developed stovepiped solutions to an art form. Stovepipes r us!

It is very lighthearted and certainly not something an auditor would say in a report. In fact, we would be accused of lack of balance if we ever said anything like that.

**Mr GEORGIU**—Or even that you had a sense of humour!

**Mr McPHEE**—That is right, and we are a bit dry. I think it captures the essence of the issue in a succinct way.

**Mr GEORGIU**—When will that process be completed? I know how argumentative people can be about changing their systems, even in as highly disciplined an organisation as Defence.

**Ms MESSER**—The chart of accounts review is trying to complete its work for implementation from 1 July, along with the implementation of customer supply arrangements at that time. The review is attempting, as was noted, to make congruent charts. There will obviously always be information that you wish to capture at natural account levels that are different for the different systems and the different information that you are collecting. It is attempting to bring those together. 1 July is the implementation date for the outcome of the chart of accounts review.

**Mr GEORGIU**—You do not foresee any problems in it?

**Ms MESSER**—No, I came from a meeting about that this morning. There will always be problems but certainly at this point in time the chart of accounts review is on track.

**CHAIRMAN**—Recommendation 4 says:

The ANAO *recommends* that Defence:

a) clarify the Chief Knowledge Officer's role as the customer for acquisition projects that he sponsors ...

And you agreed. Can you tell me exactly what sorts of projects you sponsor. Do you then maintain those systems or do you hand them over? What is the procedure?

**Air Vice Marshal NICHOLSON**—A good example is the JORN.

**Mr GEORGIU**—Tell us about that—we know about that one!

**CHAIRMAN**—We know quite a lot about JORN actually, including how late it is and how much more it is costing.

**Air Vice Marshal NICHOLSON**—You will be aware then that the software that will be delivered with JORN is as specified at the beginning of the project. In the meantime, our research and development has worked to improve the capability of that software.

**CHAIRMAN**—We are aware of the fact that the software that GEC-Marconi wrote would not work on a 24-hour clock and got scrapped.

**Air Vice Marshal NICHOLSON**—Yes, there are a number of things. I am sponsoring a project which is to put improved software into that system after it is delivered.

**CHAIRMAN**—Okay, but you are not going to operate the system.

**Air Vice Marshal NICHOLSON**—No. I am sponsoring it and I maintain that watch on the system until it is delivered—in this case, a phase with new software—to the system which the Chief of Air Force actually operates.

**CHAIRMAN**—Do you have personnel who report to you that live at RLM in Melbourne?

**Air Vice Marshal NICHOLSON**—No, that will be done through the materiel organisation.

**Ms McKINNIE**—My organisation has people that are collocated with RLM in Melbourne overseeing the software development part of the project—indeed, all of the aspects of the project.

**CHAIRMAN**—Including the development of the algorithms?

**Ms McKINNIE**—Yes.



**CHAIRMAN**—I am a bit confused here. I do not understand how the chief knowledge officer is sponsoring and responsible for this when you have no personnel involved in the decision making from day to day.

**Ms McKINNIE**—The chief knowledge officer defines what the requirements are that need to be met.

**CHAIRMAN**—Such as?

**Ms McKINNIE**—Such as the period of operations that we will need to be able to run the radar, the extent of the range of surveillance, the number of tracks that we might want to detect at any one time and, broadly, how we want to use the radar in terms of overall Defence capability. The chief knowledge officer decides that through the investment analysis processes that we have. When they are agreed, those requirements are handed to me in the case of JORN. I am accountable for delivering a JORN system which is consistent with the requirements set by the chief knowledge officer. I report to the chief knowledge officer on any areas where I will not be able to meet the capability. Depending on the extent of the problem, the chief knowledge officer will make a decision as to whether it is acceptable. If it is a major capability issue, it would be referred back to the Defence investment committee for consideration as to whether it was acceptable or not acceptable, or whether I would have to take some other type of action.

**CHAIRMAN**—Hypotheticals are not good, but perhaps they are appropriate here. What happens if you discover a major deficiency, decide to try and fix it yourself or get it fixed and neglect to advise the chief knowledge officer of the deficiency? How does he fulfil his responsibilities?

**Ms McKINNIE**—I would not be fulfilling my responsibilities—

**CHAIRMAN**—We understand that, but these sorts of things happen from time to time.

**Ms McKINNIE**—What we have attempted to put in place to ensure that I keep the sponsor well involved and advised on what we are able to achieve is coming through the stakeholder—the project boards that we have put in place. Through that process there is a substantial amount of visibility to the sponsor and to the end-user of the system.

**CHAIRMAN**—Let us go to the specifics. You have challenged me now. Let us move from JORN to Collins. Does the chief knowledge officer have any responsibility for the combat control systems?

**Air Vice Marshal NICHOLSON**—No.

**CHAIRMAN**—Why?

**Air Vice Marshal NICHOLSON**—Primarily because that system is an integral part of the platform. In any case, it was in place long before our organisation came into being.

**Mr GEORGIU**—So was JORN.

**CHAIRMAN**—I would have thought that a similar circumstance existed with JORN.

**Air Vice Marshal NICHOLSON**—No. The combat system of the submarine is regarded as an integral part of the working of the submarine rather than a part of the Defence information environment.

**CHAIRMAN**—I was going to use it as an example, assuming that you did have some responsibility. This committee was constantly told that the combat control system would meet specifications and would ultimately be installed. In fact, it never will be. We all know that now. But when you say, ‘I can’t do that. I can’t not tell the chief knowledge officer that something is going wrong’, I say to you that this committee has more than one experience of being given information which turned out to be wrong.

**Ms GILLARD**—With the Collins class combat system—which I think is emblematic of a broader problem—how is it envisaged that that is going to talk to the rest of the knowledge system in Defence? Given Defence is in an acquisitions environment now as a result of the white paper and as a result of a series of government announcements following the white paper, what degree of confidence can we have that at the end of those acquisitions we are going to have the maximum possible interoperability, given the historic problems that there have been with the development of interoperability?

**Air Vice Marshal NICHOLSON**—I cannot talk about the Collins, because as far as the combat system and the platform are concerned we have no responsibility at all for that. As far as its ability to communicate outside to the Defence information environment is concerned, it has a communications suite which was specified to be able to interface with various parts. I cannot tell you now exactly what they are but that was the way it was designed. That was not designed to a communications architecture, which is the way we are now doing business; it was designed the way the sponsor thought he would operate the submarine at the time of specification.

**CHAIRMAN**—There is, however, a program which we understand runs very successfully. I have forgotten what it is called but it keeps track of on-board stores, it keeps track of future maintenance requirements—that is, the time the boat is run and when certain maintenance is due for certain items—what spares are required to be put on board when it hits the dock and all those sorts of things. I understand that is highly successful and it certainly does communicate with other Defence information systems.

**Air Vice Marshal NICHOLSON**—That sort of system—and there are many systems like that for different weapons systems and platforms—operates through what we would generally call logistic support. That main logistic support system is called SDSS, which stands for Standard Defence Supply System. The level that you are talking about is operating at a relatively low level in that SDSS. The control that we are trying to get on those sorts of stovepipe systems is at a higher level to make sure that the finance can talk. When it is used for its purely functional purposes for logistic support of a submarine when no-one outside that system needs to know that sort of detail, then we do not get involved. In fact, the principle that we use is that the business process owner is responsible for that. There is some level at which he must exchange information with other systems, and that is when we become involved. That is what the architecture is all about.

**CHAIRMAN**—Do you own any systems?

**Air Vice Marshal NICHOLSON**—No.

**CHAIRMAN**—The second part of recommendation 4 was:

(b) consider the costs and benefits of establishing an Integration Authority, along the lines of that established in the UK Defence Procurement Agency.

If you agree, could you tell us where that stands?

**Mr GEORGIU**—They actually do not.

**CHAIRMAN**—They do not what?

**Mr GEORGIU**—They do not agree.

**Ms McKINNIE**—We have started looking in more detail at how the Integration Authority in the UK is operating, and we are currently trying to come to grips with how that is working. Our initial understanding is that the Integration Authority is in part working as a small organisation but is also using integrated project teams—IPTs—types of arrangements, processes and tools as part of the mechanisms that they are developing. The use of integrated product teams in the UK Procurement Agency is one of the principles that underpins how they are approaching the acquisition of new systems.

**Mr GEORGIU**—I would like to pursue this. You say that Defence has not yet formed a view that organisational change is required to achieve the integration function. Usually that means that Defence has formed a view that organisational change is not required to achieve the integration function.

**Ms McKINNIE**—We do not know yet. At the moment we have a number of activities under way, such as the formalisation of the Defence materiel organisation. As part of that we are looking at our role with the Defence Information Systems Group and where the boundaries might lie there, including the boundaries associated with who is going to be responsible for technical and systems architectures and the like. We are also looking at what processes of governance we need to have in place that will ensure that the architectures being defined by CKO are going to be implemented. What we are suggesting there is that it is highly likely that we may actually have a solution which is a combination of organisational restructurings, but we are hoping that we might be able to capture that as we are going through the current DMO establishment processes as well as tools to assist people in implementing the architectures as they are defined. We just do not know what the combination is likely to be.

**Mr COX**—It would be fair to say that Defence still has not got on top of life cycle costing and life cycle planning in the acquisitions program. That has been an issue for some years. It was starting to be an issue 10 years ago. I presume that over the last 10 years some progress has been made. When did this integration, which is the next level of complexity that is being added, start to find its way into the consideration of acquisition programs?

**Ms McKINNIE**—I am not sure I understand your question.

**Brig. McKENNA**—Do you mean the ability of us to integrate our systems to be able to talk to each other? Is that what you mean?

**Mr COX**—Yes. When was that introduced?

**Brig. McKENNA**—All I can say is that, in relation to the white paper of 1997, that was the biggest push we had in relation to pushing the knowledge edge as a capability and building integrated command and control systems, integrated surveillance systems and integrated intelligence systems. Certainly the idea of more integrated joint forces has gone back much before that but I think, in terms of a point at which there was a substantial push, the 1997 defence white paper would have been one of those points.

**Mr COX**—So it was pretty early. In terms of new projects that are starting now, it will be an inexact science and process in terms of the way those projects are developed, won't it? It will be something that we are back here looking at in five years time—if any of us survive that long—in the same way that, in the last couple of years, we have been looking at life cycle costing as a—

**Brig. McKENNA**—Now you are back to the life cycle costing question.

**Ms McKINNIE**—There are a number of things that we have under way to improve life cycle costing. Given the duration of the systems that we buy and how long they are going to be in service, it is extremely difficult to come up with any life cycle costing estimate and say, 'That's absolutely what it's going to be.' In the new capability development process that we are working through at the moment, we are developing operational concepts documents that will look more thoroughly at what the support arrangements will need to be in service.

The bringing together of the acquisition organisation and support command I can guarantee certainly focuses your mind on the through-life costs when we are considering proposals in the investment committees. On top of that, we are looking at a number of cost estimating models and are trialling the use of some of those models that we have obtained from the US and other sources to see if they will not only assist with the estimating of the investment costs, but the through-life support costs. In addition to that, with the introduction of accrual accounting, we are looking at how we might seek approval for an investment project which includes an estimate of its whole-of-life costs. We are proposing that we negotiate an approach for how that might be developed with Treasury and Finance.

**CHAIRMAN**—We will be talking about the *Manoora* this afternoon. Life cycle costing might be an appropriate question to ask at that time, Mr Cox.

**Ms GILLARD**—I do not think I got an answer to the second part of my previous question which is, given that we are in the commencement phase of a large number of acquisitions in Defence, what is the degree of confidence that the current systems you have got will ensure that the knowledge systems—the defence information systems—on those acquisitions will be able to talk each other in a combat effective way?

**Air Vice Marshal NICHOLSON**—A high degree. The reason is that we now have in place this government's mechanism whereby every project passes through one of these two subcommittees I spoke about or the main committee. The defence instruction which is in draft, which we are now starting to use—and we will refine it in the next few months—includes specific checkpoints for all of those sorts of things. So the project will not proceed unless it actually meets those sorts of things or unless there is a compelling argument for it not to reach it. The third thing is the actual architectures themselves, which is very much a top-down approach. We have started at the top level and we are working down, tackling the most important or the highest priority things at the beginning. As you have heard, getting the chartered accounts right for the end of the financial year is the highest priority right now. But we will work through a whole range of those processes with each of the architects in each of the business processes. So those three things together, I think, give me a very high degree of confidence that we are actually on top of this problem.

**Ms MESSER**—I would like to add to that. The chartered accounts work will be introduced from 1 July and the results of that will therefore take a year for us to see the benefits. So it does not mean that our problems are solved on 1 July.

**Ms GILLARD**—No. I am really trying to focus on the operational questions rather than the administrative questions. The administrative questions are, of course, important but I think probably the degree of confidence we need the greatest assurance about is around the operational questions. In terms of supporting all of this work, how are you going with IT and knowledge staff career paths and recruitment and retention of the sort of staff that you need to support this kind of work? What training and development opportunities have they got and is any of this work being hampered by the inability to recruit or retain appropriate staff?

**Air Vice Marshal NICHOLSON**—We have started a scoping study on all of the personnel who work in the defence information environment to work out the magnitude of the problem and ways to fix it. There is no doubt that the sorts of people who have the skill sets that are required to work generally are in high demand in the marketplace. I would say, generally, we have not as much problem recruiting as in retaining them. That is what the study will be looking at. So for the first time we will be looking at all those sorts of people as a whole rather than separately in their own streams, as they have been in the past.

**Ms GILLARD**—With a view to introducing some sort of retention bonuses? Have you got any idea where that might take you?

**Air Vice Marshal NICHOLSON**—No. At this stage, no. The study is planned for the next six months.

**Brig. McKENNA**—The reason we qualified our statement was that we are not absolutely certain a centralist approach is necessary in this area; some degree of central supervision is, and that is what we are seeking to do. So our first step is really to focus on what are the issues and, in particular, what are the common competencies across all the different areas that are needed to see whether, for instance, we want to do some common training in those areas. Also, as we post, say, a Navy person out of Navy into the Defence Information Systems Group, while he or she is in the Defence Information Systems Group he or she may need some additional training so they are ready to go back to the Navy on their next posting, and we need to make sure that all of

those sorts of mechanisms are coordinated properly. It is still very early days, but we really did want to approach it with a pretty open mind. I think we have all got a sense that this is a really important issue, and I think that is the reason that ANAO mentioned it and you asked the question, but we want to get our facts straight first.

**Mr GEORGIU**—Just on that, the ANAO actually puts the point reasonably strongly. It says that shortages of skills in one area are addressed by:

... denying essential skills to another. Defence's information environment is vulnerable to shortages in staff with the appropriate skills and experience.

4.51 Statistics provided by Defence indicate that the Services encounter difficulties in recruiting and retaining the highly-skilled personnel needed to support the DIE ...

Somebody just said, 'No, recruitment is not a problem.'

**Air Vice Marshal NICHOLSON**—No. Retention is a bigger problem than recruitment.

**Mr GEORGIU**—So recruitment is a problem and retention is an even bigger problem.

**Air Vice Marshal NICHOLSON**—Yes.

**Mr GEORGIU**—I get a bit literal at times.

**Mr COX**—What does JP 2034, minimum essential emergency network, comprise now? I can remember what it comprised 10 years ago, but I just wondered whether it had changed.

**Air Vice Marshal NICHOLSON**—I do not think so.

**Brig. McKENNA**—That was just a HF network, to provide absolutely minimum communications if all the satellites and all the fixed systems are closed down. That is all it is. It was a very simple system.

**Mr COX**—It was that and it still is.

**CHAIRMAN**—If ANAO and Defence do not have any final comments we will conclude this session. Thank you very much.

**Proceedings suspended from 11.52 a.m. to 1.32 p.m.**

**HAIG, Mr Scott, Auditor Manager, Australian National Audit Office**

**McPHEE, Mr Ian, Deputy Auditor-General, Australian National Audit Office**

**MINCHIN, Mr Tony, Executive Director, Australian National Audit Office**

**NEUMANN, Mr Claude, Inspector-General, Department of Defence**

**ROCHE, Mr Michael John, Under-Secretary, Defence Materiel, Department of Defence**

**RUTING, Commodore Trevor, Director-General, Maritime Support, Department of Defence**

**CHAIRMAN**—We now come to the third audit report to be examined in today's public hearing. 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 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. 8: *Amphibious transport ship project*. I welcome representatives of the Australian National Audit Office and the Department of Defence to today's hearing. Mr Roche or Commodore Ruting, do you have a brief opening statement you would like to make?

**Mr ROCHE**—No, Mr Chairman.

**Mr McPHEE**—I have a brief statement. This audit was another in our series on the management of major equipment acquisition projects in Defence. Many of the problems arising from this acquisition can be traced back to the capability, development and acquisition stages of the project which were not suitably addressed in the face of the opportunity buys presented by the two US navy tank landing ships. The project has experienced significant time and cost extensions. As a result, at the time of the audit, completion time had increased from 14 months to 44 months. Costs had increased from \$125 million to some \$395 million—recognising that some of these costs relate to capability enhancements. Navy has learnt some lessons along the way on this project and the department's own reviews have highlighted shortcomings in the approach adopted, particularly the reviews undertaken by the Inspector-General. Our report made five recommendations, which were accepted—one with qualification.

**CHAIRMAN**—Who actually went to the United States and did the survey work?

**Cdre RUTING**—Two naval officers and they hired a commercial surveyor from the United States to assist them with that activity.

**CHAIRMAN**—Are those two officers still with Defence?

**Cdre RUTING**—I know that one of them is not. I am not sure about the other. I will have to take it on notice to confirm whether the other Defence officer is still with the department.

**CHAIRMAN**—Have we taken any legal action against the independent surveyor in the United States?

**Cdre RUTING**—I do not believe so.

**CHAIRMAN**—Why not?

**Cdre RUTING**—I do not know the reasons why.

**CHAIRMAN**—I have been all over the *Manoora*, and it is my understanding that when we got the ships back here and we started to do the refit work—and we would like to go into some detail about how much has been spent for maintenance and how much for refit; that is, new acquisitions, essentially, to change their capability, enhance it or whatever—very substantial problems were found with rust behind insulation, with structural members that were rusted and inadequate and with wiring and piping that could no longer suit the purposes required for the vessels. Would you care to comment?

**Cdre RUTING**—I think that is a valid statement of the condition that we subsequently found after we had access, particularly as you mentioned, to taking linings and other materials off to gain access behind fittings. That is quite typical of what we find in refitting our own ships—you do not know the details until you can take equipment out and gain access to quite a number of areas, take the linings off the compartment bulkheads and find that there has been seepage of salt water in behind it perhaps and that corrosion has occurred where it cannot be seen. That is part of the reason why, in the life cycle of ships, we conduct refits of that type and take the insulation material off. We would expect over many years that this can occur on certain occasions and in certain locations. But they are difficult to predict up front and, until you can pull the ship apart, you cannot find a lot of these problems.

**CHAIRMAN**—How old were the ships when we bought them?

**Cdre RUTING**—They were 23 years old when we bought them in 1994.

**CHAIRMAN**—Are they steel vessels?

**Cdre RUTING**—Yes, they are steel.

**CHAIRMAN**—Would you have expected them to have exhibited rust behind the insulation?

**Cdre RUTING**—You would expect that in some locations that would occur.

**CHAIRMAN**—How much did we allow to do that work, and how much did it cost?

**Cdre RUTING**—I think we allowed \$8.7 million for that in the ships, based on US experience of what they had been spending in their typical refits for the ships for the last two refits. Our actual expenditure on that for the total repair of equipment and hull is \$142 million.



**Mr NEUMANN**—At December 1998 the original estimate, as I understand it—this is in my report—was \$A8.7 million. The current estimate, which was two years ago, was \$142 million. I might go on and answer the other questions you posed. A lot of the work includes hull rectification, repair and overhaul of the machinery and systems. The \$8.7 million figure was based on the USN's provision of \$US5 million for the next USN scheduled refit. The assumption did not take into account that, firstly, the USN had been running their ships down prior to future decommissioning and, secondly, the USN maintains its tier 3 vessels, particularly those of that age—20-plus years—to a lower standard than the RAN standard. Upon arrival in Australia, we understand these ships underwent considerable repair and refit work at ADI, survey work and preliminary modifications. Considerable emergent work was found as cladding was removed and previously inaccessible spaces were opened up for survey, revealing extensive areas of corrosion.

**CHAIRMAN**—Not a very nice picture, Commodore.

**Mr COX**—When Navy went to the government for approval to spend the money on this project, might they have deliberately underestimated the amount of survey required work that would be forthcoming to get approval to buy the ships?

**Mr ROCHE**—I do not know that either the Commodore or I could speculate on that.

**Mr GEORGIU**—I am uncertain what happened. We bought these ships; they were rust buckets. What happened then? Did everybody get exercised? Did they say, 'How did this happen? Who's responsible? Who are we going to sue'? What happened?

**Mr ROCHE**—Not being in the department at the time, I do not know that there was anyone to sue because the ships were clearly bought on an as is, where is basis from the US.

**Mr GEORGIU**—What happened when this was discovered? What did Navy do? Did it throw up its hands?

**Cdre RUTING**—It was headquarters of the Australian Defence Force where the development division was responsible for the acquisition of these ships. When Navy discovered that the condition of one of them, *Manoora*—when they put it into the dock at Garden Island after arrival—warranted considerably more work, Navy used its ship repair funding to effect those sorts of repairs. These were ones that might have been expected to be repaired later in the life of the ships. However, it was determined that, because the ships were going to be available for the maintenance period and, in particular, second ship *Manoora* was not being operated and was sitting in Sydney prior to waiting for the contract for the capability upgrades to be effected, it was opportune to do this repair work now.

**Mr GEORGIU**—So basically there was not any great distress about all this. It is quite important because this is a major expenditure problem. It is a major capacity problem, a major opportunity cost problem. That is the sense that I am getting out of this. I appreciate that you were not there and I appreciate that Mr Roche was not there. It is also the characteristic of these inquiries into less than successful acquisition projects that nobody who appears before this committee was actually there at the time, so we have to do our best. Basically you said, 'Gee, it's rusted badly.'

**Cdre RUTING**—The Chief of Navy at the time was certainly concerned about the additional expenditure. The deputy chief started a series of roundtable gatherings. We brought many of the internal defence stakeholders, people who were involved in the activity, together to try to get a better understanding of what was the likely direction that this activity would proceed in. That was subsequently upgraded in its formality.

**Mr GEORGIU**—Was there any pursuit of the issue of how it happened? I know that may look unfortunately backward looking but this is one of a series of these issues that have come before this committee. The response is, ‘It’ll be all right soon. We’ll have a fantastic product. Just wait.’ This is usually accompanied by, ‘The people who were responsible aren’t here,’ because of a variety of reasons. It is part of a pattern; it is not just a one-off.

**CHAIRMAN**—Mr Georgiou said it well.

**Mr NEUMANN**—I would like to go to back a little on that one. In the report that we did we have got a side heading which confirms your view. Part of the problem was, we thought, because senior level oversight of the project outcomes was rather limited to functional areas of responsibility. A number of organisations were involved, which was a problem. It was organisation based, so again people just did what they thought in their own particular areas. There were no higher level management arrangements enabling effective control and authority to be exercised. That was our conclusion in the report of December 1999. That does not quite answer the full extent of your questioning but it puts it—

**Mr GEORGIU**—That is another line: ‘That will never happen again.’ It is a recurrent theme in these—

**Mr NEUMANN**—The split of authority is, I think, the key issue.

**Mr ROCHE**—I think that there have been some changes made in the department which make the likelihood of this happening again somewhat remote. Probably the most important of those is bringing together the support and acquisition arms of the organisation into the one organisation. During this process, they and Navy—and indeed Army—all worked independently.

**Mr COX**—Since this saga began, have you ever contemplated buying another second-hand ship on the cheap from the US?

**Mr ROCHE**—I have been quoted a number of times as saying, ‘Over my dead body.’

**CHAIRMAN**—Recommendation 1:

The ANAO *recommends* that Defence undertake a life-cycle costing analysis of the LPAs so that all costs associated with their operation are known and are budgeted for at an early stage.

Defence agreed. When?

**Mr ROCHE**—When did we agree?

**CHAIRMAN**—Will you do it? I do not care when you agreed; I just want to know when you are going to do it.

**Cdre RUTING**—We have started gathering that data for a more accurate life cycle cost assessment, and are fitting an asset management and planning information system on board the ships—for our routine operation of them—that will allow us to more accurately gather a lot of this information. Currently, Navy uses activity based management for gathering a lot of the Navy costs of operation in classes of ship. That is being extended to this particular class now that we have the *Manoora* operating. She commenced operations only last year. She has now completed that phase of the delivery trials and work-up activities and has been operating normally since about April last year when she did her first deployment up to the north of Australia. So we are gathering data from last financial year and building that up over this financial year.

**CHAIRMAN**—I understand that *Manoora* at least—I cannot speak for the other vessels—is a very capable platform and that some opportunity was lost because it was not available for Timor. I think that is well understood. Is that agreed?

**Mr ROCHE**—It is. But to take the other part of your comment, it has, I think, proved its worth in the Solomons. I think it has now had three cycles through the Solomons and it has proved to be a very capable platform up there for the work that we need.

**CHAIRMAN**—That is my understanding, too, Mr Roche. I would never denigrate any of our assets, our vessels or our personnel, but it concerns me that both of these vessels have limited life left. They are already over 25 years old. Ships that go to sea, particularly milspec, have got only so many years before you run them to the scrappers. This committee has concerns that that lifecycle costing be done at an early stage, as soon as possible, and that we have some idea that you are comparing those costs with the necessity for the platforms in the first place and what it costs us if we do not have them or if we replace them.

**Mr ROCHE**—I think we have some measures of what it costs if we do not have them and that is partly related to the lease costs for the *Jervis Bay*, for example, in relation to Timor.

**Mr GEORGIOU**—How much?

**Mr ROCHE**—I do not have the costs with me but we were aware of those costs.

**Mr GEORGIOU**—In round figures.

**Mr ROCHE**—I do not have them with me.

**Cdre RUTING**—A very rough estimate is that the actual lease costs are \$15 million per year including maintenance, and then there are operating costs—fuel, which is about \$6 million per annum on top of that—and personnel costs.

**Mr ROCHE**—If I were pushed I would have said \$25 million a year.

**Cdre RUTING**—They are only very approximate figures.

**CHAIRMAN**—There would be some savings because *Manoora* was still in the dock.

**Mr ROCHE**—We were not running *Manoora* at the same time.

**CHAIRMAN**—That is right.

**Mr COX**—Did you go back into a desktop study of what it would have cost to build the same capability new?

**Mr ROCHE**—It was done at the time, a couple of years ago. The view was that at the current budget cost these vessels have come in at around half the cost of a new vessel and around half the life of a new vessel. We are budgeting on a 15-year life for them. They are in the white paper to be replaced in 2015. So the equation in terms of cost per ship years is fairly close to in balance. There will obviously be increased maintenance costs—and I think that is what the chairman is getting at as they get closer to the end of their life. We are going to have to keep a very close eye on that and make sure that we manage it very carefully.

**Mr COX**—Do you think that they are probably value for money?

**Mr ROCHE**—We are getting them at an equivalent ship-year cost that we would have got had we bought new.

**Mr NEUMANN**—We are getting two ships at once for 15 years instead of taking one new build for 30 years.

**Mr GEORGIU**—So it is a good deal, except that when we started we thought we had a fantastic deal.

**Mr ROCHE**—It is an okay deal.

**Mr GEORGIU**—Let us have a run at this one because I am starting to see a success story emerging out of the ashes.

**Mr NEUMANN**—I asked the question to try to get some handle on where we are at: could a new build, with a notional 30-year life for a new build, be compared with the 15-year life we expected out of each of these? You end up with two times 15 which gives you the same 30 ship years, which is what Mr Roche is talking about.

**Mr GEORGIU**—I sort of got that much.

**Mr ROCHE**—We estimated about \$2 billion for a new build—\$1 billion each. I do not know that we would move too far from that.

**Mr NEUMANN**—The trade-off becomes difficult, and I will explain. On the one hand you have two ships now, so you can have two ships at sea in two different areas of operations.

Whereas if you have one new build you can do only one area of operation. It does become complicated. We kept it very simple just in terms of ship years but there are other capability factors that come into it. Depending on how Mr Georgiou wishes to view it—

**Mr GEORGIU**—I am not a strategist but if you have two you can have one there and one there, but what that has to do with the argument is a bit of a problem. I am really concerned—and you just drove my point home—that after this is all over this will be looked at as a major achievement, which is sort of missing the point. Politicians do occasionally convert disasters into victories but I am just astonished. That is the sort of mindset that will mean that something else like this is going to happen down the track.

**Mr ROCHE**—No, we would not attempt to do that.

**Mr GEORGIU**—Don't read the transcript because you just did.

**Mr ROCHE**—In ship years that is about the cost of a new build. Towards the end of the life of the ships I think the maintenance costs are going to provide us with a bit of a challenge because the cost of maintaining a 45-year-old ship is quite different from maintaining a two- or three-year-old ship.

**Mr GEORGIU**—Do you agree with the ANAO's statements about the capability deficiencies on *Manoora*? On page 40 it states:

... the strength of the forward deck and stern door (that is, the ability to move heavy vehicles over them); heating and cooling capacity of the ship; the ability to produce sufficient amounts of potable water and transfer it ashore; and handling and stowage of watercraft in certain sea states. There are also concerns about *Manoora*'s ability to embark and disembark forces at "fixed port" facilities.

It also states that her capabilities 'do not fully meet those specified in the Joint Detailed Operational Requirement'.

**Cdre RUTING**—The strength aspects are now being investigated using an external classification society to review these. We have certainly moved a number of relatively heavy cargoes on the forward deck and the stowage arrangements for watercraft have been clarified there. There are seven deficiencies overall against the joint detailed operational requirement. It was always recognised that that was the final capability we would aspire to. It has not been funded or approved necessarily to achieve all of that at the outset. In terms of the potable water situation we have upgraded the capacity of the plant in both of the ships. *Kanimbla*, being the second completed, has a more capable system, and we are now working on some improvements to *Manoora*'s at this point in time.

Some of the other issues have been set aside to phase 3 of this project, because part of what was identified was that we would not be able to achieve everything up front. There is a third phase for capability upgrades for this ship. Items identified there will be taken into account with any other lessons we have learnt during major operations, such as forthcoming amphibious operations. That is why this third phase was intentionally left until later, after we had had some time operating the ships, as to whether there were any other small capacity or capability enhancements we would want to make.

**CHAIRMAN**—I am glad you mentioned phase 3, because recommendation 4 from ANAO states that:

... prior to commencement of Phase 3 of the project, Defence assess the design risks associated with this Phase and consider the costs and benefits of letting separate contracts for design and production.

But Defence responded with qualifications—that is, you said, Phase 3 is ‘unapproved to cover further capability’ and it will be defined later, so it would be stupid of us now to consider whether we should split design and construction portions of the contract.

**Mr ROCHE**—I think that sometimes we are too ready to agree with audit. Basically we do not agree with the recommendation that the contracts be split. We cannot agree without considering it further. In many other contracts that we are dealing with in the Defence Materiel Organisation we are looking at in fact increasing the overall responsibility for the package delivered. For example, with new patrol boats we are looking at trying to lock the builder into costs of maintenance over a 15-year life cycle. We would not consider splitting the design and construction aspects there—we would not go to one shop for designs and then get quotes to build them.

**CHAIRMAN**—You couldn’t.

**Mr ROCHE**—We believe that, while it is possible we may do it—and we will certainly look at the possibility of independent design for this when we get to stage 3—at the end of the day we might elect to put the responsibility in one place.

**CHAIRMAN**—What is your response, ANAO?

**Mr McPHEE**—We had no difficulty with the Defence response. It is important that they do assess the risk, but if the risk of putting them separately is too high then clearly they should go together. We just raised it as an issue for consideration, given the experience with the previous two phases.

**CHAIRMAN**—I have a generic question dealing with Defence acquisition and perhaps even acquisitions by the rest of the public sector. The extent to which you can let a contract for design, construction and maintenance does a much easier job of qualifying your through-life costs—the whole of the life cycle costing—than perhaps any other combination of design specification, procurement and maintenance activities. Is that reasonable?

**Mr McPHEE**—That seems to me a reasonable principle, but obviously you need to look at the circumstances in each case.

**CHAIRMAN**—And then you get down to this intangible called ‘value for money’.

**Mr McPHEE**—Indeed.

**CHAIRMAN**—And how do you define that?

**Mr McPHEE**—Have we got time? These are decisions people have to make all the time in terms of weighing up the financial costs and the benefits, and there is a lot of judgment involved because the benefits in many cases are not quantifiable but qualitative sorts of judgments. Departments make these calls all the time. An important thing is that they actually articulate the reasons why they make particular decisions.

**Mr COX**—When this project started, we had an identified need for ships to have at least one platform to go to a Pacific island that was in trouble and extricate Australians who might be under threat—that would be a reasonable assessment of what the fundamental strategic need was—and without the ship we did not have that.

**Mr ROCHE**—I stand corrected, Mr Cox, but my view was that it was more to do with actually getting troops and equipment to the site of the trouble rather than worrying so much about the evacuation of Australians.

**Cdre RUTING**—Further, if we did have HMAS *Tobruk* available during some of those activities—and this reinforces what Mr Roche was saying—you need a range of capabilities to conduct operations, and the original requirement was for a training and helicopter support ship. The original aim of the project was to be able to support quite a range of activities being conducted up there, recognising that, if an activity went on for a considerable period of time such as East Timor and the Solomons have subsequently proven, you need to be able to rotate ships through there and so you need more than a single ship to achieve that outcome.

**Mr COX**—There is a capability gap, however we define the need. An opportunity emerges to fill it relatively cheaply. Had the ships not been complete rust buckets, this would have represented quite good value for money. The issue is: how much of the refit that was done on them originally was needed at that time and how much of it was a bring forward of forward maintenance? And then there was a process of what I would call capability creep—of the services adding more and more capabilities to the ships which added to the bill. Those decisions were made over a fairly long continuum of time, I take it. When the boats were bought, the proposition that was put to government was not that they have a hospital on them and have other facilities that were subsequently fitted at considerable expense.

**Mr ROCHE**—There was one hospital in the original spec.

**Mr COX**—Yes, in the original spec—and now both have them.

**Cdre RUTING**—Yes.

**Mr COX**—What were the capabilities that were specified at the time that they were bought and what were the capabilities that were subsequently added, and in what years?

**Cdre RUTING**—The original specification that was used as an operational requirement document was one that was written for a training and helicopter support ship. At that time, in May 1993, the department was potentially looking at only one vessel but, when the LSTs were then acquired, there were some 14 capability upgrade packages that ranged from removal of the bow horns, conversion of the forward deck into a flight deck, extension of the stern to give two flight deck positions for medium lift helicopters there through to the installation of a 70-tonne

crane, the hospital upgrade and quite a number of other upgrades in this package. Because of the funds that were available at the time, it was determined to restrict how many of those 14 packages were actually installed on both ships. As Mr Roche indicated, one ship was going to have the hospital and the other ship was going to have the crane as a way of really only spending as much money as was available at that time. However, the need for amphibious activities in the region has changed over time, and the relative priorities of that have warranted the government making decisions to install the capabilities on both ships. So we have now two ships with basically the same capabilities. It has considerably increased the flexibility of operations to government through having those two ships, plus HMAS *Tobruk* that has subsequently being retained, as identified in the Defence white paper.

**Mr GEORGIU**—I would just like to make one observation which I think is important—it may not be important, but I would like to make it anyway. Part of the difficulty I have is that, every time one of these projects come up, what emerges is that for a protracted period of time we are denied a capability. We are denied a capability that we used to have, as in the case of Collins class; or we are denied a capability that we should have had, as in the case of JORN. In these cases, my concern is that it seems to me that Defence never actually works out what the cost of that lack of capability is, given that we do get these vessels and over the horizon radar networks for a purpose at a particular point in time. That is one point that does worry me, and Defence never really comes to grips with that except to say, ‘We always like to have it whenever we can get it.’

The second dimension that worries me is that these are all failures of different kinds. It is one thing saying JORN was very difficult to build because it is cutting edge technology; it is another thing to say that Collins class was a really complex technical task; and now we are saying we have got a couple of old boats there and we could not even sort out that they were rusty. So with every new lack of achievement there is a different rationale. But what comes out in the wash is that for whatever reason—come in late, come in over time—totally different sorts of projects fail and the rationale is totally different. The only commonality is we did not get them when we expected them, at the price at which we wanted them and that delivered the capacity that we expected at the time that we designed them to be in place.

**Mr ROCHE**—I agree.

**Mr GEORGIU**—Thanks. You have disarmed me.

**CHAIRMAN**—Recommendation No. 5 states:

The ANAO recommends that the lessons to be learned identified by the Management Audit Branch, the Minister and the ANAO from this project be formalised into guidance and disseminated widely in Defence to assist future acquisition projects.

That is a nice way of saying make sure this never happens again. Defence response, ‘Agreed.’ How are you going to do that and when?

**Mr ROCHE**—We have already done one significant thing and that is form the Defence Materiel Organisation.

**CHAIRMAN**—I knew you were going to say that.

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**Mr ROCHE**—One of the critical reasons for this project going bad was that there were four different players in it. It is now clearly understood within the department that there will be one player and that will be the Defence Materiel Organisation. It will have both through life support and contract people working on the acquisition.

The second issue, as the audit report points out, is that we got into contract before we had finally resolved exactly what the project was going to finish up like. I am working with the Vice Chief of the Defence Force for a new approach to capability definition specification and specifically agreeing the point at which the project is actually approved, taken on and comes into my organisation. We are fairly close to having that settled. Some aspects of it require government approval and we would expect to go to government very shortly with that.

This again is not a case of necessarily disseminating advice to a whole lot of individual projects that these are the things to look out for because this project should not have even started. It should have been caught at the point that it came into the Defence Materiel Organisation. We are demonstrating now with our requirements for a complete statement of capability requirements and a complete operational concepts document that we are not permitting projects to get under way before the detail is resolved. We are actually doing it with projects now.

**CHAIRMAN**—I hope what I heard is not exactly what you meant. You said you would not proceed until you fully detail the project. Does that mean that you once again going to go back and specify the hardware architecture for a Collins class combat control system? If that is what you are saying, I do not think I like that much.

**Mr ROCHE**—No, that was a poor choice of words—until we have fully agreed of the functional requirements for it. In this case we had not fully agreed the functional requirements for these vessels before we started work on them and signed the contract. There was a further issue and that was the inadequacy of the survey and the inadequacy of the allowance for repair of an older ship. Within Commodore Ruting's area there is now very clear understanding of the sort of allowances that we would just automatically apply to any older vessel if by chance the acquisition of an older vessel was contemplated ever again.

**Mr COX**—If over your dead body—as you have said earlier?

**CHAIRMAN**—I have not divided 145 by eight but that is several thousand per cent increase in cost.

**Ms GILLARD**—I want to be clear about the costs figures. It seems to me that there are two streams of expenditure on these ships. One stream of expenditure was fixing up what was wrong with them. Another stream of expenditure was adding capability to them that they otherwise would not have had. I understood you, Commodore, to say at the start that, for the stream of expenditure to fix up the problems with them, the original estimate was \$8.7 million. Is that right?

**Cdre RUTING**—Yes.

**Ms GILLARD**—And the final expenditure was \$142 million?

**Mr NEUMANN**—It might be useful if I go back to my report and run through it. It is not as simple as that. The acquisition of the LSTs from the USN, which the Defence Acquisition Organisation as it then was funded, the original estimate was \$76.3 million. The current estimate is \$62 million. In other words, there was a variation of minus \$14.3 million. It was the only thing we did well on. The second thing was the phased modification of ships to the landing platform—

**Mr GEORGIU**—What is the current estimate?

**Mr NEUMANN**—It is actually finished.

**Mr GEORGIU**—So it is an actual?

**Mr NEUMANN**—It is an actual. The original estimate for the modification of ships to the LPA configuration, which was funded by the acquisition organisation, was \$32.8 million. The estimate at December 1998 was \$99.1 million. The variation is \$66.3 million. The repair and refit work, which was Support Commander Australian Navy funded, was \$8.7 million in the original estimate. The estimate in December 1998 was \$142 million. That is \$133.3 million if my figuring is right. Then Army funded some capability for \$15 million for which there was no provision originally. Air Force funded some enhancements to allow helicopter operations for \$20 million and there was no provision for that originally.

Then there were marine pollution control requirements for \$2 million, which there was no provision for originally. Then there was estimated additional repair and refit funds required of \$35 million for which there was no estimate originally required. Then there was the living out allowance, accommodation costs of RAN personnel in Newcastle—\$2.6 million was the original estimate and the current estimate was \$5.8 million; the difference being \$3.2 million. So at December 1998 the figure comes close enough to \$381 million, whereas the original estimate was about \$121 million, leaving you with a \$260 million deficit.

**CHAIRMAN**—Is the contractor now driving Ferraris?

**Ms GILLARD**—It would be a pretty good Ferrari for \$260 million.

**Mr NEUMANN**—No, different people got them.

**Ms GILLARD**—I am not confident we have got the key figure yet. It seems to me that, when you went to the United States to look at these ships, you thought their condition was at this level. When you actually got the ships back to Australia and had a better look at them, you found their condition was at a different level. What did the failure to properly survey and inspect in America cost us?

**Mr NEUMANN**—That is the difference between \$8.7 million I would say and \$142 million, so about \$133 million.

**Ms GILLARD**—So, if you—and this is in the generic Defence sense; I know it was not you individually—had known at day one when you were in America having a look at these ships

that it was actually going to cost you \$133 million more than the figures you then had in your mind, would you still have purchased them?

**Mr NEUMANN**—I do not know if I could answer a hypothetical question like that.

**Ms GILLARD**—It seems to me quite a key to the analysis.

**Mr ROCHE**—It is a hypothetical question, but on a ship year basis it would still represent a reasonable proposition.

**Ms GILLARD**—So that is a ‘probably, yes’.

**Mr ROCHE**—I do not know. If I saw an estimate of \$133 million for rust and structural repairs on these ships, I would be starting to get pretty nervous about the deal, regardless of the projection of ship year costs.

**CHAIRMAN**—And Petro’s point about the time.

**Mr ROCHE**—Yes, absolutely.

**CHAIRMAN**—With the greatest of respect, he is right. All these projects we are talking about, except the ANZAC frigate that seems to get rolled down the waves pretty regularly, are years and years behind.

**Ms GILLARD**—Having sat through a number of these now—though not as many as Petro and the Chairman, I concede—it seems to me that that analysis is pivotal. It seems to me that, knowing whether you would have proceeded on day one if it was going to cost you \$133 million more, is the difference between it being a costly error and a complete fiasco. It seems to me that Defence, in terms of working through forward systems, probably needs to have a good analysis of how bad those errors of the past have been. I would have thought that, if you made an error like that in your private life—if you purchased a car and ended up paying \$20,000 more for it than you were expecting to—you would be making a very hard-headed decision about whether or not you should have purchased that car to help you inform your thinking about how you are going to deal with your next car purchase. It just seems to me Defence never actually chases the analysis down to that point.

**Mr ROCHE**—It is why a lot of people buy new cars I guess. I think all of us have probably had an old car once. I think we would be unlikely to be looking at ships of that age ever again.

**Mr GEORGIU**—There is an age caveat on it now, is there?

**Mr ROCHE**—They were not just second-hand; they were really old ships.

**Ms GILLARD**—But the two propositions cannot be right—that they are a reasonable deal in ship year terms and you would never do it again—can they?

**Mr NEUMANN**—Let me try to put this in a historical context. The actual training and helicopter support ship project was cancelled on cost grounds in the context of the August 1993 budget. If I could just slightly rephrase your question: if we actually knew the full costs of buying the two ships in the States, for whatever reasons would we have actually done it? I think the answer is probably not, given that a single new ship was actually cancelled on cost grounds and that cost—I cannot remember the figures—around \$500 million at that stage.

**Mr COX**—It was definitely the August 1993 budget?

**Mr NEUMANN**—That is what I have got in my report, so I hope it is correct.

**Mr COX**—I hope it is correct too because it means I was not responsible for it.

**Mr GEORGIU**—Now is not the time to be running for cover.

**Ms GILLARD**—So if the answer is ‘probably not’—

**Mr NEUMANN**—The only reason we have come to the ship years one is because I asked the question. In trying to deal with the value for money and to get some measure on it, I said to my staff, ‘What happens if we look at it in terms of ship years?’ We came up with this. If we assume a new ship would last 30 years and you get rid of it then, and their ships are two at 15 years—which happened to match the ship years—what is the cost of having two of these versus one new build. Then you get to this problematic question that, even though the money might be the same for two ships, while they give you greater running costs—if you took that through life cycle costs—there will be an increment. I do not know how much that will be. You will have the ability to operate in two separate areas or you will have twice the capability in one area at the same time or you will have one in refit and one not; whereas, if you have one ship and some refit you will have no capability. You get into those sorts of quite difficult capability arguments.

**CHAIRMAN**—Have you considered the fact that, as one of them runs on a reef and because they are old and the holes are no longer at original thickness that you scrap the vessel or it sinks—which amounts to the same thing—you might make a different analysis?

**Mr NEUMANN**—Yes, but it is the same thing if you run your one ship onto a reef. Even if it floats, you still have no capability for the time it takes to refit it. They are the arguments. There is no answer to that argument. It is trying to compare two with one.

**CHAIRMAN**—Yes, but you might run a new vessel onto the reef, back it off and it is okay with a bit of putty. The *Manoora* might not quite make it because the hull ain’t so thick no more.

**Mr ROCHE**—The reality is that since the decision was made to buy these things, the actual need has been to operate in two discrete operational areas. We had *Manoora* in the Solomons three times and we had to replace her with a frigate or *Tobruk* when she has not been there—neither of which are as capable—and, of course, we had the Timor exercise on the other side. The availability of two will, in fact, work out well.

**Mr GEORGIU**—Can we have that document—your listing—tabled, please?

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**Mr NEUMANN**—I think it is already on the web. We can certainly get you the hard copy.

**Mr GEORGIU**—That would be great.

**Mr COX**—Could you do one thing to add to it—you can take this on notice—and that is tell us the dates on which each one of those capability enhancements was put to government?

**Mr GEORGIU**—If, indeed, they were.

**Mr COX**—If they were not, that is even more interesting.

**Mr ROCHE**—We might have that information.

**Mr GEORGIU**—Claude, are you trying to get me to use the web now?

**Mr NEUMANN**—No, I am just saying that it is already publicly available. I always print it off. I have to say that I cannot read it if it is not on paper.

**CHAIRMAN**— Mr Roche, please remember that I did ask about who went to survey the vessels and who was hired in the United States to assist with that survey. Also, what—if any—disciplinary or legal action has been taken, considering the huge discrepancy between what they found and what it actually cost?

**Ms GILLARD**—Perhaps while we are asking you for things, could we have something that indicates how you have done that calculation about ship years?

**Mr COX**—One of the small ironies about this is that American Congress almost thwarted the deal at some point. I think we had to have an extensive lobbying exercise to be allowed to take these boats off their hands.

**Cdre RUTING**—At the time, there were several other countries also vying for these ships, including Spain and Malaysia. US Senate concerns about where they might be used by some of the other owners contributed to the complexity. There were certainly some vying for a South American area as well. They had concerns about the other sales. Ours was part of the omnibus submission for sale. It did delay it.

**CHAIRMAN**—Mr McPhee, do you have any final comments?

**Mr McPHEE**—No, thank you.

**CHAIRMAN**—It has all been said, has it? Thank you very much for coming and contributing to the debate.

[2.32 p.m.]

**BOWEN, Mr Phil, General Manager, Property Group, Department of Finance and Administration**

**CRONIN, Mr Colin, Executive Director, Performance Audit Services, Australian National Audit Office**

**HUTSON, Mr Jonathan, Group Manager, Financial Framework Group, Department of Finance and Administration**

**KAUFMANN, Mr Brett Andrew, Manager, Accounting Centre of Excellence, Department of Finance and Administration**

**KILLESTEYN, Mr Edward, Executive Coordinator, Department of Immigration and Multicultural Affairs**

**LONG, Ms Tina, Senior Director, Performance Audit Services, Australian National Audit Office**

**MACKAY, Ms Trixie, Senior Director, Office of Asset Sales and Information Technology Outsourcing**

**McINTOSH, Mr Ian, Executive Director, Cluster 3 Contract Management Office, Department of Immigration and Multicultural Affairs**

**McPHEE, Mr Ian, Deputy Auditor-General, Australian National Audit Office**

**SMITH, Mr Ross, Chief Executive, Office of Asset Sales and Information Technology Outsourcing**

**WHITHEAR, Mr Rod, Senior Director, Office of Asset Sales and Information Technology Outsourcing**

**WILLIAMS, Mr Neil, Senior Director, Office of Asset Sales and Information Technology Outsourcing**

**YARRA, Mr David, Executive Director, Office of Asset Sales and Information Technology Outsourcing**

**CHAIRMAN**—We now come to the last audit report to be examined in today's public hearing. I remind witnesses that the hearings today are legal proceedings of the parliament and warrant the same respect as the 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. 9, *Implementation of whole-of-*

*government information technology infrastructure consolidation and outsourcing initiative.* I welcome representatives from Australian National Audit Office, the Department of Finance and Administration, the Department of Immigration and Multicultural Affairs and OASITO. Does anyone from DOFA have an opening comment they would like to make?

**Mr BOWEN**—No, Mr Chairman.

**CHAIRMAN**—Does anyone from OASITO have an opening comment?

**Mr SMITH**—No, Mr Chairman

**CHAIRMAN**—Department of Immigration?

**Mr KILLESTEYN**—Yes. I will be brief with my opening statement. DIMA is a member of the Cluster 3 outsourced agencies. We are a member, with a number of other agencies, including the Australian Electoral Commission, parts of Industry, Science and Resources—which includes the Australian Government Analytical Laboratories and the Australian Government Land and Information Group—and a number of other organisations including parts of DOFA, and specifically the Electoral Office Support Group.

Each agency in the cluster has its own contract manager, but overall strategic management of the Cluster 3 contract is carried out by a cluster management committee, with senior representatives from all agencies. I chair that cluster management committee in my role as executive coordinator and chief information officer of the Department of Immigration. DIMA has the largest share of the contract value of Cluster 3.

The Cluster Management Committee is supported by a cluster management office of which my colleague, Mr McIntosh is the executive director. Cluster 3 is now over 2½ years into its outsource operations. That includes mainframe services, mid range, desktop, voice, wide area network, local area network, and a number of bureau customers receive a mix of voice, wide area network and mainframe services.

The Cluster 3 contract for infrastructure services is for five years, with the exception of voice and data network services which expire on 30 June 2001. In respect of voice and data services, I should advise the committee that the Cluster 3 agencies are currently engaged in a public tender process for the provision of voice and data services from 1 July 2001. The ANAO recommendations contained in this report presently before your committee are being taken into account in the management of that tender process. Our submission to the committee has focused on how these recommendations are being taken into account. I should also note that the voice and data tender is being managed by the Cluster Management Committee through the cluster management office of Cluster 3.

**CHAIRMAN**—Thank you very much. ANAO, do you have an opening statement?

**Mr McPHEE**—This is a substantial audit report which drew on the experience of agencies in IT outsourcing. We made some 20 recommendations, of which 16 were accepted by the whole-of-government response, with four disagreed. Subsequent to the report, as the committee would

be aware, the government announced the Humphry review. Mr Humphry made 10 recommendations which were broadly accepted by the government.

**CHAIRMAN**—There were 20 recommendations, five of which were accepted with qualification and four of which were disagreed. I have been with JCPAA—formerly Accounts and now Public Accounts and Audit—for about four years. I do not recall ever seeing an audit report with such a level of disagreement between the agencies and Audit. Since most of the response is DOFA as a whole-of-government response, could DOFA give us some idea of why there are major areas of disagreement?

**Mr BOWEN**—DOFA coordinated the whole-of-government response and did so at the request of the government because this audit cut across so many different agencies. The response that DOFA coordinated is included in the audit report against each recommendation. There were a small number—I think it was only three, but if there were five, I stand corrected—of recommendations that were either disagreed or agreed with qualification.

**CHAIRMAN**—I just counted them. I counted ‘Disagreed—four’ and ‘with qualifications—five’. That is nine out of 20. That is almost 50 per cent, Mr Bowen.

**Mr BOWEN**—I stand corrected, Chairman. Nonetheless, the response that we coordinated was a response on behalf of all of the agencies that were involved in this audit. I am happy to go through each recommendation and repeat the response that was made, but I do not know that I can really add substantially to what has already been put forward.

**CHAIRMAN**—Does OASITO have a view as to why some of your recommendations were either disagreed with or agreed with qualification?

**Mr SMITH**—Mr Chairman, I will make a general comment and then I will ask Mr Yarra to give details. The last time I was in this place you expressed concern about the level of disagreement that OASITO, in particular, had been involved in with this committee and with the audit reports. I kept that squarely in mind. We worked, I thought, extraordinarily hard and constructively with ANAO to go as far as we possibly could in reaching agreement with the audit office to a point where we essentially agreed—the way I view the words ‘essentially agreed’—with 16 recommendations and disagreed with four. I gave you that undertaking when I was here last time to make sure we had a much more open mind about that—

**CHAIRMAN**—You did.

**Mr SMITH**—I hope that we have demonstrated by that that we did work hard, rather than it be a negative outcome. I ask Mr Yarra to comment on the individual recommendations.

**Mr YARRA**—Mr Chairman, the only way that I think we could usefully respond to your question is to address the recommendations that we have agreed with qualification and whole-of-government response. I go to the response that we gave in the report. As far as OASITO’s participation in the whole-of-government response is concerned, we took each recommendation in turn and formed our response to it with, as Mr Smith said, a positive intent to take on board as many of the recommendations as we felt we could. While you might identify five as being agreed with qualification, those qualifications are not so much as to render the whole-of-



government position on those recommendations in the negative—that is, it does not turn them around—it is a comment or a qualification on each recommendation. If you wish, I will go through each in turn.

**CHAIRMAN**—We can read your answers.

**Mr McPHEE**—I think Mr Yarra summarised it fairly well. I read them as being agreements but with some additional commentary added because the various agencies wanted to make a point perhaps about the history, rather than going forward. So I think they used it as a bit of an opportunity to restate their position in their own words. But I would take David Yarra's point that, going forward, I believe the agreed recommendations have all been accepted.

**Mr GEORGIU**—I ask the audit office: when did the government begin a commitment to outsourcing IT?

**Mr CRONIN**—In 1997.

**Mr GEORGIU**—When did the previous government begin its commitment to outsourcing IT?

**Mr CRONIN**—There has been a longstanding tradition in the Commonwealth Public Service for outsourcing.

**Mr GEORGIU**—What happened between 1991 and 1996 in terms of IT outsourcing?

**Mr CRONIN**—Outsourcing has continued at an agency level. One of the most famous example of that is the Veterans' Affairs outsourcing.

**Mr GEORGIU**—That happened when?

**Mr CRONIN**—That was back in 1992, I believe—the early 1990s. It has been rolled over. DOFA would be able to provide more information because they are part of the current Veterans' Affairs cluster there.

**Mr GEORGIU**—Would DOFA care to comment on how much outsourcing went on between the initial commitment by the Labor government and the 1996 issues?

**Mr BOWEN**—I cannot give specifics, but there was significant outsourcing during that period, some of which would have been on varying scales—from outsourcing of particular activities through to larger, whole scale outsourcing such as the Veterans' Affairs.

**Mr GEORGIU**—In which year was that?

**Mr BOWEN**—I cannot give you that year.

**Mr GEORGIU**—Between 1992 and 1994?

**Mr BOWEN**—I think it was and then rolled over again around 1996 or 1997.

**Mr GEORGIU**—I have read the Humphry report with some interest. Humphry's key conclusion—I do not know if usually the ANAO puts it in terms of risk et cetera—is that:

There has been a general lack of buy-in by senior management and an unwillingness to accept that the initiative is the most appropriate approach to IT outsourcing. This lack of buy-in is by far the most significant risk factor for implementation management. The lack of acceptance by agencies has presented the initiative with difficulties at every stage.

Does ANAO accept that?

**Mr McPHEE**—Yes, we accept that it is Mr Humphry's view.

**Mr GEORGIU**—Do you accept that observation that there were significant resistances on the part of agencies to the IT outsourcing initiative? Do you want a context?

**Mr McPHEE**—Yes.

**Mr GEORGIU**—I have skimmed through your very substantial report so I cannot pretend I have read every page but what I have picked up is, for instance, statements such as:

Shortfalls in expected industry capacity and participation have been a significant factor in the need to revise and extend the implementation schedule.

As an analysis of implementation, is there an analysis of agency response to the initiative?

**Mr CRONIN**—What we are looking at is actually completed contracts. All the agencies which completed in this went through the whole process from the conceptualisation through to the implementation. There are agencies such as DIMA. We are actually looking at the agencies that have completed a successful outcome. Whether other agencies stood outside that, we did not actually look at.

**Mr GEORGIU**—But when you are assessing implementation and there is a view formed by another audit of this implementation that one of the key problems in implementation was the resistance of agencies, would you not pick that up? Should you not pick that up? If you do not like one, take the other.

**Mr CRONIN**—In terms of the resistance, there are obviously many people who are personally affected by the outsourcing. This can be seen in the low take-up of movement across of people to the external service provider. It was basically only one-third compared with the estimated two-thirds.

**Mr GEORGIU**—You have a report that apparently does not mention agency resistance?

**Mr CRONIN**—In terms of what we were told in talking to the agencies, we have not got evidence to support agency resistance. In terms of that—

**Mr GEORGIU**—You probed and found nothing?

**Mr CRONIN**—In terms of the people we talked to and in terms of the agencies. We are talking at the end of the contract.

**Mr GEORGIU**—But you make a whole lot of observations about the process of implementation. That is what this is about. Nowhere did it click that there was significant agency resistance to the IT outsourcing initiative?

**Mr McPHEE**—We saw no evidence of that and we were not given any evidence of that, Mr Georgio. I think the point Mr Cronin is making is that in our work we are required to have substantial evidence to draw conclusions. Mr Humphry had different terms of reference. He was looking at future implementation risk. He had a much broader canvas in terms of looking at the whole range of agencies and he spoke to a whole different range of people. I think the reviews are focused on different elements.

**Mr GEORGIU**—If you came to the conclusion that—and I quote again:

There has been a general lack of buy-in by senior management and an unwillingness to accept the initiative is the most appropriate approach to IT outsourcing. This lack of buy-in is by far the most significant risk factor for implementation management. The lack of acceptance by agencies has presented the initiative with difficulties at every stage.

What would you make of that? How would you integrate that into your report?

**Mr CRONIN**—Essentially we have to look at the evidence which is presented to us. One of the areas in gaining evidence after we have made our initial investigations is that we send out the section 19 reports to the agencies. We go through a very extensive consultation phase. This phase spanned the period from December 1999 through to the tabling of the report in September. The agencies did not come back to us and say that there is this huge problem.

**Mr GEORGIU**—‘We don’t like government policy so we are not going to implement it.’ What a surprise.

**Mr CRONIN**—I think the closest we got to this particular issue is paragraph 18 on page 16 where we basically say:

Experience also suggests that, within the policy context, there are areas in which the structure of agency groupings could be enhanced to better support agency business requirements, including in terms of the relative size, business-focus, funding arrangements and security requirements of grouped agencies.

**Mr GEORGIU**—That is pretty close to what he said, isn’t it?

**Mr McPHEE**—That is a very diplomatic way of presenting the position as it was presented to us in the policy context. No bureaucrat is going to say to us that they have concerns with government policy in this area.

**Mr GEORGIU**—I had not realised it was actually a recording of on the record statements by agencies. I thought it was an actual analysis of what the risk factors were. The audit has been around the place long enough to be able to discern significant agency resistance. If that is your description of ‘there has been significant agency resistance’, Henry Kissinger should stand

aside, because you are a much better diplomat than he is. This says that there was ‘wholesale resistance to the initiative’.

**Mr McPHEE**—I do not know what evidence he had for that.

**Mr GEORGIU**—As I understand it, he spoke to agencies. That is the key. You found no inkling of this?

**Mr McPHEE**—We found what we presented in paragraph 18.

**Mr GEORGIU**—I was focussing pretty intently, and it was pretty impenetrable if that says agencies did not like it and that was the most significant risk to the implementation of the project. We have gone through this with Defence. We have heard about Defence cultures, we have heard about resistance to change on the part of Defence—we have heard all of this—yet we have what appears to be a wholesale resistance on the part of the bureaucracy to IT outsourcing, and one little paragraph.

**Mr CRONIN**—We looked at three clusters and Mr Humphry looked at the whole clusters, including things which had been completed after this. He looked at Centrelink. He was looking at the health clusters. Many of the people who went into the initial clusters were quite willing to go into that. DIMA and AEC had dominated that cluster, and quite a few of them were very willing to participate in the new initiative. They could provide you with a broader perspective. As to whether they saw themselves as resistant to change, many of them went willingly into the cluster and needed to go in there to upgrade their computer systems.

**Mr GEORGIU**—So your counter proposition is that a wholesale embracing of change and resistance was not a problem?

**Mr CRONIN**—We can only look at what—

**Mr GEORGIU**—Is that what you are actually proposing?

**Mr CRONIN**—We can only look at the three groupings that we considered. There was the DIMA, cluster 3, AEC grouping; there was the ATO grouping, which was a stand alone; and then there were a series of policy departments which were grouped together.

**Mr GEORGIU**—Given that Finance is that sensitive, did you intuit some sort of resistance to the IT outsourcing initiative?

**Mr BOWEN**—Mr Georgiou, I guess I can only rely on what Humphry has reported. He was an independent reviewer, under no direction from government, apart from his terms of reference. He interviewed, as I understand it, a wide—and I think he reports that in his report interview—range of heads of agencies and other Commonwealth people. As a reputable rapporteur, I do not doubt his conclusion.

**Mr GEORGIU**—Thank you. That was very delicate and very diplomatic. I ask ANAO whether they agree with Humphry’s conclusion that:

There is a broad agreement that in the aggregate that the initiative has delivered significant savings.

**Mr McPHEE**—Certainly in the aggregate it has delivered significant savings.

**Mr GEORGIU**—Do you agree there has been significant debate about the extent to which savings have not accrued as a result of the initiative? While the Auditor-General has commented upon the savings, he has been very clear in his report that, regardless of the methodology for the calculation of savings, there are significant savings. I could not actually find that in the report.

**Mr McPHEE**—I think the report shows quite clearly that various clusters have made significant savings and others have not. While I agree with the comment that, in aggregate, savings have been achieved, you cannot universally apply that to each cluster.

**Mr GEORGIU**—So the generalisation is correct that, regardless of the methodology for the calculation of savings, the savings are significant?

**Mr McPHEE**—Indeed, that is correct.

**Mr GEORGIU**—Can you please tell us what the differences in methodology are between the various people about AAS17 or whatever? Can somebody illuminate a poor humble backbencher as to what the conceptual debates are about the magnitude of saving? We have had an earlier briefing and, unfortunately, it went right over my head. Can we see what the basis of this agreement is? Can we start with AAS17?

**Mr McPHEE**—I am happy to have a go. AAS17 is an accounting standard on leases. It fundamentally determines the two sorts of leases: an operating lease and a finance lease. The accounting treatment differs very significantly, depending on which categorisation the lease falls into. In terms of an operating lease, the department or agency leasing does not really carry any of the risks or benefits incident to ownership. The risks and benefits incident to ownership reside with the lessor. In a finance lease, because of the nature of the contractual conditions, the risks and benefits incident to ownership actually go to the lessee—that is, the owner transfers a lot of the risks across to the lessee, for instance, guaranteeing residual values.

It is an accounting standard where the preparers of accounts and auditors have to take a decision about where substantially all the risks reside. If at the end of the day it is determined that an agency carries substantially all the risks, the transaction relating to the lease should be accounted as a finance transaction which affects your balance sheet in terms of both asset and liability disclosures. If, on the other hand, the risks are still with the lessor in the books of an agency, it would be an operating lease and the only impact is an expense going through the particular operating statement. It obviously changes in a commercial world the leverage in terms of balance sheets of enterprises.

The reason this standard came into play was many years ago many large companies were taking on very large obligations which fundamentally were finance leases but there was limited disclosure in the accounts, so the accounting profession adopted this leasing standard. But it is controversial in the sense that not that the standard is unclear but that judgments are required and the auditor has to determine where substantially the risks lie.

**Mr GEORGIU**—Given that there is agreement amongst everyone that there were significant savings, how less significant are the savings because you have taken one approach and other departments have taken other approaches?

**Mr McPHEE**—We can show you that in one of the tables on page 19.

**Mr CRONIN**—In terms of the table, you need to go down to the second bullet point ‘Cost of net Commonwealth obligation for end-of-period ESP assets’. Our evaluation actually increases the size of the savings for cluster 3 by \$2.6 million. The reason for that is that the evaluations change between cluster 3 and the ATO group 5.

**Mr GEORGIU**—I have difficulty focusing on this after Defence have lost the best part of \$150 million on two ships, so be very slow.

**Mr CRONIN**—Our analysis in terms of treating this as a finance lease actually results in an increase in the savings reported for cluster 3 of \$2.6 million. Their analysis at that time included the whole amount in the evaluation of the end of period assets. When we get across to the ATO group 5, OASITO changed the evaluation methodology to exclude the end of period assets of the vendors. We classed all three clusters as having finance leases. The result of our changes are seen in the ATO, which decreases the savings by \$12.85 million. Of the total decrease in the financial savings for the ATO the question of the finance leases accounts for one-third. The largest proportion is attributed to our inclusion of residual values on agency assets. For the group 5 it is a negative \$2.6 million. So the question of finance leases/operating leases in total has about a \$13 million effect which, compared to the effects of the residual value, is quite minor. That is in terms of the financials.

**Mr GEORGIU**—Finance, can I have a comment on that?

**Mr BOWEN**—It might be appropriate for OASITO to comment on the detail.

**Mr GEORGIU**—Sure.

**Mr BOWEN**—I am happy to comment at the end, but they are much closer to—

**Mr GEORGIU**—This is a search for knowledge.

**Mr YARRA**—As you will see in our reaction to the audit recommendations, we have not formed the same view as the Audit Office on that matter. Our advice from our legal advisers that we retained for the initiative indicates that there was no lease at all, anywhere. Nevertheless, if you accept the argument that there is a lease somewhere embedded in the documents, then we have a specialist leasing firm and two other accounting firms that have advised us that if there is a lease it is an operating lease and not a financing lease. We are not the experts. We go and ask the experts for the answers. They are the answers that we got, and those answers are reflected back through the whole-of-government response to the audit report.

**Mr BOWEN**—Mr Georgiou, to complete the triumvirate: DOFA took advice in a different context. It was in the context of the preparation of the whole-of-government financial statements—the consolidated statements—and not in the context of IT outsourcing. But it was

about the same issue of whether or not these contracts were appropriately classified as finance leases or something else. Our advice came through quite clearly that these arrangements were in fact service agreements and should be expensed as a normal operating lease arrangement would be accounted for, and that is on an annualised basis rather than being capitalised. In short, our advice supported the advice that OASITO had on this issue, and in the whole-of-government financial statements these transactions have been treated as service agreements and not as finance leases.

**Mr COX**—Did that treatment increase or decrease the level of savings that were recorded against the contracts?

**Mr BOWEN**—We did not do it in the context of the IT outsourcing; we did it in the context of whole-of-government reporting. Our motives were entirely pure, in the sense we wanted appropriate—

**Mr GEORGIU**—Can you underline that, please!

**CHAIRMAN**—Do we want *Hansard* to put that in bold?

**Mr BOWEN**—I am happy to have it bolded, Mr Chairman! We wanted appropriate transparency in the accounts in accordance with the best advice we could get on the appropriate treatment under the accounting standards, and that is what we did.

**Mr COX**—As pure as you claim your motives were, can perhaps Mr Smith clarify whether that accounting treatment increased or decreased the measure of savings attributable to the IT outsourcing initiative?

**Mr BOWEN**—Mr Cox, I cannot clarify that, because that was not the perspective we came from.

**Mr COX**—No, I asked Mr Smith to.

**Mr BOWEN**—Apologies. I thought you were looking at me.

**Mr YARRA**—I have no reason to question the methodology adopted by the Audit Office, working on the assumption that they had a finance lease. If they had a finance lease then I assume it produced the results that they said. We disagree that it was a finance lease. If it were a finance lease then it would produce the difference indicated by the Audit Office, but we do not believe it is a finance lease.

**Mr COX**—If you used the Audit Office's technique, would the savings attributable to the IT outsourcing initiative be lower than you reported?

**Mr YARRA**—This report says that they would be lower, and I accept the methodology they employed, on the assumption of a finance lease.

**Mr COX**—The other issue is the discounted cashflow technique. There is a Department of Finance and Administration publication that tells people how to do it, and it tells people to include residual values in that analysis. That seems to be consistent with the limited amount of financial training that I have had, but the Audit Office tells me that you adopted a different technique that did not do that. Why was that?

**Mr YARRA**—I have read the 1993 finance report—I think it was called *Getting value for your IT dollar*— and I understand and accept the premises in that report. It does take pain to point out that you must be very careful in the assumptions that you adopt in any of your evaluations. We very carefully consider the assumptions that we adopt and the policy guidance that we are operating under. This is reflected in one of our responses in the audit report. The key driver of the difference between the Audit Office view of what we should have done and our view of what we should have done is the assumption that we make about what the government policy is, in particular, in relation to what you do at the end of the evaluation period in terms of what comes next. Our view was that we applied government policy, the policy being that you should outsource, that outsourcing will happen, that it will happen as a once and for all change and that there was no reversion to in-house provision. That is the assumption that we used for the purposes of the evaluation, and we combined that assumption with the pure cash approach that we adopted in our methodology, which has not been challenged by our expert advisers or by the Audit Office. That resulted in our not including the value of end of term assets.

**Mr COX**—So it was a government policy that caused you to depart from the published finance department report?

**Mr YARRA**—This report says that you must attend carefully to the assumptions you make. For example, it says in that report that you include end of term assets where applicable.

**Mr COX**—You have said that it was government policy that led you to make that assessment.

**Mr YARRA**—It is government policy that determined the assumptions that we made in order to carry out an evaluation that we thought was robust.

**Mr COX**—I think that is close enough. Did adopting those assumptions cause the savings from the IT outsourcing initiative to be greater than they would have been if you had used the standard finance department technique which would have incorporated the residual values?

**Mr YARRA**—This report says that the savings would have been greater.

**CHAIRMAN**—Mr McPhee or Mr Cronin, was OASITO not entitled to make the assumption that they did regarding government policy?

**Mr McPHEE**—The question is whether there is a residual value to the Commonwealth at the end of the day. I guess our assessment was that there was. Government policy or not, I do not think that is really the central issue. I think the central issue is how to do discounted cashflow analysis, how to compare propositions.



**Ms LONG**—The issue of whether it was government policy that once you were outsourced it should be expected that you would remain outsourced is actually irrelevant to the question being addressed in terms of the DCF. We are looking at the option of retaining it in-house and what your position would be over the five years and at the end of the five-year evaluation period if you just continue with the in-house? Whatever government policy was or was not in regard to IT outsourcing and how that should be extended, should not really impact on how you construct the in-house case, if you could just continue business as usual.

**CHAIRMAN**—Do you have a response to that, Mr Yarra?

**Mr YARRA**—We do not agree, Mr Chairman.

**CHAIRMAN**—Why?

**Mr YARRA**—We have assembled our methodology supported by expert advice. That advice indicates that the way we approached the cash analysis is correct and robust, and we followed it. If it does not do what the Audit Office says we do, and they say, ‘We should do that,’ we do not agree with them.

**CHAIRMAN**—Did ANAO test OASITO’s external advice?

**Mr CRONIN**—Yes, we looked at whether this is a generally accepted approach. We are unaware of this being a generally accepted approach in the literature or in terms of public sector or private sector practices. We have got a little example that is on—

**CHAIRMAN**—No, I asked: did you examine the advice or not?

**Mr CRONIN**—We examined their advice. We had a great deal of difficulty understanding it, for the simple reason that we viewed an evaluation as essentially a technical exercise and it does not really involve questions of policy. It is essentially a straight up and down technical measurement approach. What happens at the end is another matter.

**Mr GEORGIU**—Sorry, can you spell that out for me—what happens at the end is another matter?

**Mr CRONIN**—At the end of the period you are looking at whether you outsource or not and you are making the decision whether you will outsource or not, because a requirement of the tender evaluation was to demonstrate substantial savings. There had to be a precondition for this whole thing and in the three contracts that we looked at it was substantial savings. So you are actually evaluating whether there is substantial savings.

**Mr GEORGIU**—But the conclusion is that there are substantial savings.

**Mr CRONIN**—Not on each of the contracts. As Mr McPhee said, overall of the \$83 million of financial savings that we report, there was \$61 million in terms of Cluster 3, essentially \$28 million in ATO and we estimate a \$7 million loss on the group 5 contract. So overall we are estimating a saving of \$83 million at the evaluation stage.

**Mr GEORGIU**—In the attempt to pour oil on troubled waters I am probably going to throw a big match in but, after you cut through all this stuff that is really important to everybody about AAS17 and is government policy government policy—

**Mr COX**—It is fundamental charter of budget honesty stuff—

**Mr GEORGIU**—No, excuse me, because the point was made about substantial savings, and that is what I need to understand.

**CHAIRMAN**—Mr Bowen has a comment he would like to make.

**Mr BOWEN**—I will preface my comment by saying that neither me nor other people in DOFA were closely involved in the implementation and the evaluation that was undertaken in this case. However, I think it is important to get on the record that it is not just a matter of achieving substantial savings or savings at all for that matter. The government's procurement guidelines are very clear on this, and that is that value for money must be demonstrated. I think if we are not careful we will lose sight of the fact that there can be value for money from procurement, whether IT or whatever it is, that does not necessarily involve lower cost. It can involve better service, more effective provision of service to the end user and greater flexibility in how a department or company will operate. I think it is a little bit simplistic to be concentrating only on savings. Value for money is the principle.

**Mr McPHEE**—Mr Chairman, if I could just respond to that. I do not disagree generally with what Mr Bowen is saying. I just make the point that the government's stated objectives were to realise significant savings from this exercise and that is the reason it featured in the report. But I agree there is a whole lot of industry development and other advantages seen from this exercise, but you do have to have regard to the government policy objectives.

**Mr BOWEN**—Mr Chairman, that is an objective but it does not override the objective of value for money.

**Mr GEORGIU**—There are always multiple objectives in programs.

**Mr McPHEE**—Yes, and value for money for money takes into account many things, so it is a judgment. Just picking up on the issue Mr Georgiou was trying to get at and, as I understand it, the question is: does all this technical difference of opinion really matter?

**Mr GEORGIU**—What I was trying to get at was this: if there is a consensus that there is no definitive guidance inherent in the Australian accounting standard AAS17, and I am afraid I am in no position to make any sort of coherent, rational, half-way intelligent judgment on that—we have been going backwards and forwards—what am I left with? It is the notion, amongst a number of objectives, of making significant savings. I have here a report, which you will confirm, indicating that the Auditor-General believes that there have been significant savings, as well as a whole list of other things. I just wanted to lock significant savings in my mind and say that, even though you may not be able to penetrate something, if AAS17 is not very clearly defined and you regard it as fundamental to this charter of budget honesty, I honestly cannot argue with you.

**Mr COX**—Whether the government adheres to accounting standards or not is a fundamental aspect of this government's charter of budget honesty.

**Mr GEORGIU**—Let me address that because there is a lack of definitive guidance about AAS17. That is correct or incorrect?

**Mr McPHEE**—The difficult thing is that it is a judgment. It is a judgment to make the call about where substantially all the risks lie.

**Mr GEORGIU**—As I said, I cannot penetrate that. What I am saying is that, at the end of the day, we have gone backwards and forwards. Do people who know better than I say that there are significant savings? The Auditor-General has said there are significant savings. I am sure the definition of the standards will take a lot of everybody's very important time and they will come to very important conclusions. I have understood what I wanted to understand.

**Mr McPHEE**—Just for clarity, our assessment is that individually one of the projects based on our assessment did not realise significant savings but, as we said before, in aggregate we have accepted and acknowledged the government's position.

**Mr COX**—While we are on the subject of the charter of budget honesty and accounting standards, did the government report that it had deviated from the accounting standard in the way that it had treated these leases?

**Mr WHITHEAR**—I think the explanation we have offered you suggests that we have not deviated from that accounting standard. As Mr Georgiou read out from the Humphry report, there is some element of judgment to be applied here and some difference of opinion between experts.

**Mr COX**—I think the Auditor suggests you have departed—

**Mr BOWEN**—Can I comment on that? The department of finance—and the minister for finance, for that matter—have responsibility for the whole of government financial statements which sweep up all of these activities into one financial report for the Commonwealth. On the expert advice that coincides with the advice that OASITO has had, as I said before, we are perfectly satisfied that those accounts are consistent with the accounting standards. I believe I am right in saying—and I am sure my audit colleagues will tell me if I am not—that the accounts were not qualified for any such reason.

**Mr McPHEE**—The reason the accounts were not qualified was that the differences were immaterial when you bring together the whole of government accounts. At an individual agency level, in one particular case at least, we did qualify the accounts of a particular agency because of the leasing treatment. But when you consolidate and aggregate up all the Commonwealth's assets and liabilities, this issue was not material in that context. Therefore, consistent with the accounting standards, the accounts were not qualified.

**Senator MURRAY**—The point that I want to establish, which is behind this, relates to the selection of the accounting standard to be used and the interpretation of it. Did the agencies

concerned—those which would benefit from a favourable view—adopt the most favourable interpretation which you are saying went too far and should be less favourably viewed?

**Mr McPHEE**—Each agency obviously took their own view on the matter. Finance informed agencies what it intended to do at the whole of government level and that may have influenced some agencies.

**Senator MURRAY**—But behind it is the motivation which in commerce is unkindly called ‘creative accounting’, where if you are running a public company or you want a bank loan you ensure that you select the accounting standard which gives you the best interpretation of your assets or your balance sheet, particularly if you are dealing with assets, both tangible and intangible, which can have a different treatment. Very frequently you will arrive at the bank and they will say, ‘Let’s just try this with a different set of accounting standards and see what happens.’ Essentially, your job is to rein in, if you like, those in government who would benefit by a more beneficial interpretation. So behind Mr Georgiou’s question is really that point: was the interpretation deliberately manufactured to be a little more favourable than it might have been. In your view, was it?

**Mr McPHEE**—I could not say that; I do not know the motivation. We did encourage agencies, where we believed the leases were Finance leases, to treat them that way. As I said before, it is very important to look at each contract. As an office we agreed certain leases were Finance leases but certain leases also were operating leases.

**Senator MURRAY**—But the fact is that your significant savings are less than their significant savings, isn’t it?

**Mr McPHEE**—Indeed.

**Senator MURRAY**—I think that makes the point, doesn’t it?

**Mr McPHEE**—Yes.

**Mr GEORGIU**—Part of the problem is that some of the things you choose to focus on in terms of the audit actually show their treatment as putting them in a worse light.

**Mr McPHEE**—Indeed.

**Mr GEORGIU**—Which I think is the point you are making.

**Mr McPHEE**—Some go one way and some go the other. It was not a case of us wishing to show them in the worst light.

**Mr GEORGIU**—No, I understand.

**Senator MURRAY**—I would like to pick up another line of interest. I am interested in Mr Yarra’s remark about the end of term asset value. Mr McPhee, firstly, I wonder what end of term

assets there might conceivably be. Secondly, I think the words you used were: 'sometimes it is relevant and sometimes it is not', to paraphrase you. When would it be relevant to look at them?

**Mr CRONIN**—There are two things. The end of term assets are very critical, because you are making the decision as to whether you will outsource, and you are looking at agencies' assets at the end of the term.

**Senator MURRAY**—What assets are those?

**Mr CRONIN**—The computers, the hardware systems. These run to a number of millions of dollars. This is the largest factor that leads to the differences between the ANAO and the OASITO approach. For example, in figure 7.1 on page 154 of the report we show the example of how it actually works through the system. It makes a big difference to the outcome of the evaluation. What we show there is the fact that if an agency buys equipment in year 5—the last year of the evaluation—it would record a cost of \$9 million. At the same time the outsourcer would be paying just \$3 million in each of the years for leasing the equipment over a three-year life. In year 6, which is outside the evaluation period, that asset might be worth \$6 million. But in the OASITO evaluation it would merely record a cost to the agency of \$9 million, making it less attractive to insource than to outsource. That \$6 million—the assets the agency has in years 6 and 7—is not counted.

**CHAIRMAN**—I am amazed by your example. I do not know of a computer you can buy for \$9 million that is worth \$6 million after three years. If you do, perhaps you would point me down the right path.

**Ms LONG**—That is after one year, assuming a three-year life. We have just done a straight line—

**Mr CRONIN**—Depreciation.

**Ms LONG**—So, if you bought it in one year, a third of your value is gone—

**CHAIRMAN**—This is the real world: computers do not depreciate in a straight line, unfortunately.

**Mr McPHEE**—Just assume any residual value, Mr Chairman—it does not have to be \$6 million; we are talking about any residual value. It is an illustrative example rather than intended to be—

**CHAIRMAN**—I would have thought any residual value was minimal.

**Senator MURRAY**—I should perhaps indicate to you why I am pursuing this line of questioning. I recall that, where assets are valued internally without regard to outsourcing, in this field in the Commonwealth's accounts there is very little recorded. I believe you write off software in two years on your balance sheets. Is that correct?

**Mr McPHEE**—Maybe a little longer, but it is not very long.

**Senator MURRAY**—Most of the balance sheets I have been looking at are around about two years—a couple are three. The chairman's point about hardware is that, generally speaking, that is wiped out pretty soon as well. I accept that there is sometimes a residual value—but I wouldn't know how to arrive at it. That is what I thought was the relevance of Mr Yarra's comment but I could not see when it would be relevant. I would have thought an outsourcing contract of less than five years is pretty worthless. You would not go to all that trouble, cost, expense and evaluation and lose your internal capability on a three-year risk and then bring it back in. You are going to adopt a fairly long-term view.

**Mr McPHEE**—I think this is comparing two different scenarios: one where you own your own equipment and would seek to replace it; the other the leasing arrangements.

**Senator MURRAY**—Yes, I see that.

**Mr McPHEE**—To pick up your other point, the assumptions we made about residuals reflected the heavy depreciation of IT equipment, so we factored in a heavy discount.

**Ms LONG**—The calculations we made were based upon the assumptions that were incorporated in the evaluation conducted by OASITO. All of the evaluations, in terms of constructing cost baselines for the agencies and also the terms under which the tenderers were asked to submit their bids, were based on specified life cycles. Those were the assumptions that we applied.

**Senator MURRAY**—Unless I have misunderstood what I have had before me, it seems to me the reverse of the point I made earlier. In that case they were running a more favourable version and you weren't. It seems to me that, with regard to end of term values, you are running a more favourable approach than they are. Is that right? Have I understood that correctly?

**Mr CRONIN**—No, our approach is more unfavourable to them on residual values because we count the values to the agency. By them not counting the values to the agency at the end of the evaluation period, which is year 5, they are making outsourcing much more attractive than in-house provision. The reason this becomes very significant is because in each of the requests for tenders there was the requirement that the preferred tender would deliver a substantial and acceptable level of cost savings. So it had to be a substantial and acceptable level of cost savings—not value for money, but costs savings.

**Senator MURRAY**—Are you telling me creative accounting again?

**Mr CRONIN**—No, I am saying that, to actually proceed with this tender, the outside tenderer had to demonstrate clearly that they were more cost competitive than the in-house provision. That was a requirement on the RFTs for each of the three contracts which are examined in this—

**Senator MURRAY**—But they did it by making different assumptions on the end of term values than you have.

**Mr CRONIN**—Yes, we are saying that if you had incorporated the end of term assets of the agency you would have got a lower cost saving on two out of the three contracts.

**Senator MURRAY**—So on the precautionary principle, because the point of all this is that whatever outsourcing is done in future should be done with a realistic view, it would surely pay the agency to come to you with both their brief and the tender in response and ask you, the Audit Office, ‘Are assumptions being made at these various levels doctored in any way?’

**Mr McPHEE**—I think agencies will be much more alive to the contractual conditions they sign up to and probably make sure the risks reside with the lessor rather than with the agency. I think that will be an outcome of this process. I think many of these issues have not been understood going into the transaction, and it is certainly not uncommon practice for agencies or certainly for entities in the private sector to consult with their auditors in advance on complex transactions and see if there is concurrence on the accounting treatment for those.

**Senator MURRAY**—I think, Mr Chairman, that if I were a minister without a degree in financial accounting I would require whatever figures to go back to the ANAO before I ticked it off.

**CHAIRMAN**—I don’t know; I have just done a brief analysis. I said that four of the 20 recommendations by the ANAO were disagreed and five were agreed with qualification, excepting recommendation No. 8, where in fact ANAO recommends, as Mr Bowen mentioned before:

... tenderers ... be ranked in terms of a combination of value for money/cost savings and industry development criteria.

But DOFA disagreed, saying:

The evaluation planning process is clear and takes full account of Government policy objectives

Whatever that means. But, outside of that, all the rest of the disagreements are about this one issue. All three of them are about this issue of treatment of whatever assets there are at the end of the lease. I have in the course of our discussions today come to a different understanding of this issue than I had when we undertook the hearing. So I retract what I said at the beginning about the major differences between DOFA, OASITO and ANAO. It appears I was wrong. Did you have any more questions, Senator Murray?

**Senator MURRAY**—No. I found out what I wanted to.

**Mr COX**—I want to take a couple of separate tacks for a moment. It is my understanding that the government in late 1996 came to a decision that it was going to require agency managers to systematically review the cost effectiveness of each of their agency’s functions, focusing on defined steps and using the range of market based performance improvement tools, including competitive tendering and contracting. Why then was IT outsourcing given to a central agency and not to individual agency managers?

**Mr BOWEN**—Mr Cox, I cannot speak on behalf of the government. It was a government decision to do that.

**Mr COX**—So it was government policy.

**CHAIRMAN**—That is your answer.

**Mr COX**—Did the government do a scoping study before it took that decision?

**Mr BOWEN**—We have to be fairly careful about answering individual questions of that nature. If you look at our submission to this committee it does outline some background to the government's whole of government IT outsourcing initiative. There was a scoping study undertaken, and that was in the context of the 1997-98 budget, and during those budget deliberations the government put its IT implementation strategy in place. So, yes, there was a scoping study. It was not specifically about establishing a central body. In fact, I think that central body was already in existence at that time, in the form of the Office of Government Information Technology which, if I recall correctly, was put in place by the previous government.

**Mr COX**—Can the committee have a copy of the scoping study?

**Mr BOWEN**—No, Mr Cox. It was a study that was prepared for a cabinet deliberation, and I think you are aware as well as I—

**Mr COX**—I am well aware, but I should ask these questions. I notice that in Mr Humphry's report he says that in addressing his terms of reference he had adopted an approach to risk identification and management that is consistent with AS/NZS4360:1999, which assesses risk in terms of consequences and likelihood. Can you tell me whether, in doing the scoping study, that standard, or an equivalent standard, was used.

**Mr BOWEN**—No, I cannot help you on that, I am sorry.

**Mr COX**—Not, 'No, I didn't use that standard.'

**Mr BOWEN**—I have no knowledge of whether or not it was there, and if I did I probably could not help you.

**Mr COX**—Mr Georgio was drawing out the issue of the level of resistance of agencies to the IT outsourcing initiative. He suggested that there was some. I have a number of questions going to whether these agencies advised the government of their concerns before the decision was taken. Would anybody have identified major business and management risks, without there being financial gains in all cases? Would any of the agencies have suggest that there might have been—

**Mr BOWEN**—Could you repeat or amplify the question, Mr Cox. I do not really understand.

**Mr COX**—Can you tell us whether any agency may have advised the government that they had concerns about the outsourcing initiative because they thought there might be major business and management risks without, in all cases, certain financial gains?

**Mr BOWEN**—I cannot comment on that. That individual agencies advised the government is a matter for those agencies and the government.



**Mr GEORGIU**—Did you sign off on the IT outsourcing plan or did you just dump it on them and say, ‘Take it and run with it’? What was the process?

**Mr BOWEN**—We do need to be careful here. The government consulted, as it always does in developing a policy position. There was a very extensive scoping study undertaken by the former Office of Government Information Technology, with the assistance of the Department of Finance at the time—probably the most comprehensive scoping study of IT in the Commonwealth that has ever been undertaken. That formed part of the government’s decision making process, as well as the normal consultation with individual agencies who have an opportunity, as you know, to comment on those sorts of proposals. I cannot comment further, even if I could recall every one of those comments—which I cannot.

**Mr COX**—Can you rule out any agency saying that the presumption of savings and their attribution to particular departments and agencies is premature and likely to be unsound?

**Mr BOWEN**—I cannot comment on that.

**Mr COX**—Or that there were no means to comment on the viability of the savings?

**Mr BOWEN**—I cannot comment on that.

**Mr COX**—I could probably go on for ever. Does the submission adequately reflect the business risks?

**Mr BOWEN**—I am happy to keep saying ‘I cannot comment’, but I literally cannot comment.

**CHAIRMAN**—I have to say that I think your line of questioning is not producing fruit.

**Mr COX**—I think it is producing fruit! Did anyone say that the clustering of agencies for the implementation of the tendering process could result in the failure to adequately recognise the savings achieved in small agencies where operating costs are already below industry best practice? Can you help with that? Can you recall that?

**Mr BOWEN**—Whether or not I can recall it, I cannot comment.

**Mr COX**—Do you remember this comment: CSIRO believes that it should be exempt from the budget savings proposal of the cabinet submission because the majority of IT expenditure is related to scientific research?

**Mr BOWEN**—I cannot comment.

**Mr COX**—Or do you remember this one: difficulties could exist in buyback lease arrangements where the current written down value of assets are low or a notional sale price is negotiated which effectively could make some lease arrangements very financially onerous?

**Mr BOWEN**—Would it help if you tabled the document you are reading from, Mr Cox?

**Mr COX**—These are just some notes that—

**Mr BOWEN**—I cannot comment on your notes, I am sorry. I have not seen them. I do not know what their status is and, if they purport to be anything that relates to a cabinet consideration, obviously I cannot comment.

**Mr COX**—No, I could not verify whether they are or not.

**Mr GEORGIU**—You just said that they are your notes.

**Mr COX**—They are my notes of advice that I have been given by people around the traps. No, you could not comment on concerns that the proposals would seriously disadvantage the local IT industry in favour of the few major multinational outsourcing organisations?

**Mr BOWEN**—I could not.

**CHAIRMAN**—Mr Cox, we are not really getting anywhere. Have you got anything that you would like to ask for which an answer is likely to be possible?

**Mr COX**—No.

**CHAIRMAN**—As there are no further questions, on behalf of the committee I thank all the witnesses, Hansard, the committee secretariat and observers. I thank my colleagues.

Resolved (on motion by **Mr Cox**):

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.

**Committee adjourned at 3.41 p.m.**