



COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

**Reference: Review of Auditor-General's reports, first and second quarters 2004-05**

MONDAY, 27 JUNE 2005

SYDNEY

BY AUTHORITY OF THE PARLIAMENT



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**JOINT STATUTORY COMMITTEE ON  
PUBLIC ACCOUNTS AND AUDIT**

**Monday, 27 June 2005**

**Members:** Mr Baldwin (*Chair*), Ms Grierson (*Deputy Chair*), Senators Hogg, Humphries, Moore, Murray, Scullion and Watson and Mr Broadbent, Ms Burke, Miss Jackie Kelly, Ms King, Mr Laming, Mr Somlyay, Mr Tanner and Mr Ticehurst

**Members in attendance:** Mr Baldwin, Mr Broadbent, Ms Grierson, Miss Jackie Kelly and Mr Laming

**Terms of reference for the inquiry:**

To inquire into and report on:

Review of Auditor-General's reports, first and second quarters 2004-05.

**WITNESSES**

**COCHRANE, Mr Warren, Acting Deputy Auditor-General, Australian National Audit Office ..... 1**

**EDWARDS, Brigadier Phillip, Director, Stocktaking Remediation Project, Joint Logistics  
Command, Department of Defence ..... 1**

**GOODWIN, Mr Ian Philip, Group Executive Director, Australian National Audit Office..... 1**

**GUMLEY, Dr Stephen John, Chief Executive Officer, Defence Materiel Organisation,  
Department of Defence ..... 1**

**LEWINCAMP, Mr Frank, Chief Operating Officer, Defence Materiel Organisation, Department  
of Defence ..... 1**

**McGAHEY, Brigadier David Francis, Director-General, Materiel Information Systems,  
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**MOORE, Mr Ken, Acting Chief Finance Officer, Department of Defence ..... 1**

**PRIDDLE, Mr Peter Kenneth, Director, Supply Chain System Program Office, Department of  
Defence ..... 1**

**SMITH, AO, PSM, Mr Ric, Secretary, Department of Defence ..... 1**

**SPENCE, Air Vice Marshal Christopher Geoffrey, Commander, Joint Logistics, Department of  
Defence ..... 1**



**Committee met at 11.56 am**

**COCHRANE, Mr Warren, Acting Deputy Auditor-General, Australian National Audit Office**

**GOODWIN, Mr Ian Philip, Group Executive Director, Australian National Audit Office**

**EDWARDS, Brigadier Phillip, Director, Stocktaking Remediation Project, Joint Logistics Command, Department of Defence**

**GUMLEY, Dr Stephen John, Chief Executive Officer, Defence Materiel Organisation, Department of Defence**

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**SMITH, AO, PSM, Mr Ric, Secretary, Department of Defence**

**SPENCE, Air Vice Marshal Christopher Geoffrey, Commander, Joint Logistics, Department of Defence**

**CHAIR (Mr Baldwin)**—I welcome you to this public hearing at the Defence National Storage and Distribution Centre, Moorebank, Sydney. We will be taking evidence today on the Australian National Audit Office reports Nos 5 and 21 of 2004. Before we commence we have answers supplied to questions on notice from the Department of Defence. Those answers are accepted as submissions from the Department of Defence. I remind witnesses that the proceedings today are considered to be proceedings of the parliament and are subject to parliamentary privilege. Evidence given today will be published as a matter of course. If there are any items that are considered to be sensitive, witnesses may ask at any time that evidence be heard in camera. The committee will then decide whether that is to be the case. I invite witnesses to make an opening statement.

**Mr Smith**—I do not have an opening statement, Chair. We were about to start on leave records last time but I will leave it to you as to where you wish to resume.

**Mr Cochrane**—I do not have an opening statement in connection with report No. 21 or report No. 5 but I do want to mention the tabling of Audit report No. 56 last Friday, which is entitled the *Interim phase of the audit of financial statements of general government sector entities for the year ending 30 June 2005*. When that was tabled on Friday we brought that report to the attention of the committee secretariat because, importantly, it gives an update on the interim

audit for 2004-05 and outlines where we are up to with SDSS. Importantly, it brings to notice a couple of very significant issues from our point of view in terms of the future of SDSS, and I will be happy to discuss those as we go through with the hearing today.

**CHAIR**—Given that the committee is inquiring into reports Nos 21 and 25 I need to seek approval from my committee that we embrace the aspects raised in this current report. I think they are in agreement. Perhaps you would like to give an analysis, from that audit report, how it relates to the areas where we are investigating at the moment.

**Mr Cochrane**—I will ask Mr Goodwin to go through the detail, but the two significant issues that we are dealing with are, firstly, what is called a Julian date on the SDSS and, secondly, the question of security and access around SDSS. The importance of both of these issues is in the remediation of SDSS. They add to the problem, if you like, and need attention before we can assure ourselves in the financial audit sense that SDSS is a reliable system.

**CHAIR**—Could you start by explaining what a Julian date is?

**Mr Goodwin**—I will give a quick snapshot but it is probably better for Defence management to explain that. Julian date, in its most simple form, is akin to the Y2K issue that has come and passed. It is a software boundary. In this case it relates to the date set. SDSS has a start date of 1 January 1980 and a boundary date of 9,999 days from then on, which is 17 May 2007. Like Y2K, you need to be satisfied that when you hit that date it will go back to 0000 and what the impacts on SDSS will be at that point. Our understanding is that Defence management have made an assessment of the impact, so it is probably better for Defence management to further explain the issue.

**Mr Smith**—The Julian date issue is a design limitation in the date function of the original system, which provided a life for the system of 9,999 days which, as Mr Goodwin said, runs out on 17 or 18 May 2007. We have been aware of that issue for a number of years. The original schedule we had for JP2077 would have brought it into effect before that date. There is some doubt now whether it will come into effect before that date so we have asked Mincom to correct the problem, which they have agreed to do and I believe they have made some progress on it. Perhaps Dr Gumley or Mr Lewincamp, the chief operating officer at DMO, could comment on that.

**Mr Lewincamp**—As the secretary has said, the Julian date issue occurs on 18 May 2007 when the four 9s roll over to four 0s and the computer system does not recognise that as a sequential date after all the previous entries. So a number of the functions in the software cease to function properly. The reports will not include transactions that have been processed. The transactions will not appear in the correct order and some system processes will simply stop functioning. In a sense it is a catastrophic effect on version four of the MIMS software which we are currently running on SDSS. As the secretary has said, there are two solutions to this. One is to put a fix on that particular problem and we have engaged Mincom in a discussion about that. They say a technical fix is quite straightforward. They are prepared to do the fix on the core software at their expense and they have agreed to do so.

**CHAIR**—Will that be as simple as adding zeros in front and going to a six-digit number?



**Mr Lewincamp**—I am not aware of what the technical solution will be.

**Brig. McGahey**—What has to occur is that the clock that sets that Julian date has to be changed. We are currently doing an initial planning study to work out the best method of fixing that timing device and the subsequent issues are in the regression testing for the rest of the system.

**Ms GRIERSON**—Are we fixing this just to keep the SDSS and the Get-Well upgrade going or are we fixing it to build on it with JP2077?

**Mr Lewincamp**—There are two elements to the solution we are pursuing. One is to replace the software at the moment. The second is to pursue 2077 and the upgrade that has just been approved by government and announced by the minister last Friday. That is an upgrade of the core software from version 4 to Ellipse. Both are produced by Mincom. Ellipse does not have that date processing shortcoming in the software.

**Ms GRIERSON**—We are basically talking both.

**Brig. McGahey**—We are doing both because we do not have 100 per cent confidence that we could implement the Ellipse upgrade in time for May 2007. As a measure of additional assurance we are also putting in place a technical fix on the date processing function in parallel to pursuing the upgrade.

**Mr Goodwin**—I will pick up on some of the comments mentioned. One of the issues from an audit perspective is that the extent of the problem is largely unknown. Partly the assessment needs to be completed and with two years to go that is something that would need to be done. The other issue is version 4, which is at the heart of SDSS. It is a system that has a high level of customisation so it is not as simple as an off-the-shelf system where you can just run a patch. We are going to have to make an assessment of all the codes within the customisation in doing that, which potentially is a fairly large exercise. As the chief operating officer from DMO pointed out, in the worst case scenario the system may fail completely or certain transactions may become unusable or unstable. At this stage we are waiting for an assessment from Defence as to the extent of the problem and the timetable required to fix the problem.

**CHAIR**—Will that relate mainly to stock or mainly to pay records?

**Mr Goodwin**—This is within SDSS so it is within the logistics system.

**Mr Lewincamp**—I will add to Mr Goodwin's comments. He is quite right that whilst the technical fix to the core software version 4 is quite straightforward, there is a difficulty for Defence in flowing that through all the various systems which are connected to SDSS to ensure that the flow-through is consistent and they all continue to operate properly. We are still scoping that particular dimension of the problem.

**CHAIR**—If there are no questions from the committee on that comment, would you like to continue going through the outcomes of your latest audit report and how it relates to this?

**Mr Goodwin**—The report that was tabled on Friday is titled the ‘Interim phase report’. It is the assurance report that we present to parliament across the APS focusing on materiel general government sector agencies. It has a commentary as to what is at the midpoint of the audit, and obviously a commentary on Defence, which runs from pages 101 to 125. It provides an overview as to findings in 2003-04 along with the remediation activities and any additional findings at that point in drafting the report relating to the current year audit.

The report says that the risk of materiel misstatement in Defence financial statements is high and it is because of all the internal control breakdowns noted in the prior year. It also notes the number of category A and category B findings issued at the close of last year’s audit. As has been commented on before, there was a significant increase in category A findings. The report also highlights that Defence is undertaking a significant and extensive remediation exercise and considerable resources have been applied to the assessment, correction and substantiation of data as a result to those remediation activities. These remediation activities span a number of Defence’s core information systems and business processes.

Focusing on the audit currently under way, the report has sought to summarise in qualitative terms the current issues flowing through the audit. I will briefly touch on those and their implications. One of the outcomes, as the committee is aware, of the Get-Well program was to identify the business process compliance environment. Flowing from that were some 118 recommendations that were accepted by Defence to increase the strength of the business process compliance environment. However, at the time of writing the report only three of those had management action plans developed. That means in simple terms that Defence have acknowledged that there are business process compliance issues but, as a result of timing, they are still yet to be implemented. That will have an impact on our assessment for the current year audit.

We also carried out an extensive IT review of SDSS, focusing on the application access environment. In paragraphs 5.126 to 5.128, we summarise a number of issues impacting on the overall security of the system. They are the use of generic user IDs; a number of users having access to all system functions; users having incompatible access, which is a breach of the segregation on duty principles; user access often not being commensurate with officer duties; and there being no formal, explicit and timely review mechanisms over access related issues. As a result, from an audit perspective, we are not able to place control reliance on SDSS as a system, both because of security implications arising from open access and because a number of business process compliance issues are yet to be bedded down.

The other aspect of the IT audit is that a number of pricing issues continue to occur, including zero price items being incurred within the current year. While that affects the valuation, it is separate from the quantity aspects. As a result, the planned stocktake timetable that we had agreed with Defence management had to be reconfigured to focus entirely on the year end. I would add that that is a significant cost for the Audit Office. At this time something like 10 per cent of our office is out in the field, conducting stocktakes. We have had to do a very significant and substantive stocktake because we are not able to place control reliance on SDSS, both from a business process perspective and from a security system aspect.

**Mr Cochrane**—Putting that into plain English, we have been trying to put much more work into SDSS so that we can rely on the system and give a good opinion on the financial statements. However, in doing that extra work, we have found extra problems.

**Mr Goodwin**—I will touch on the last two issues. I have mentioned that there has been an increase in category A findings and we have looked at why that might be the case. We have commented that a number of audit findings, both ANAO and internal, have been outstanding for an extensive period or have been assessed as being remediated or closed but, on subsequent review, that was found not necessarily to be the case.

I would also point out that Defence has been dealing with the DMO becoming a prescribed agency from 1 July 2005. We have undertaken a review of the IT environment within the ROMAN system, which is the general ledger system. Initially, we raised with management some concerns around the extensive number of users that had dual access to both the DMO and the Defence. As I understand it, Defence management is in the process of remediating that issue.

That is a snapshot of the main findings, which I will summarise. We have noticed an issue around dealing with audit findings; some have been left to go past due. There are issues around security access within SDSS. In addition, there are issues around the implementation of business process compliance recommendations that have impacted on our control reliance and we are doing a very extensive stocktake at the moment. On the other hand, Defence are also applying considerable resources to remediating known issues. That is the flavour of the report. We are happy to take questions at a later stage.

**CHAIR**—Does Defence wish to respond to any of the concerns that have been raised?

**Mr Smith**—Yes, certainly. I would point out again that the 118 recommendations derived from our own work on part of the SDSS Get-Well Program; currently we are working through prioritising those. We will not be able to resolve all of them at once. We are certainly focused on those that can be and need to be resolved by 30 September.

The SDSS IT report, to which Mr Goodwin has referred, was helpful to us. It identified five category As and I think one B. We have a program for addressing the issues that it raised. But the report was helpful to us in understanding what in particular we need to do at this time. Mr Lewincamp or Dr Gumley might wish to comment in more detail, particularly on the security issue.

**Dr Gumley**—I think it is important to recognise that what is going on here is more ‘peeling of the onion’. We are getting deeper and deeper. These problems have been here. It is not like in the last six months these have suddenly popped up.

**CHAIR**—How long will it be before we get to the centre of the onion and there is no more to peel back?

**Dr Gumley**—As we delve down deeper and deeper into the systems there are probably some more things to be found. But at least we are looking.

**Mr Goodwin**—I think it is important, in reflecting on the ‘peeling the onion’ analogy and reflecting on the secretary’s comments, that the positive aspect of all of this is that Defence management have been quick, responsive and proactive in dealing with the audit findings. There was an extensive process of making sure that the facts were right, but there is not a disputation. There is a responsiveness to get on with dealing with the issue.

**CHAIR**—Before going further, could I ask: are there any members of the media out there in the broader environment? I need to make you aware that you need to report the facts of today’s proceedings accurately and fairly. We do not restrict you in what you say; we just need you to report accurately. I might pass over to members of my committee who have questions.

**Ms GRIERSON**—I have a question to the Audit Office. When you again audited the interim report, was that against previous recommendations, the remediation plans or both?

**Mr Goodwin**—The interim report is doing the audit of the 2004-05 financial statements for 30 June this year.

**Ms GRIERSON**—So you looked at what I saw in the portfolio budget statements that had outcomes against them?

**Mr Goodwin**—We are auditing the processes and the systems that flow into the final numbers that go into the financial statements. In doing that, several things would happen. We would have regard to the remediation activities that Defence is doing and make an assessment where those remediation activities may have an impact for 30 June this year. If they do, we will audit that. If our view is that they will not—they have a later impact—then we take a different audit strategy which is heavily trying to substantiate data.

**Ms GRIERSON**—Basically, when I read the portfolio budget statement for the end of 2004-05 and then for the next budget, there was no appraisal of the major outcomes that were set for 2004-05; it was just what they were hoping to achieve. But I do not know what has been achieved. How will I know what has been achieved?

**Mr Cochrane**—Generally you would have to go to the Defence annual report. The annual report, in theory, reports back against the portfolio budget statements.

**Ms GRIERSON**—I might ask more specific questions on the remediation plans.

**CHAIR**—Does anybody else have any questions on the topic covered so far?

**Ms GRIERSON**—I am happy to ask some more. I would like to ask Defence what their comment would be on the increased category A, particularly, and category B qualifications on the financial statements.

**Mr Smith**—Those are the ones that Mr Goodwin just mentioned—the additional five?

**Ms GRIERSON**—Yes.

**Mr Smith**—As I said to you, they arose from the SDSS IT audit. We found the identification of those issues helpful to us and we are addressing them. If you would like Mr Lewincamp to explain what he is doing with them, I would be happy for him to do so.

**Ms GRIERSON**—I would love to hear.

**Mr Lewincamp**—We accept the findings of the Audit Office on the SDSS IT audit. We accept that they are unable to get the necessary level of controls reliance on SDSS. As Mr Goodwin said, that arises in two broad areas. The first is in the area of business processes and compliance with the business processes. As the secretary mentioned earlier, they arise from 118 recommendations that came out of the SDSS Get-Well Program. We are developing management action plans for each of those. We have identified a responsible officer for each. We have a plan now for about half of them. We will complete the remaining plans very shortly.

We have identified the priority to be attached to each of those. We have identified 26 as critical, 36 as high priority, 22 as medium and 34 as low. We have a developing plan for implementation of those over the next 12 months. We will seek to have the critical items in place by 30 September this year, because they will have an impact on the financial statements for 2005-06.

On the second item, which is the security and access controls, we acknowledge that we have not been careful enough in understanding, cataloguing and recording the levels of access that different users of the system have had. That has in part been due to things like the operation imperative—of simply getting things done and giving people in deployed forces the levels of access they need to do the job without asking the types of ‘segregation of duties’ questions that we might have asked. So we need to go back through and look at the way we do our business, segregate some of those duties and catalogue more carefully the level of access that we give—we acknowledge that.

One point I would make is that up to now we have not had a standard against which to be audited, and one of the things we are discussing with the Audit Office is an agreed standard for a controls framework so that in future we know the measure that we need to achieve to be able to determine for ourselves whether we have met it or not. So far it has been a question of saying to the auditors, ‘Come in, do you have any problems?’ rather than our having a standard against which to measure.

**Ms GRIERSON**—Why haven’t you had a standards control?

**Mr Lewincamp**—There is no standard that I am aware of. The expectation about the level of controls has increased dramatically since the introduction of SDSS 12 years ago. It was never set up to meet what would nowadays be seen as a reasonable level of a controls framework for a system of that sort. So we need to develop that understanding so we can build it into our forward plans.

**Ms GRIERSON**—But you must have clear guidelines on who accesses it and at what level.

**Mr Lewincamp**—We do, but—

**Ms GRIERSON**—Are you still going to have your data contaminated over and over again—or risk that happening?

**Mr Lewincamp**—One of the issues here is that there is no direct correlation between levels of access and levels of contamination. We do not know what impact an excessive level of access actually has on the data that is in the system.

**Ms GRIERSON**—But you would identify it as a risk or potential risk, wouldn't you?

**Mr Lewincamp**—It is a risk we need to manage, yes, and we have agreed with the Audit Office that we will do that. We think in this area there are some quick fixes available. We are putting in place a new matrix this week so that we start the next financial year with a better matrix which reduces some of the levels of access and, over the next three months, we will progressively introduce some remaining measures to bring the access level back to the type of level that the Audit Office would like to see and which we think also is necessary for our management purposes.

**Ms GRIERSON**—And does that mean you have to consult with TenixToll as well to put those things into action?

**Mr Lewincamp**—This will have some impact on our work force. It may increase some of the numbers of staff needed to work in different areas and it will have an impact on our contractors. If that is the case, we will need to negotiate with our contractors.

**Ms GRIERSON**—Does the Audit Office have a view on the response so far from Defence to getting that access controlled so that the data will eventually be reliable?

**Mr Cochrane**—It is critical to have it in place. It needs to be done. Someone needs to go through it to make sure that the framework and the matrix are there and that individual users are given the right level of access.

**Ms GRIERSON**—The explosive ordnance items—and we are talking about significant items—still show quantity variances. Does someone have some information on how that continues to happen? It has continued over the last 12 months even though one thing that was going to be responded to was explosive ordnance items being correctly quantified, located and identified.

**Mr Goodwin**—I would be happy to explain that but I would request that, if I were to do that, we would do that in camera.

**Ms GRIERSON**—Okay. We will do that in camera at another time. I could not really understand the evidence from the DMO about prescribed agency and codes. There was a comment from the Audit Office about who was doing what.

**CHAIR**—I just want to go back one step. I am sorry to interrupt you but it is very relevant. We took evidence last time in camera yet, during the Senate estimates hearings into Defence, I heard on the radio the stuff that we had been asked to put in camera to this committee. Can you tell me why things are in camera to this committee but a matter of public record at Senate

estimates? I am sorry to interrupt you, but I think it is very pertinent when people request in-camera sessions. It makes it pretty hard to justify—not just to the committee but to the broader public, given this is a public hearing—why things should be in camera.

**Mr Cochrane**—It certainly came up at the Audit Office's turn at the Senate estimates. What happened was that we were asked questions about items that had gone missing. We were not volunteering that information.

**Mr Goodwin**—We actually said twice that did not believe it was appropriate to be divulging whatever information that was.

**Mr Cochrane**—Having said that, the Senate has the power to ask us. The point to be made is that individual senators themselves raised with us items of particular interest, not vice versa.

**Ms GRIERSON**—And they raised trucks and then tanks didn't they?

**Mr Cochrane**—Yes.

**Mr Goodwin**—They raised trucks and ambulances.

**Mr Cochrane**—And the famous tank.

**Ms GRIERSON**—Yes. So this prescribed agency, in allocating codes—

**Mr Lewincamp**—The key difference for prescription for the Defence Materiel Organisation is that, under the FMA Act, the CEO will have separate financial accountability directly to the minister. To ensure the complete separation of the financial transactions and accounts of the two organisations, we should not have agents who are able to operate with the accounts of both Defence and DMO. That is what Mr Goodwin was referring to. We need to be very careful with the access that people have, the delegations they use and the cost codes that they are able to use to make sure that every individual is operating very carefully inside either the Defence organisation or the DMO. That is the issue.

**Ms GRIERSON**—How will that operate when DMO is a separate prescribed agency?

**Dr Gumley**—It will just be like a customer-supplier relationship. It will be more at arms length. Although we have had many hundreds of people on both sides of the divide with access up to now, we are closing down that access. From 1 July 2005, 44 DMO personnel will be given roman access to the defence accounts and some 190 defence personnel will be given access to the DMO accounts. These access approvals are managed at branch head level and will be regularly reviewed. Hopefully within six to 12 months it will be as much at arms length as any other two supply organisations are with each other.

**Ms GRIERSON**—The inventory pricing for stock that exists is still showing as zero. Do you have a view on why that continues to happen?

**Mr Moore**—That is one of the problems with the control environment in SDSS, where users still have the ability to set prices at zero.

**Ms GRIERSON**—Can I just interrupt you before you go on. Who has the access entitlement or position in the hierarchy to put the quantities in? Are they people in your section?

**Mr Moore**—There might be some confusion. We are talking about two separate systems. The dual access is to the financial system, which is called ROMAN. It is a SAP based product. Defence and DMO have decided to share that one system rather than DMO setting up another one. Mr Lewincamp's answer is on restricting dual access related to the ROMAN system. There are people in Defence who will access the company structure in ROMAN to do end-of-month journals and so on. It makes business sense. We have to restrict that dual access in ROMAN. A number of people require that access on an ongoing basis but we have to satisfy ourselves that the controls are there so we can see what they are doing, that they are authorised to do it and that it is subject to audit. The problem around inventory pricing is not within ROMAN itself; it is in SDSS. Dr Gumley would be more qualified than me to comment on that.

**Ms GRIERSON**—What controls do you think need to be put in place to make sure financial entries are at an accurate base, whether it is the inventory, leave entitlements or whatever?

**Mr Moore**—As part of what Mr Lewincamp is addressing as a result of the ANAO controls audit, he is putting in place sufficient systems controls within the SDSS system itself and business process controls that should prevent any user being able to not record the accurate pricing for inventory. Once those controls are in place to a sufficient level, we will have the Audit Office retest SDSS to see if they are satisfied that we have them in place. That should fix the problem.

**Ms GRIERSON**—Does that satisfy the Audit Office?

**Mr Goodwin**—The agreed plan going forward does, which is that we have provided our finance to management and we have categorised those things. There are five A findings arising from that. There is a plan to say that the security issues will be dealt with by a certain point this year and the business process compliance issues will be dealt with at a later point. When each of those milestones are met, we will come back in and do an audit to make sure that the issues identified have been rectified.

**Ms GRIERSON**—Of those 118 follow-up recommendations, there only three items have plans to action them. That does not give me much confidence. Are the three that have been detailed with an action plan of the highest priority?

**Mr Lewincamp**—I reported earlier that half of them have action plans, and we are seeking to finalise the other half as quickly as we can. Twenty-six of them are critical items that we will implement by September, and we will implement the remainder through the rest of the year. I want to comment briefly on the zero price issue. There are a very small number of instances where zero price is the appropriate price on SDSS, and it relates to repair orders. The vast majority of them result from noncompliance with the appropriate business processes by the users of the system. A range of initiatives with the business process compliance, properly identifying items first found will help to correct this problem and minimise its occurrence. There will still be a very small number of legitimate occasions where there is a zero price.



**CHAIR**—My own view is that I am less concerned about the pricing issue than the stock content issue. Pricing is an issue where it can be 1c or \$1,000. If it is going to be redundant after a couple of years, and you have it on the books as \$1,000 and it gets written down, the processing time is an accounting or financial aspect. But the key concern reflected by most people I speak to is the ability to understand where your stock is and the accuracy of those stock levels, not just the pricing of them. In relation to the things that Ms Grierson just raised, I am concerned about the accuracy of data. In the new report tabled last week, the number of generic users who seem to have unfettered access to all aspects and all functions was highlighted, which can lead to inadvertent or wilful data corruption. Your view is that it must be satisfactory because somebody has approved delegation for these people to have access at that level.

**Mr Smith**—On the first point about the importance of quantity issues relative to pricing, that is so with respect to the effectiveness of our organisation. However, efficiency must also be measured by us and audited by ANAO. Pricing is still critical because it is that which defines the volume of uncertainty. It is that, in turn, which defines the nature of one of the other qualifications. That is why we are so concerned. There is also a cultural issue around that—that people who do not enter correct prices are taking the system too lightly. That is important to us.

**CHAIR**—I was not stating it for that purpose, but it is no good having all the pricing accurate if you do not know what stock you have or where it is.

**Mr Smith**—That is correct.

**Mr Lewincamp**—I might add that getting the numbers and the stock right is a significant part of the remediation plans that we have in place, which. I guess we will come to that shortly in some of the other questioning.

**Dr Gumley**—We consider it is important to get all the pricing correct except for the pricing that is historically almost impossible to get. So for 2000, moving onwards, we are working very hard to get the correct pricing into the computers.

**CHAIR**—One would assume, given there has been a relative shake-up, that pricing is now entered on purchase price and that is reflected accurately. But if it is to be an item that becomes redundant or expires, such as a food ration that has an expiry date, that is perhaps treated differently. These are concerns: having an understanding of where your stock is; whether you have two, five or 10 of them; whether they are here, somewhere else or nowhere; or—what is even more funny—when you actually have stock that you do not need. Acquittal of that process is absolutely critical. As reported in the audit report, there are around \$7 billion worth of assets that are unallocated or wrongly priced. We are not talking about just nickel-and-dime items here and there—a couple of spare O rings or washers—\$7 billion amounts to a lot of money. There is no answer back, so perhaps you agree with me.

**Mr Smith**—We are in full agreement. I would not say that \$7 billion is unallocated. Some of those are allocated.

**CHAIR**—What is the correct term, Audit Office? You might correct me on this point.

**Mr Goodwin**—There was an audit scope limitation, over time, to some \$7 billion of assets. That meant that we could not get evidence to verify either a quantity or a valuation aspect.

**Ms GRIERSON**—Given that the accounts could not be signed off 12 months ago—so everyone acknowledged that it was a serious problem and issue that needed the whole attention of the defence department—are you satisfied, Audit, with the progress made?

**Mr Cochrane**—I think Mr Smith has made the point before that it is going to take a couple of years to get some of this fixed. What we have to do is, every year, come to an opinion on the financial statements. What we are saying for 2004-05 is that, based on this interim report, we are in trouble again and the end result is going to be very critically dependent on the results of the stocktake. For the purposes of giving assurance on the financial statements, we cannot say that the system is working. We are still looking at the remediation plans. We made the point earlier in the hearing that there should be a reasonable action taken within a reasonable time frame. If it drifted out any longer than one to two years, I would be very unhappy.

**Miss JACKIE KELLY**—In Senate estimates, you said ‘several years’. Is ‘several years’ one to two years for you?

**Mr Smith**—I had intended before we finished today, if opportunity allowed, to offer a summary of where I think we are at overall. We can do that now should you wish or we can wait until you have been through more of the detailed discussion.

**CHAIR**—I would like to explore some things because then, as we explore things, you might be able to include those in your summary response.

**Mr Smith**—I just want to say, though, that I doubt we will get to a clean skin—with absolutely no qualifications—in my lifetime. The important thing is—

**Ms GRIERSON**—You are only going to be doing this job for two more years, is that right?

**Mr Smith**—I read that in the newspapers, yes.

**CHAIR**—You cannot believe everything you read in the media.

**Ms GRIERSON**—It has not been confirmed in the parliament.

**Mr Smith**—I am staying on longer because I think we can achieve this, and I would like to.

**Ms GRIERSON**—It is nice to be positive.

**Mr Smith**—But some of these issues will not be resolved. The important thing is, for me, that we make enough progress and correct enough of the problems to move back across the line into an area where an opinion can be formed. That is the first objective.

**Ms GRIERSON**—Have enough resources been allocated to this task? I ask for each person’s view on that.

**Mr Smith**—The others can disagree with me.

**Ms GRIERSON**—They would be very brave if they did.

**Mr Smith**—If they do, they have an opportunity to come to me for more. I believe they would. I have always said that our allocation of resources will be as fulsome as it can be up to a point where we impact on operational effectiveness or preparedness. Those are the lines we cannot cross.

**Ms GRIERSON**—Audit Office, you have already said in your interim report that you do not feel enough resources are being adequately allocated to these tasks. That is a concern you raise. How much is it an issue of contractors having to do it and how much is it an issue of Defence personnel having to do it? Is it Defence budget, having a contractor demand more to do these tasks or what?

**Mr Cochrane**—That is entirely a matter for Defence. Where they get the resources to resolve the issues, whether it is through a contractor or Defence staff, is not an Audit Office matter at all. Our judgment is really to come to the parliament regularly and say what the state is with Defence and whether they are on the right track. Mr Goodwin has made the point that they are being responsive to the audit findings but I think we would like to see more progress. We would like to see faster progress, as everyone would. I am sure Defence would like to see some of these issues go away, and we would too. We would much rather give a positive opinion about the Defence financial management. At the moment the bottom line is that we cannot, so the judgment then becomes whether the owners—that is, parliament—are satisfied with the progress Defence is making. We are certainly not coming to you and saying that Defence are not listening. They have people looking at these problems and working pretty hard to resolve some of them. But, sure, there is a frustration there. We would like to see them resolved.

**Ms GRIERSON**—Failing to resolve some matters just compounds over time and the problem gets bigger and bigger.

**Mr Smith**—We would all like to see more and faster progress—and I would have liked to have seen it over the last two years. But it is not just a matter of resources, either money or people.

**Mr BROADBENT**—I would like to ask one quick question before we go to lunch. Mr Smith and Mr Goodwin, we talk about billions of dollars being missing and then the two equations: one is the price and one is where that article is. So there are really three things. We know it exists but we are not quite sure where it is and what the value of it is. As a farmer, if I came across a gearbox for a particular tractor that I run and I did not buy it—and I am talking about F111s and those sorts of things where we have to buy in particular equipment that we probably would not otherwise buy except that we happen to run that bit of equipment. We are doing all sorts of things like that. When you are talking in billions of dollars that sounds like an enormous amount to the public—and I know it is—but in the scope of what we actually hold as a defence department and all those overlays it is not an enormous amount of money. In fact, the core action of what we are doing is being addressed. Is that reasonable?

**Mr Smith**—I would certainly agree that it is being addressed. It was not billions of dollars missing. The point, to my very simple mind, is that when it gets to past a 10 per cent error rate you effectively declare uncertainty around the whole. That is the billions of dollars.

**CHAIR**—We will break for lunch.

**Proceedings suspended from 12.43 pm to 1.02 pm**

**CHAIR**—Mr Smith, I understand somebody from Defence wants to table a document from this morning's presentation.

**Mr Smith**—Yes. Miss Kelly asked if she could have a copy of a brief. We can give that to you or table it, whichever you would prefer.

**CHAIR**—It is easier to table it than to include it as a submission.

**Mr Smith**—I generally seek the minister's approval to do that but on this occasion I think we can bear the risk of doing that.

**CHAIR**—Thank you for the document. Ms Grierson, you are in continuance with your questions.

**Ms GRIERSON**—We have dealt with resources and standards. My questions go more to some of the earlier questions about JP2077. If people have questions about qualification of the accounts, I would be particularly happy to leave mine.

**Miss JACKIE KELLY**—The key thing that I want to dwell on concerns the ANAO. Obviously you did not have a problem with Defence as to 2003-04 but you have since found a problem, and there is the statement by Mr Smith that there is unlikely to be in his lifetime any resolution of things.

**Mr Smith**—To get to a clean skin.

**Miss JACKIE KELLY**—What is the difference between prior to 2004 and now? What is the standard of audit?

**Mr Cochrane**—It is a question of order. For a couple of years prior to 2004, we had what we call an 'exception qualification' on the Defence accounts in some areas. But what actually happened in 2004 is that the collective exceptions crossed a line or jumped over a hurdle. For auditing standards that means that we had to come to an inability to form an opinion on the accounts, so 2004 was just a particularly bad culmination of a lot of problems that we had had previously.

**Mr Smith**—I can comment on this. Some of that was the accumulated effect of the issues that had been the subject of exception for a number of years, some of it was the greater depth and more rigorous assessment, I believe, on behalf of our own auditors and ANAO and, frankly, some of it probably resulted from some deterioration in that year in some areas due to a higher operational tempo against inadequate systems.

**Miss JACKIE KELLY**—In late 1993, all the single-service supply systems were amalgamated. This SDSS system then somehow came into being and was mandated as the system that all services would use. Since that time, it has been upgraded repeatedly until in 2000, with the application of version 3.6 and an upgrade, it was finally brought to a level where the material it produced could come to the ANAO's attention. Would it be fair to say that it was the SDSS system itself that brought about the accounting transparency by which the ANAO can now come to a more accurate opinion than was probably the case without the SDSS or even with it in its 10 previous versions?

**Brig. McGahey**—In part, that is true. The problem was that the previous systems were stovepipes, so there was not a universal view in terms of the holdings. As we have progressed through version 3, more and more of those stovepipe systems have come on board and we have a more universal view of what is in the system currently; but, more importantly, we have come to realise what data is currently in the system and its condition.

**Miss JACKIE KELLY**—Would it be fair to say that back in 1993, when SDSS was first conceptualised, it was felt that Defence was not getting a good accounting of its stock and from that time was heading towards a situation where you could get to this sort of transparency and accountability?

**Brig. McGahey**—I do not think that was the prime mover. I think the prime mover was operational—although it is dual. There was an understanding that we needed to understand, in terms of Defence's holdings, the total inventory holding. The prime mover was an operational one in terms of having operational visibility of what was in our supply chain. That is what drove us down the line, like every other military in the Western world, of having a common supply chain management system.

**CHAIR**—I understand that we have Peter Priddle with us in the room. I understand that he was involved in the original development of SDSS version 3 from 1988 to 1990 and was the project director from 2000 to 2003. Is it okay with Mr Smith or the person to whom he reports if we ask him questions going to the very basis of the evolution of this product?

**Mr Smith**—Going to the history of SDSS?

**CHAIR**—Yes.

**Miss JACKIE KELLY**—I want to follow this line of 'overdue and over budget'; it seems to happen repeatedly. Now is opportune to look at why these projects—not just IT projects but all sorts of Defence acquisition programs—go over time and over budget repeatedly. Peter, you first came on board in 1988?

**Mr Priddle**—I have worked in the department since 1980 and have been involved in the upgrade of SDSS since about the middle of 2000.

**Miss JACKIE KELLY**—So, from 1980 to 2000, you had 20 years of experience in the department but not on SDSS.

**Mr Priddle**—I was placed at the Navy supply centre at Zetland on the day I started in the department. There I was using the precursor to SDSS, which was then called NAVSUP, to buy items for Zetland and distribute them in a way that is analogous to what you see now at the DNSDC.

**Miss JACKIE KELLY**—So it was just a phone call from command or from Mr Smith to NAVSUP and they could have told you operationally back to the last stocktake, which was annual or biennial.

**Mr Priddle**—I think the import of your previous question was: what is different about using SDSS? As my superior David McGahey mentioned to you before, the first essence of SDSS is its end-to-end nature. It now covers all of our warehousing operations and extends into the operational logistics area, where all of our units are now part of the SDSS system. So all Army units, all Air Force ‘squadrons’, as they are known, and—as was mentioned in earlier discussions outside this committee room—all Navy ships are now visible within SDSS. When I started in the organisation, NAVSUP only covered Navy materiel on land; it did not cover what was on the ship.

**Miss JACKIE KELLY**—Could you reorder from that? Did it have a system whereby, as it was used, it was reordered?

**Mr Priddle**—It could reorder from the viewpoint of a warehouse, but there was another offline system to get the materiel to the ship. In 1980 it was a very crude system; it was not as you have seen it in your demonstrations today. This is a modern inventory management system; you are able to look globally across all of your items. When I started in 1980, there was no such thing as even looking at a screen. When we used our computer system in 1980, all of the understanding of the system was based upon paper reports.

**Miss JACKIE KELLY**—So in 1993, the move from NAVSUP to SDSS was not motivated by modern accounting.

**Mr Priddle**—It was motivated by a number of things. Certainly, it was considered an appropriate time to upgrade to a more modern system, as I said before. It did not have real-time capabilities. Bear with me and please stop me if this is too much detail, but all of the output of the previous system was printed in Canberra and would be trucked down to the Navy supply centre every night. So I did not know what was going on in real-time in the system. I had to wait until the report turned up on my desk. I then had to interpret the report. I then had to create paper-based transactions, which were sent to a different location and punched in by a data transcription officer. Then I had to wait another day for that transaction to show up in another report and be trucked down to me again. It was a very cumbersome system. So, if you can get a feel from what I am talking about there, the move to SDSS was revolutionary in terms of real-time access to information.

**CHAIR**—Given that SDSS has all the problems, the previous system must have been very ordinary.

**Mr Priddle**—It was a challenge to all concerned to use the old system, but then again that was the way it was in 1980. As I have mentioned, there are a number of benefits in moving to

SDSS—real-time access, global visibility of our materiel and a greater level of functionality. The other issue was that the NAVSUP system and the RAAFSUP system, as they were known then, were written specifically by Defence. They originated in the seventies and were upgraded at some point. They were based on very old technology and simply were not supportable any more. So there were a number of drivers for moving it but, as Brigadier McGahey has indicated, the primary driver was to create a single logistics system to support our three services and to have that total visibility. It has always been the department's intention up until today and into the future to make sure that the accuracy of the records that we have for our stock inventory are to the best we can achieve. As you would appreciate, we are under the process of, as we like to think of it, continuous improvement in this area.

**Miss JACKIE KELLY**—So it is fair to say that, prior to 1993, ANAO were at least in a position to form some opinion of Defence's stocktake.

**Mr Cochrane**—Let me contrast the Auditor's position by saying that it has been subject to significant change over time, including the introduction of accrual accounting by the government. Prior to the late nineties, the work we had done on SDSS and its predecessors was mainly in the context of performance auditing, because we had a focus on the logistics issues. When accrual accounting was introduced, it became a system that then was tied up in producing financial statements that were subject to audit. So we then did additional work in that context and started having problems with the system.

**CHAIR**—Are you saying that the problem was always there, it just was not as easily identifiable?

**Mr Cochrane**—It was not built as a financial system. There was no requirement to produce a financial opinion. So immediately that that requirement changed, it became an issue. We are using a system that was not designed as a modern financial management system.

**Mr Smith**—And at that time we began to ask of SDSS something for which it had not been originally designed.

**Miss JACKIE KELLY**—Was accrual accounting introduced in 1996-97?

**Mr Cochrane**—The modern legislation came in in 1997.

**Mr Smith**—I think we were first fully audited against it in 1999-2000.

**Mr Cochrane**—I think it was 1997-98. I am not sure.

**Ms GRIERSON**—Mr Priddle, were you the project manager right through that?

**Mr Priddle**—I was what was termed as the 'project director'. The day-to-day project management, as you will detect from the ANAO report, was contracted out to a company.

**Ms GRIERSON**—Was it you who did things like give KPMG a bonus? Was that on your authority or somebody else's authority?

**Mr Priddle**—At the beginning, the company concerned was known as PricewaterhouseCoopers consultants. At a point in time—I am just filling in detail here—it became IBM through a sale. Having said that, there was a bonus paid for the first phase of the activity. I did recommend to the appropriate person in my organisation that that bonus be paid.

**Ms GRIERSON**—On my calculation, that bonus represented 15 per cent of the entire project, yet it was paid very early.

**Mr Priddle**—No, it did not represent 15 per cent, if my memory serves me correctly. Again, I do not have the figures in front of me, but it was approximately five per cent of the first phase of the project. Again, without being specific about the figures, I think the first phase engendered a cost of about \$3 million to \$4 million.

**Ms GRIERSON**—In the figures that I have on the total amount of the project and the amount of the bonus, my calculation is such that it was—

**Mr Priddle**—I understand what you are getting at. The situation was that the first phase of the project had a bonus for timely completion and quality outcome. The second and more costly phase of the project did not have a bonus or an incentive component to the completion of that part.

**Ms GRIERSON**—Mr Priddle, we have heard how we started off with a system that was going to track logistics and be some sort of asset management system, without the financial imperatives where you have to itemise everything to get a proper accrual accounting base. Was there ever a point where you thought it would be best not to keep adding to that system?

**Mr Priddle**—My personal opinion is, in some ways, neither here nor there.

**Ms GRIERSON**—But you would have made recommendations?

**Mr Priddle**—I believe that the thread that the organisation is clear about is that there is continuously a requirement for an inventory management system for the ADF, the Defence Force. So there is always a requirement for an inventory management system. Today, when you went through the warehouses, you would have noticed that the day-to-day operation of those warehouses completely depends on SDSS, or another inventory management system, operating.

**Ms GRIERSON**—I would like to comment on what I did see, and that was a check done against an item. We found the item and we checked if there were 10 boxes there, making it 1,000, or whatever. We put in an incorrect entry and a report came out that said: ‘No. That is incorrect. Check again.’ We did that. That one was set up for us. When I talked to the person on the ground, who had tremendous corporate knowledge and experience, it was clear to me that he gets no feedback. Besides that instant data feedback, he does not get a view of how they have managed in the month. He does not get those overviews of what performance is like. As well as that, we tested a couple of other items and we found that the code was wrong. The barcode was not able to be read because it had not been entered into the system correctly. We did not check many other items, but every one came up as not entered correctly so it could not be read. That was adjacent to the item we did.



**Mr Priddle**—I understand the question you are asking but in the day-to-day operation of the DNSDC I am not in a position to answer those questions. I am not in a position to talk about those matters.

**Brig. McGahey**—I also point out that the system you observed at the time—the data transactions processor—is a system which we are just introducing into service here and this has been our pilot site. It is in no way a fully commissioned system. It is a work in progress. It is technologically the solution we will be running with. It does produce the fidelity of the reports that we require but it is not fully rolled out. I suspect that when we do get it fully rolled out it will provide the level of fidelity we require, bearing in mind that it is based on having the barcodes in place. That is a work in progress, as well.

**Ms GRIERSON**—Is that work for the contractor at the moment—the contractor has to get it all up to date?

**Brig. McGahey**—I would have to defer to Commander, Joint Logistics because this is his site. He can speak about the work of the contractor.

**CHAIR**—This morning we saw the gun system for looking at the stock—to pick, measure, look at the quantities that were there and report back. Why is it only in one area and not throughout the whole of the system? Why isn't an electronic system being utilised throughout the entire stock system instead of just part?

**Brig. McGahey**—It will be. The aim of Get Well is to get the system reliable and usable. Following on from that the aim is to automate handraulic processes wherever possible. So the project you observed, and this is the first site that it is rolled out on, is aimed at providing that automatic identification technology across all of Commander, Joint Logistic sites. Similarly, there is another project in the hopper to look at taking that same technology across the rest of Defence. It is not just within warehouses but within Q stores and equipment fleets where we have the ability to automatically identify those items.

**CHAIR**—What time frame?

**Brig. McGahey**—The warehouse sites will be done within this calendar year. They are currently being rolled out.

**Ms GRIERSON**—Are you talking about the 100 per cent stocktake?

**Brig. McGahey**—I am talking about the technological solution; that is the data transaction project. The other project is currently in approval. Essentially that would be a two-year rolling program from June this year, if it is approved, to provide automatic identification technology—the small contact memory buttons or two-dimensional barcodes—to the balance of Defence's inventory and assets so we can automate that process, relating it back to SDSS.

**CHAIR**—Some warehouses I have seen in other forms of life I have worked in have a fully automated pick and pack system. Someone will sit with a computer at a packing desk and type in the stock code and then it sends a forklift off to bring the box back. The number is then taken away and then it is put back. You do not have people physically looking for items, managing

items in shelves or perhaps even putting them back in the wrong area on a shelf. Has that option been explored as a stock management system? Given the number of stock items that you have and your high staff turnover there is a greater opportunity for human error to be played out.

**Brig. McGahey**—We have examined a number of options, but if you look at the scale and complexity of a fully automated depot, really this is the middle ground in terms of automating the process. I would suggest that there is still going to be a human in the loop, but we want to cut down the amount of administrative time—that is, physically entering data into the system. I would suggest that those fully automated depots that I visited and looked at do not deal with items of the scale and complexity that we do.

**CHAIR**—You talk about time and efficiency. I appreciated watching the demonstration this morning, but I noted that it took a couple of minutes from the time the box was scanned to when the operator got feedback on the gun as to whether or not there was stock there and whether or not it was complete.

**Air Vice Marshal Spence**—That simple reinforces the brigadier's earlier point that this is being rolled out and that this is a pilot site. We are not actually utilising that system right now to do the warehouse management task. The hardware is in place, the system is in place and we are now working the bugs out of it to actually put it in train as a system in this warehouse. Whilst today was representative in an indicative sense of what is intended to happen, it was not a reasonable guide as to how it is going to be when it is fully functional.

**Miss JACKIE KELLY**—But that is the chairman's point, that you can get to this state-of-art thing. Clearly at least by 1998, when you first did your accrual accounting, you figured that SDSS could be this robust; yet, when you went for this \$70 million version of the \$50 million program in 2000, the SDSS upgrade version 4, none of this was built into the request for tender or the statement of requirement and we ended up with what we have now. Then there was another contract—the Get Well—and, again, nothing was put in that. Where is the feedback from the Waynes of this world to the Mr Smiths of this world so that you can get something that works for a lot less than \$50 million? I have asked for the request for tender and the statement of requirement documents before, but I still have not seen them.

**Mr Smith**—I guess none of us here can answer for 1997 or 1998.

**CHAIR**—Can Mr Priddle answer that question?

**Miss JACKIE KELLY**—What about for 2000, when you went for the first contract for \$50 million?

**Mr Lewincamp**—The logistics information system is developing as technology develops and as requirements develop. What we do on every occasion with each stage of the project depends upon the funds available and what can be squeezed out of the defence funding program. At various times you will make judgments about what is affordable at that time, and we have done that at each stage. SDSS upgrade is one example. JP2077, where we are just now progressing phase 2B, is another example of where we are not going for the full solution that we know is available because we simply cannot afford it at this time within the overall defence budget. Phase 2B, for example, is addressing four high priority areas, but I could list another eight

priority areas that we are going to do further down the track. So at each stage we have to make those types of trade-off decisions. Having said that, your point about the SDSS upgrade is that it did not deliver everything that we wanted it to deliver. We recognised that, put in place a Get-Well program to remediate some of the immediate deficiencies and, in parallel, progressed JP2077 to take a longer term view and do some of the further enhancements. In a sense, it is a work in progress.

**Ms GRIERSON**—I would be of the view that opportunity has been lost at great cost. However, the Get-Well program is in place. If it does nothing but give us a genuine measure of the assets of defence logistics then at least we have a baseline for beginning to get the accounts and the new program right. We have to have a baseline. Air Vice Marshal Spence, where are we up to in terms of the 100 per cent stocktake?

**Air Vice Marshal Spence**—The 100 per cent stocktake here at Moorebank is completed.

**Ms GRIERSON**—And that was a 10 per cent deviation with a 3½ per cent cost value?

**Air Vice Marshal Spence**—Yes.

**Ms GRIERSON**—Has the Victorian one begun?

**Air Vice Marshal Spence**—The one at Bandiana has commenced.

**Ms GRIERSON**—How far has that progressed?

**Air Vice Marshal Spence**—They are only a month or two into that, and it will conclude around October this year.

**Ms GRIERSON**—The 10 per cent variance that existed at Moorebank: what were the recommendations to fix that up? Are they being advanced?

**Air Vice Marshal Spence**—That result came out at the end of March—that was when we concluded that. We have had a look at that result. That result could be attributed to a number of things, and you would be aware of some of them—discrepancies between the record and what is in the location areas and actually doing the counting and those types of things. My view is that the initiatives within the remediation project for which I am responsible, which is S1—and I think that we spoke last time about the various initiatives there—over the next six to 12 months should resolve those sorts of errors. In the main they are to do with people following the process and being supported by the systems, and that is where PDETs comes in.

**Ms GRIERSON**—There were two outcomes to be achieved by the end of 2004-05 and one was to complete this stocktake year, which has been done—

**Air Vice Marshal Spence**—Yes.

**Ms GRIERSON**—and the other one was to implement a compliance and assurance audit methodology. Yet we know from the most recent interim audit that that is not being done.

**Air Vice Marshal Spence**—Within this command we reintroduced a logistics compliance and assurance team in February. That team goes out to all of the business units across the command and works with the business unit itself, the Defence part of the partnership, and it also works with TenixToll—

**Ms GRIERSON**—So they are working here with TenixToll now as a result of that 100 per cent stocktake?

**Air Vice Marshal Spence**—The team is a limited team of half-a-dozen people and has a program over the year. I think I am right in saying that it has yet to come to DNSDC. It has also been involved in some of the additional audit activities that ANAO has put in place. So it is out there. It has been to a number of bases and it will continue across the whole seven business units throughout the remainder of the year.

**Ms GRIERSON**—How do we get a fix at this stage? We have had only a 100 per cent stocktake here. We are not satisfied that you are not satisfied that there are compliance methodologies and assurance methodologies in place—therefore, controls and corrections made. Without that the next phase cannot even continue. What is needed to follow up on the huge effort that must have gone in to do the 100 per cent stocktake here? What is required to get the right systems in place?

**Mr Cochrane**—There are two questions there—and I am not going to volunteer a big answer. The first one is just the accuracy for financial statement purposes. We are working under a hope at the moment that the stocktaking will produce an accurate result that will take some pressure off the financial statement opinion if the stocktaking works all right. But the ongoing system problem is much bigger. You really do need to rebuild a system and have a reliable system in place, and we acknowledge that it will take a little bit of time. Ideally, what we would like to reach is a situation where we do an interim audit, we look at this stock system and the stock system is reliable and we can rely on it. It takes a lot of pressure off having to do the intensive substantive work that is involved in stocktaking and we get a reliable result for the financial statement pending—

**Ms GRIERSON**—If 10 per cent is standard across the whole system, and that is in volume, and 3½ per cent standard across the next stocktake, and that is in value, in price, where do you eventually draw a line and say, ‘Let’s accept that and write it in?’ How big is that?

**Mr Cochrane**—We are bound by the auditing standards in forming an audit opinion and what comes into play is what we call the ‘level of materiality’, which for auditors is between five and 10 per cent. We cannot tolerate more than a five to 10 per cent error. That is a judgment we will go through every time we look at these things. That professional standard is in place, we are saying, because the accounts need to be within five to 10 per cent if the users of the financial statements are going to be able to place any reliance on that result. That is the bottom line, because you are the users of the financial statement and we are trying to say that you can rely on those financial statements within that five to 10 per cent range.

**Ms GRIERSON**—So who needs the training most—the people at the bottom, the system operators; or the system managers? Mr Moore, where would you put these limited resources to get a better outcome?

**Mr Moore**—It is not technical accounting issues that we are trying to grapple with; it is record keeping and so on. If you walked into one warehouse here at Moorebank, it would be 100 per cent clean—from register to floor you would probably find that that manager was completely on top of his or her job. You can walk into the next one, and it is not clean. I think there is a fair amount of training to be conducted at the warehouse level. That is not just Defence people, it is also as we roll DIDS out.

**CHAIR**—What are you doing to implement that?

**Mr Moore**—I can address that in terms of financial training, but it goes beyond that of course.

**Mr Smith**—The answer to your original question about what needs to be done is that, broadly, there are two things: one is an effective set of business processes and controls, and that is partly what came out of the last ANAO audit of SDSS; and the second is discipline and training among the users. We need to have both of those things. When we go to the upgrade to Ellipse, hopefully the controls and business processes will be incorporated in that; but we will need just as much discipline and training to sustain it. Brigadier McGahey can talk about the training that we have very deliberately put into SDS for users this year. There is a challenge there because of the churn rate among some of the users—not all.

**Ms GRIERSON**—Chair, I would be particularly interested to know how that affects TenixToll and the carrying out of their contract.

**CHAIR**—We will come to that in a second. We will let Brigadier McGahey respond.

**Brig. McGahey**—In terms of the training, there are several initiatives being put in place. One is that we have a common curriculum for that training. I have now been appointed as manager, joint training for the IT part of logistics. That common curriculum is now being rolled out. At the same time we have conducted a number of courses, including courses for TenixToll. We have a training team in both Sydney and Melbourne that provide cyclical training in the delivery of that curriculum to the sites and to the service schools. The major issue in our training, as the secretary has rightly pointed out, is our churn rate. We have a half-life, particularly with military postings—or even within some of the contractors—where the training has to be constantly refreshed. In order to ameliorate that problem we have designed training around e-learning and e-assessment modules that, rather than having face-to-face training, will allow site managers to train their people without moving people out of the workplace and into central training locations or having moving teams. We will still have moving teams for mentoring and initial training, but our aim is to try to have on-site training—that is, people being able to be assessed and upgrade their skills using on-screen help.

**Ms GRIERSON**—Are you delivering that for TenixToll or are they delivering the module you prepared?

**Brig. McGahey**—We deliver it for TenixToll initially. Essentially what we do is then deliver ‘train the trainer’ support and they carry out their own training.

**Ms GRIERSON**—Who is bearing the cost for that at the moment?

**Brig. McGahey**—Initially, we bear the cost, but then TenixToll do the ongoing training. I think that is correct.

**Ms GRIERSON**—Are there incentives or bonuses for workers who complete the training?

**Brig. McGahey**—No, unless TenixToll has something in place. Not as a Commonwealth issue.

**CHAIR**—Perhaps this would be a good time to ask whether we could have a representative from TenixToll at the table to answer some questions.

**Mr Smith**—I think there is an issue here about TenixToll presenting evidence in a formal hearing.

**CHAIR**—In what respect?

**Mr Smith**—They are not part of the Defence organisation. Although we are very happy for them to support the briefing this morning, they are not part of our organisation. I do not know every word of their contract, but I do not think we required that of them. We, of course, own the contract and are happy to take questions to them.

**Miss JACKIE KELLY**—Of the 14,000 registered users—

**CHAIR**—Hang on a second; I am just looking at something here. I know that the committee has the ability to summons any witness it may wish at any time. I will not be sure of this issue until I read the *Practice*, because this is a report of the committee into Defence and not a broader public hearing, even though this is a public hearing. I will leave that issue until I read the standing orders. I need to be across what I say before I bring anyone else to account, so I take that on notice and I will review the standing orders. Please proceed.

**Miss JACKIE KELLY**—Of the 14,000 registered users, approximately 8,000 are active users. What has happened to the other 6,000? Did they get training, did the other 1,600 concurrent daily users get training and who is paying for it?

**Brig. McGahey**—The aim is to provide base level training to all the users but they would each have different profiles. So, in terms of our initial cut over to version 4, the aim was to get all of those 14,000 users trained. The 8,000 active users will receive different levels of training depending on their profiles. If they have one or two different profiles within the system then they will receive additional training as required.

The other issue is that it is not just a question of training. As part of the team that provides the training, we aim to mentor users who are in particular positions—that is to actually visit the sites. And that is what Get Well aims to do: to actually go to sites, spend time with users, understand what their issues are and then teach them the best way to address their particular business processes and their particular access to the system.

**Miss JACKIE KELLY**—And what about phone support and phone support lines; if you are in the middle of doing something, is there a—

**Brig. McGahey**—We have two methods We have a help desk they can ring directly, or most tend to email the help desk. We recently conducted a poll and had some feedback, and the satisfaction rate on the use of that help desk was over 70 per cent.

**Miss JACKIE KELLY**—And email or help desk—

**Brig. McGahey**—It is both. The help desk takes both phone and email.

**Miss JACKIE KELLY**—I was just wondering if those extra 6,000 registered users, as opposed to active users, relate to some kind of churn? How many new users per annum would you have to train?

**Brig. McGahey**—There is not a standard churn per annum. The 14,000 would be previous users; we actually have 8,000 on the system at any given time. I would have to take on notice the question about what the annual churn rate is.

**Miss JACKIE KELLY**—In terms of staffing outside of training: over the whole SDSS, how many Public Service and uniformed personnel would be involved in that contract, apart from those users?

**Brig. McGahey**—In the entire business process?

**Miss JACKIE KELLY**—Yes.

**Brig. McGahey**—I think, in the entire business process, it would be multiples of those 8,000. I would have to come back to you on that.

**Miss JACKIE KELLY**—That adds to the cost, doesn't it? None of those staffing costs would have been put into the project costs that we have been given, would they? Do we have any idea of how many and at what time, plus the training?

**Brig. McGahey**—Not at this stage.

**Miss JACKIE KELLY**—Will you take it on notice?

**Brig. McGahey**—Yes.

**Mr Lewincamp**—Excuse me, Chair. Could we get some clarity about exactly what you are asking us for, because, if we are talking about everybody who is engaged in the logistics system at some point, that is a very large number.

**Miss JACKIE KELLY**—No, just those setting up and running the SDSS.

**Brig. McGahey**—So you mean the 8,000 active users?

**Miss JACKIE KELLY**—No; apart from the 8,000 active users—

**Mr Lewincamp**—People engaged in the support and maintenance of the system.

**Miss JACKIE KELLY**—And in operations of it, and so on.

**Brig. McGahey**—We can certainly come back to you with the figures on that, in terms of the local site administrators, the people within Supply Chain SPO who actually support the system.

**Miss JACKIE KELLY**—Who are not part of TenixToll?

**Brig. McGahey**—Yes.

**Miss JACKIE KELLY**—You have got TenixToll's personnel—how many have they got on site?

**Brig. McGahey**—I am sorry, but just to clarify the question, do you mean in actually administering the system or using the system?

**Miss JACKIE KELLY**—Isn't the whole system going to TenixToll eventually?

**Brig. McGahey**—Yes, but I am trying clarify the question. Are you asking how many users from TenixToll use SDSS?

**Miss JACKIE KELLY**—How many people do TenixToll have on board and how many are they likely to have when the whole thing has been handed over? How many are we using to do the same thing? And then, after it is handed over, how many of our personnel are still going to be part of that?

**Brig. Edwards**—In terms of the number of people at TenixToll on the system, I can come back to you with an answer on that from TenixToll. However, in terms of the number of people in the system, that is universal for Defence—so if I am an Air Force logistician on an Air Force base, I will be on SDSS as well.

**Miss JACKIE KELLY**—You are one of the 8,000 users, though, because you are just using that.

**Brig. Edwards**—Exactly right—I am one of the users of the system.

**Miss JACKIE KELLY**—But if you are one of the people who are still maintaining it or involved with it—rather than just using it as a tool in your daily job which is defence related—

**Brig. Edwards**—Transaction type stuff.

**Miss JACKIE KELLY**—how many are actually working in support of that contract?

**Brig. McGahey**—We can come back to you with those figures. Do you mean the administrative overhead of running the system—is that the question?



**Miss JACKIE KELLY**—The corporate supervision.

**Mr Lewincamp**—I think there is a confusion underlying the question here. SDSS, in terms of its planning, maintenance, sustainment and future, will remain a core in-house Defence function. It is not being contracted out. We will continue to manage its future development as a process. Some elements of that process may be contracted out to individual organisations to help us in that. And it will be the case that on a particular basis, as we have here, there will be a contractor employed to actually manage some of the warehouse operations. TenixToll is doing that here. But the overall responsibility for the system will remain with us.

**Miss JACKIE KELLY**—The number of people involved in that—

**Brig. McGahey**—I understand, we will come back to you with that on notice.

**Miss JACKIE KELLY**—Historically as well, and into the future. I am also getting at that \$15.87 million figure. I think it is a bit light on.

**Brig. McGahey**—Okay.

**CHAIR**—At this point we will call a representative from TenixToll. I point out that the Public Accounts and Audit Committee Act of 1951, under section 13, allows the committee, either the chair or deputy chair, at any time to ask for a person to appear as a witness either by invitation or by summons—I would not like to go down that track. I also remind those here today of section 16, about preventing a witness from giving evidence, which says that a person shall not knowingly dissuade or prevent a person from obeying a request or a summons. There is also section 19 which provides privilege and protection of witnesses.

**Mr BROADBENT**—Chair, before you do that, I have a query. I have had a lot to do with compulsory competitive tendering, I have been one of those people who have taken this community down a different road, and I just have to ask about the relationship here and how that is reflected in the responsibilities that are then allocated. This has never been addressed before this committee, so on this occasion I would suggest, before you call that person, that this committee takes further advice rather than just acts on a reading of the act as it stands. I say once again that I am the Russell Broadbent who introduced compulsory competitive tendering when I was the chair of the committee for the Victorian state government, and there was a big issue there about new relationships with parliaments and parliamentary committees. We are dealing here with the Defence Force, not only with a department. We are dealing with an authority apart from a department, so we are dealing with two lots of people here. Before we go down the track of inviting to this committee somebody under a contract to one of those parties, to the department, I would like you to take further advice.

**CHAIR**—The advice I have taken is under the act, looking at it clearly under the act. Yes, there may be questions of commercial-in-confidence that are not able to be addressed, and we could look at those. But in relation to questions pertaining to processes in managing the warehouse, I think that is fair and open game, and I rule that way.

**Mr BROADBENT**—I would just ask you again, Chair, to reconsider your position.

**CHAIR**—If you would like to, we will close the hearing, have a private meeting and then reconvene.

**Mr BROADBENT**—I think we should do that.

**Mr Smith**—Chair, I apologise that we did not anticipate this question and get advice from our minister, but he does approve the list of people from our organisation who may give evidence. He may wish to have a view on this. Could I also say that the contract is with Defence and, as I said, the contract does not require TenixToll to make public appearances before inquiries or committees, and nor does any other Defence contract do that. If we were to adopt this practice, we would probably be reshaping the process of tendering. Would you, for instance, have ADI here to talk about FFGs? Would you have Kaman here to talk about Seasprite helicopters? If that were to be part of their contract, what are the overheads they would build in to cover it? There are some quite complicated issues.

**CHAIR**—I take on board what you are saying there. From my understanding, the intention was not to ask about commercial-in-confidence details but to ask specific questions about logistics management. Whilst others that have had contracts with Defence or, indeed, with other government departments, have not been subpoenaed as witnesses, they have quite regularly given evidence and submissions to committees and willingly appeared. Those people at the time have had current contracts with Defence or other agencies. But we will to close the hearing now for a private meeting of the committee and reconvene shortly.

#### **Proceedings suspended from 1.52 pm to 2.02 pm**

**CHAIR**—On the basis that TenixToll have not been forewarned of questions that may be asked and given that the committee is right to take the action outlined before, as prescribed in the act, the committee has decided in the interest of procedural fairness to issue questions on notice, through you, Mr Smith. We expect answers from the department and the inclusion of information from TenixToll—not on commercially sensitive stuff but on the ability to perform operations within this area here. Once the committee has received that advice, it then has the ability to determine whether it will then call TenixToll as a witness to this committee.

**Mr Smith**—Thank you.

**Ms GRIERSON**—I would like to ask a series of very quick questions on the remediation plans. Firstly, to Mr Moore: how many business capability workshops and SES training courses have been run and how many people have been trained? Do you have data available to us on that?

**Mr Moore**—Yes. We held the first of our SES workshops in Canberra about two or three weeks ago. It was attended by approximately 20 SES band 2 and band 1 officers and military equivalents. It was supported by speakers from the highest levels of Defence, but I also add that the Auditor-General provided the keynote speech for the dinner, and we are very grateful to the Auditor-General for doing that. The Acting Secretary of the Department of Finance and Administration also provided a very good presentation. The feedback we have received about that workshop is very positive; all the participants believed it was a very worthwhile way to spend two days. They did not come out of that with accounting 101 skills, but have a far better

appreciation particularly of our financial management and audit issues. We have several more workshops planned for the rest of the year. The next one, from memory, is in September. It is already oversubscribed.

**Ms GRIERSON**—So that was a bit of a first?

**Mr Moore**—Yes, it was.

**Ms GRIERSON**—It was long overdue but excellent. What about training and competency assessments?

**Mr Moore**—Before I move on to that, can I say we are also rolling out a similar workshop to director/colonel level equivalents. The duration will be a bit longer than two days; it will drill down into more detail on the issues. That course could be up to five days long. We are still finalising the scoping, but we hope to start that happening within the next month or two. We are really targeting the senior leadership group and the level immediately below them.

**Ms GRIERSON**—Are you confident that you have the budget to continue that process and do it effectively?

**Mr Moore**—Yes, I am. I am not confident that we have a holistic financial training strategy in place. These are very good—

**Ms GRIERSON**—You are not taking them into IFRS yet?

**Mr Moore**—No, not quite, but we will be having a very close look at our total financial training strategy with our personnel area over the next six to 12 months and putting in a far more expansive structure. Our personnel executive are the people who do most of the delivery of training. That is not core business to my job in the CFO group. What is core business for me is to specify what our financial training requirement is and to make sure that is delivered throughout the organisation.

**Ms GRIERSON**—So you would put forward a training plan now?

**Mr Moore**—Yes, a financial training plan that would look at certification of staff, which gets back to your original question about looking at what financial jobs in Defence need certification in a competency sense. How we do that could be as simple as exercising financial delegation: what core skills and knowledge you have before we activate a financial delegation. In terms of putting journal entries together, we would expect a lot of people to have those technical accounting skills already before they join Defence; it is more the general financial management aspects of making decisions and pushing financial transactions through the systems.

**Ms GRIERSON**—Do you have a general view about whether you have sufficient staff across the Defence organisation trained in financial management or do you need more?

**Mr Moore**—I think the answer to the question, just within my own group, is that I am satisfied I have enough financial people. My problem is their corporate knowledge. We are losing far too many. The turnover in my group at certain levels is about 50 per cent per annum. It

is a combination of people with the technical financial skills plus some corporate knowledge of being through the process before and knowing the way Defence actually does it.

**Ms GRIERSON**—That is a mystery.

**Mr Moore**—Across the other groups, I think it would be a pretty similar story. Very good financial people are in high demand, not just in Canberra but also in most other places where Defence works from. We are all chasing the same type of people.

**Mr Smith**—Across the organisation as a whole, we almost certainly do not have enough people for what we are now asking of them. There are of course enough people trained in cash accounting but certainly not enough in what is now required. That would be true of the Public Service as a whole, I believe. I think we are the biggest trainer, not surprisingly and quite rightly, of people in this area in the Public Service, and we have to do even more.

**Ms GRIERSON**—Do we have a general stores financial accounting system yet or is it still dependent on these stocktakes and counts?

**Mr Moore**—The accounting policy for inventory in Defence is no different from any other organisation in Australia. We have to comply with Australian accounting standards. As we move forward to AEIFRS, we will be having a very close look at how we transition our inventory pricing in particular to the new international financial reporting standards. We are doing a couple of other things too, if you like to narrow the target in a financial accounting sense. For example, within SDSS we have a lot of very old stock that is kept, if you like, for insurance purposes that has a very low turnover or no turnover at all. There is an argument under the accounting standards that we could expense that stock and write it down to zero. We are looking at that closely right now, both with the Australian National Audit Office and with the department of finance, without trying to break away from any accounting standard but to look at the scope we have within those standards.

**Ms GRIERSON**—I think we would be all happy if there was an agreed approach, not just accidentally writing things off or putting zero values against things. If there was a policy developed that was mutually acceptable, I think we all understand that there will often be stock that has been there too long, is unnecessary or is no longer used et cetera.

**Mr Moore**—There is a lot of stock that becomes obsolescent over time. We do have an obsolescence policy and we have an accounting process for that. We are also looking at stock that we still need to keep, just in case we need it one day. We are looking at whether in fact we can expense that as well. We have a paper with the Audit Office asking for their views on that very issue. We already have the views back from the department of finance supporting our position.

**Ms GRIERSON**—A human practice that is often used if you do not have confidence in the system is that you over-order just to make sure that it will be there when you need it. Is that happening?

**Mr Moore**—I must stress that, even though we might be able to remove a lot of inventory from the financial statements process, if they are still required to be kept by Defence for

operational reasons we still need to account for them in a logistics sense so that we make sure that we know where they are if they are ever required. What we are trying to get away from is the intensive audit activity that we currently have for the stock that remains on the financial statements. One of the keys in the long term, as far as I am concerned, is that it controls compliance within SDSS. Once we achieve that, we implement a program of rolling stocktakes, which should enable the auditors to just come in annually and test that controls environment. If it passes, we will get away from 10 per cent of the Audit Office having to do saturation audits. So it is my hope that we can get to this situation in 2005-06.

**Ms GRIERSON**—What about the supply customer accounts? Has an owner been allocated to all those yet? Have they been quantified? Has a stocktake been done of those in any way?

**Air Vice Marshal Spence**—We have certainly completed the ownership for SCAs. The stocktaking is, in the main, complete. There are a number of the areas—perhaps within some small areas in Army, within the VCDF group—where we will probably need another month or two beyond the end of this financial year to complete the stocktaking process.

**Ms GRIERSON**—Is there a difficulty with all these processes and training filtering down to the reserve forces, or is that not a problem?

**Brig. McGahey**—The training for the reserve is the same as for the regular forces. There is no difference.

**Ms GRIERSON**—Is access just as much?

**Brig. McGahey**—Access is the same; it is the same system. To take your previous point about over-ordering, SDSS has, as a parallel system, an advanced inventory management module which actually are advanced algorithms that prevent over-ordering.

**Ms GRIERSON**—That is good. One of the outcomes in the remediation plan for this year for explosive ordnance was to remediate approximately \$440 million, which was just over half of the explosive ordnance pricing qualifications. Being out by almost \$1 billion we were hoping to correct that by almost half, or just over half. Has that occurred?

**Dr Gumley**—That has occurred. It looks like we should be okay on that one, subject to Audit Office finding—

**Ms GRIERSON**—Does the Audit Office agree?

**Mr Goodwin**—At the moment we are working through the information.

**Ms GRIERSON**—But you have still found qualifications on explosive ordnance in the interim—is that right?

**Mr Goodwin**—In terms of the interim audit the main focus was on the findings of SDSS. We have done stocktakes on explosive ordnance and I have responded, but we will talk about that in camera. In terms of the pricing, which is the existing qualification, at the moment that is still a work in progress so we will see where that goes.

**Ms GRIERSON**—I am aware that my colleagues will have questions, but I will just go through these remediation plans.

**Dr Gumley**—Could I clarify that about \$300 million of the \$440 million of explosive ordnance has been presented for quality assurance by the Audit Office.

**Ms GRIERSON**—And they have not done that yet?

**Mr Smith**—It is a work in progress.

**Ms GRIERSON**—That is progress anyway.

**Dr Gumley**—It is progress, and there is more to come.

**Ms GRIERSON**—It did not reach the target, but that is progress.

**Mr BROADBENT**—I have a general question, Mr Smith. You spoke before about speeding up processes and moving ahead as best we possibly can within the constraints of the finance we have to throw at the problems. Is there scope, after all this discussion, revelation and inquiry, for us to actually spend a bit more money on speeding up the process of where we are headed with regard to this program?

**Mr Smith**—If I can be shown areas where more spending will deliver some of the results we want, then I will certainly try to find the money for it. Obviously not hundreds of millions but odd millions I would certainly find.

**Mr BROADBENT**—Where would those submissions come to you from?

**Mr Smith**—From any of those responsible for the remediation plans, or any of the line areas of the organisation that are involved in working SDSS, or the leave records or any of those other issues.

**Mr BROADBENT**—How often do you go to your people and say: ‘I’ve got some money. How would you like to spend it on this audit program?’

**Mr Smith**—That can work, because the CFO is responsible for many of the programs and he knows what money we have. But from another point of view, at our monthly project board meeting, if anybody has a proposal to deliver a result that requires some money, we can deal with it there.

**Mr BROADBENT**—Does the Audit Office believe that Defence is spending enough on the audit program and the updating of its systems?

**Mr Cochrane**—I do not think that is for us to judge, but I suspect that more money is going to be required as we move through to a replacement system for SDSS. I do not know how much that is going to cost.

**Air Vice Marshal Spence**—As a supplicant for resources I will offer a view. I am very pleased with the support I have had from the secretary, obviously, and the CFO in a number of areas. For example, both the 100 per cent stocktake here and the 100 per cent stocktake at Bandiana have been resourced in a financial sense. I have been assured that, should there be any future requirement, that will be forthcoming as well.

**Mr Smith**—Within reason.

**Air Vice Marshal Spence**—Yes, indeed. In terms of personnel, I spoke earlier about increasing the corporate governance capability within the command and the business units, and I have received quite a significant increase in personnel to achieve that. Certainly, for the moment, I am quite confident that resources are being applied in my area.

**Mr Smith**—On the upgraded system, Ellipse, JP 2077, the Defence Capability Plan—where it is listed as a project, along with all the other projects—has a provision of between \$100 million and \$150 million for this phase.

**Ms GRIERSON**—Are you happy to go on to JP 2077?

**Mr BROADBENT**—I have one more question before we move on to that. The tolerance for auditing this particular area of Defence—stores—is only five and 10 per cent. From walking around today and looking at some of the processes, I feel that is an intolerant tolerance. I think the tolerance should be expanded because of what Defence does. We should look at the age of the stores. I looked at a D-bolt today for an anchor chain for a ship; not everybody needs a D-bolt for an anchor chain for a ship. There needs to be some greater tolerance. Private sector auditing does a completely different job to what Defence is doing, particularly in stores.

**Ms GRIERSON**—Mr Broadbent, I have a strongly different view to that. When you quantify what that represents to the Australian government budget, I do not think the Treasurer would be very happy with that either.

**Mr BROADBENT**—Do you mean in percentage terms?

**Ms GRIERSON**—It is 3.75 per cent of the Defence budget, of inventory et cetera.

**Mr BROADBENT**—I am talking about inventory.

**Mr Smith**—I do not think it affects the budget.

**Ms GRIERSON**—No, but inventory of stores and your asset quality.

**Mr Smith**—I accept that the ANAO is the champion of the ultimate, as Senator Minchin described it. That is something that we should aspire to. I think that with the best of systems and the best of training, given our activity levels, the continuing focus on effectiveness and, frankly, the absence of the sort of incentive that the private sector has, it is going to be quite difficult to achieve at the best of times. But it remains the aspiration.

**Ms GRIERSON**—I still have to qualify that and say that the Financial Management and Accountability Act applies to every Commonwealth department, and it is quite specific.

**Mr Smith**—Quite so; and if it did not, I would not be here. I understand that very fully. But I make the point again that the incentive for us is different from the private sector.

**Ms GRIERSON**—I think the incentive is a higher one.

**Mr Smith**—The incentive of the private sector is to make money. If it does not it does not exist. That is not what we exist for.

**Ms GRIERSON**—The effectiveness of the Defence Force is the end result.

**Mr Smith**—The effectiveness of the Defence Force has not been called into question.

**Ms GRIERSON**—I will always say to you, Mr Smith, in these hearings that the more effective the defence department is, the more effective the defence forces will be. It is a wonderful relationship.

**Mr Smith**—The effectiveness of the defence department is not in question, either; it is its efficiency as measured by the private sector.

**Ms GRIERSON**—Good.

**CHAIR**—At your opening statements, when you came to give evidence, I said to you that everyone here agrees that most of the effort needs to go to the very sharp end, that we do not call into account your ability to undertake your jobs.

**Mr Smith**—Ironically, we are not accountable under the law for the sharp end, but we are for this end. That is the commitment.

**Ms GRIERSON**—You never know. I think the sharp end for many people is their leave records and, certainly, their entitlements. Could someone perhaps explain the pilot phase of leave stratification?

**Mr Moore**—To give you some context to leave in Defence, during this financial year we expect both military and civilian personnel to take something like 2.6 million leave days, which is going to cost Defence \$660 million of our defence budget. Taking of leave is a big business in Defence. The problem we have around—

**Ms GRIERSON**—Would it be right that, in Defence, you often put off your leave—so you accumulate a great deal of leave—rather than take your annual holidays, because of operational needs or whatever?

**Mr Moore**—Historically, that is very true. For operational reasons, particularly in the military, people have not had free access to taking of leave and have built up a lot of leave balances. But the same is applied for different reasons on the civilian side. If people take about \$660 million worth of leave every year, if you look at our financial statements, we have accrued about two



years leave on average—about \$1.3 billion—across annual, long service and many other types of leave.

**Ms GRIERSON**—Do you hold that or does consolidated revenue hold that?

**Mr Moore**—In terms of funding support behind the liability, we have about 38 per cent of that accumulated leave balance funded in an appropriation receivable that is held by the department of finance. If everybody in Defence took their leave in the next two years, we would have to reorder the priorities in the budget to account for it.

**CHAIR**—I think that is fair across all of our government departments, which is why they are looking at the official arrangements.

**Mr Moore**—It is a bit patchy, actually. Some agencies, particularly the smaller ones, have got it 100 per cent funded. Some others are in a worse position than we are.

**Mr BROADBENT**—That would include this year's leave too, wouldn't it?

**Mr Moore**—Yes. The problem we have from last year is mainly around military leave. It really is verifying the balance of leave on our corporate personnel system, which we call PMKEYS.

**CHAIR**—Is that because, when people go off on deployment, they get accelerated leave entitlements?

**Mr Moore**—They get more types of leave on top of their annual and long service leave. But the problem we have is record keeping. It is a bit the same as inventory. It is verifying their leave balances against the source documentation—in my case, going back many decades—and whether in fact they have kept all their original leave applications, which I certainly have not. The Auditor-General found difficulty in verifying the leave balance on our corporate system against source documentation. In that respect, it is very similar to our problems with inventory.

**Ms GRIERSON**—What have you done in the last financial year for people exiting the system?

**Mr Moore**—We do a verification process on cessation. The starting point is their leave balance on our corporate system. If they can prove that that leave balance is incorrect, with documentation, we adjust it.

**Ms GRIERSON**—So they can appeal it, but they have to prove it.

**Mr Moore**—Correct.

**Ms GRIERSON**—And you do not keep your leave records. That is a high expectation.

**Mr Moore**—A number of people do, but I certainly have not from the day I started.

**Ms GRIERSON**—Is there no appeal process?

**Mr Moore**—In terms of being able to put in statutory declarations and so on, of course there is. We do not expect them all to have their original leave applications because, until about last year, all this leave going through the system was paper based.

**Ms GRIERSON**—Have personnel ever been given an annual statement on their leave?

**Mr Moore**—The statement is now on PMKEYS. They can go into the system through self-serve, which is being progressively rolled out, and actually see the state of their balances and, at any point in time, query it through their personnel areas.

**Ms GRIERSON**—So they would be very wise to do so, wouldn't they?

**Mr Moore**—On top of that, in response to the Auditor-General's concerns, the three services on the military side have undertaken a very extensive search of records to try to locate as many of those leave records as possible to help verify those leave balances. We know that if we undertook a complete 100 per cent stocktake of all leave applications going back many decades, we simply would not know where they were because they were never put on personnel files. They have been stored all over the place.

**CHAIR**—Do people get paid overtime, either on the Public Service side of it or on the military side of it?

**Mr Moore**—The military do not get paid overtime. They get an allowance called a service allowance. Up to a certain level in the Public Service, you get paid overtime but, beyond that, you do not. The other thing about what we are doing on the leave records is that we have undertaken two sampling exercises, one with our own internal auditors and one with Ernst and Young just to try, through a sampling exercise, to verify the extent to which the balances on our corporate system PMKEYS are materially correct. We have found with the first internal auditors' exercise that for long service leave the error rate is very small. In net terms it is about 0.4 per cent, and that represents about 700 million of the 1.2 billion that could not be verified last year. We have turned those results over to the Audit Office for their review and we are still awaiting a response, but we are very hopeful that for long service leave, at least this year, we might be able to validate that balance.

**Ms GRIERSON**—And have a progressive link—

**Mr Moore**—So, for 2004-05, we are hoping to get long service leave validated or verified. For annual leave, the internal audit work indicates that the error rate is higher than for long service leave—from memory, about 3.4 per cent initially in net terms. Again, we will pass that across to the Audit Office for review, but I am less hopeful of getting annual leave verified for 2004-05. In terms of going forward, and we know we cannot find all these historical leave records, what we will be looking at—and we are still forming an opinion on this—would be to accept, particularly for annual leave, the leave balance on our corporate system as our legal liability. We have to go through a pretty—

**Ms GRIERSON**—As a minimum?

**Mr Moore**—Yes. It is a pretty rigorous process to do that in terms of the secretary's responsibilities under the FMA Act. We also have an industrial relations issue where we would have to give each of our members the opportunity to accept that leave balance or come up with evidence to suggest that it should be—

**CHAIR**—Why can't you find the records?

**Mr Moore**—We simply have not filed them on personal files. They have been batched by date or by the person who did the processing into our various leave systems over the years.

**CHAIR**—Was that outsourced or done internally?

**Mr Moore**—No, it has been done by Defence personnel.

**Ms GRIERSON**—Have you considered a communications strategy for that? I would have thought that morale does not need that sort of problem.

**Mr Moore**—We will, and that is part of the industrial relations exercise we will have to conduct in 2005-06 if these two sampling activities do not verify the balances, particularly for annual leave. We will have to undertake a very good communications exercise with our own people, saying, 'This is our proposal, and you are being given ample opportunity to either accept the balance of leave on our corporate HR system or agree with them that it should be another number.'

**Ms GRIERSON**—Can you identify who is most affected by that? Is there a period in time—years and dates? Are there people who have served longer?

**Mr Moore**—The people who have served longer generally have the most leave accrued. As we roll out self-service in our corporate HR system, we will not have this problem. The leave balance, looking forward, will be within the controls framework within our corporate system. It is the old grey hairs like me who have the biggest problem, if we have not kept our leave records and relied on the department. The senior leadership group went through this process last year—in 2003-04—because it led to problems that the Audit Office had with our executive remuneration note. We went through a self-certification process where most people were happy to sign up to the leave balance. A number of people had kept their records.

**CHAIR**—You were shaking your head, Mr Smith.

**Mr Smith**—I have not kept my leave records. I just admire people who do that sort of thing.

**Ms GRIERSON**—But for troops at the bottom it is more important.

**Mr BROADBENT**—I have not kept my records either, Chair.

**CHAIR**—And you have come and gone more times than—

**Mr BROADBENT**—I keep getting automatic leave!

**CHAIR**—Every three years!

**Ms GRIERSON**—What about valuations? You were hoping to complete all land, buildings and infrastructure valuations by 30 June and all other plant and equipment valuations by 30 June. Has that been done and has the Audit Office seen that?

**Mr Moore**—The work with the Australian Valuation Office is on track in terms of completing their contract to visit all our sites. This is a huge exercise, going right across the Defence estate for land, buildings and infrastructure.

**Ms GRIERSON**—So it is going to happen or it is happening?

**Mr Moore**—It is going to happen for land, buildings and infrastructure. The one cloud on the horizon is our information, communication and technology assets, which are in this category as well.

**Ms GRIERSON**—Are they outsourced or are they internal?

**Mr Moore**—These are all Defence owned assets, ranging from mainframes to routers and servers and also to payloads on satellites. It is all within the scope of this remediation plan. Indications are that we will have to do some more remediation activity around information, communication and technology assets in 2005-06. But we are hopeful of getting the rest of the valuations done in 2004-05.

**Ms GRIERSON**—Mr Moore, it does not sound to me as though you are just acting at the moment; I think that is perhaps an injustice. We have talked very much about stockholding controls, and the other questions I want to ask are about JP2077.

**CHAIR**—Does anybody have any other questions in relation to anything other than JP2077? Miss Kelly, in parliament some weeks ago you had some original questions in relation to ordering systems.

**Miss JACKIE KELLY**—On ordering systems?

**CHAIR**—People raising orders, following through and ascertaining whether or not they had been delivered—in stock.

**Miss JACKIE KELLY**—In terms of contract management?

**CHAIR**—Yes.

**Miss JACKIE KELLY**—I think we will get to that with JP2077.

**CHAIR**—Then we will move to JP2077.

**Miss JACKIE KELLY**—You mentioned before that it was \$150 million and that it was always \$150 million from when it was approved in July 2001.

**Mr Smith**—In the Defence Capability Plan.

**Mr Lewincamp**—That is the current provision in the Defence Capability Plan for JP2077 phase 2B.

**Miss JACKIE KELLY**—So JP2077 was approved in July 2001 for what amount?

**Mr Lewincamp**—Phase 1 was approved in that year for \$38.9 million. Phase 2A has been approved for \$15.9 million. Both of those are closed or close to closure, and now we have phase 2B. The government gave first pass approval for that two weeks ago.

**Miss JACKIE KELLY**—For?

**Mr Lewincamp**—There is no set figure yet; it is the first pass approval. The provision in the Defence Capability Plan is up to \$150 million.

**Miss JACKIE KELLY**—That is on top of the \$38 million and the \$15 million?

**Mr Lewincamp**—That is right.

**Ms GRIERSON**—And \$37.1 million has been spent already?

**Mr Lewincamp**—On phase 1—\$38.9 million was the approval and \$37.1 million was the expenditure.

**Ms GRIERSON**—And with a further \$10 million allocated as part of the first pass approval for design?

**Mr Lewincamp**—Last week it was something like \$13 million. It was a figure of that order for the technical design.

**Brig. McGahey**—\$13.4 for the technical design.

**Mr Lewincamp**—That is for further design and scoping work prior to second pass approval, which we hope to get for part of that project later this year.

**Ms GRIERSON**—I was concerned, and the only notification I have had has been by reading a newspaper article. I really would have thought that because we asked questions earlier on this issue, we might have got a little more information from Defence, perhaps as a courtesy. We were always interested in JP2077. I think the questions on notice that I asked certainly suggested that very little was happening, but it was a matter of only a few days between when I got the answers and when I saw in the paper that JP2077 had been fully scoped by Mincom. The article said that Mincom had been ‘deeply involved ... in scoping the project and writing function definitions’.

**Mr Lewincamp**—At the last hearing we indicated that the work was going on on phase 2B to scope that work. We informed the committee that there were proposals before government for consideration about the future of phase 2B. Whilst that government consideration was in train, we were not in a position to disclose the nature of the advice that we had given to government on

those issues. The public announcement by the government of its decision on first pass approval was made last Friday.

**Ms GRIERSON**—Mr Lewincamp, it was a bit like extracting teeth to get the word Mincom out of anyone at the last hearing. Yet it was clearly known to me, and should have been something that was divulged, that they had been working on this for some time. They were the people originally involved in the SDSS system and the upgrades, and there was obviously a great involvement by them which, I would have thought, would have given them a great advantage in the next system. I want it recorded that I regret that that was not passed forward at the last hearing. I do not think it was commercial-in-confidence that it was Mincom who had been working on some of that information.

**Mr Smith**—It was before government, which had other approaches available, should it have wanted to take them. We were cautious, yes. I do not know whether you have seen the press release. Let us ignore what was in the newspaper; let us go to the minister's press release, which was put out last Friday afternoon. I am happy to make that available, if you have not seen it.

**Mr Lewincamp**—Deputy Chair, if I might just correct something in your statement, Mincom have not been involved in the unapproved part of phase 2B. We have an ongoing partnership with Mincom in terms of supporting our existing system. They have been working with us in developing a solution to the Julian patch issue, but we have not engaged Mincom so far in looking ahead on phase 2B and the options for that.

**Ms GRIERSON**—Have they, as the media report said, being deeply involved in scoping and writing function definitions for this next JP2077?

**Mr Lewincamp**—No, they have not.

**Ms GRIERSON**—So who has?

**Mr Lewincamp**—Our internal people have, plus other consultants that we have contracted for precisely that task.

**Ms GRIERSON**—Do you have a list of who those other consultants are?

**Miss JACKIE KELLY**—Not Pricewaterhouse?

**Mr Lewincamp**—No. It is SMS and KPMG.

**Ms GRIERSON**—The newspaper article said that more than a month ago Mincom were given the preferred supplier status.

**Mr Lewincamp**—That is not correct.

**Ms GRIERSON**—It was a media article, which is what the public and I read. It said that you were waiting for cabinet approval.

**Mr Lewincamp**—That is not correct.

**Ms GRIERSON**—Do you agree with that, Mr Smith?

**Mr Smith**—Yes.

**Ms GRIERSON**—For the two years planning and the expenditure of all those moneys, what do you think we will see at this initial stage?

**Mr Lewincamp**—The purpose of the current scoping work is to define more carefully the deliverables under phase 2B. There will be four such deliverables. One is an upgrade to the core transactional system—the software package from version 4 to Ellipse. The second is an improved financials package, which will meet some of the requirements of the increasing financial standards and have a better interaction with the ROMAN financial system within Defence. The third is an enhanced deployability capability in a situation of insecure communications, which Brigadier McGahey talked about earlier. The fourth is in-transit visibility, so we have visibility of stocks right through the system, from purchase to disposal.

**Ms GRIERSON**—So that is what we will get at the end of \$150 million?

**Mr Lewincamp**—Yes, they are the deliverables for that phase.

**Ms GRIERSON**—So it is a core upgrade to all the different systems?

**Mr Lewincamp**—No, it is a core upgrade to the transactional system—the core software system of SDSS, which is currently version 4 of MIMS. It is an upgrade from that to Ellipse.

**Ms GRIERSON**—How dependent is it on SDSS?

**Mr Lewincamp**—SDSS is a system of systems. It is not just the core software. It is the hardware, the business processes, the data—everything. So do not think of SDSS as a single technical system; it is a broad process. What we are doing is upgrading some of the core transactional systems at the centre of that SDSS.

**Ms GRIERSON**—What I am wanting someone to tell me about concerns what we started with in the first hearings: when a system was not working very well, we were going to get a different new system that was going to be stand alone and was not going to inherit the problems of the previous systems. Would you tell me if that is the case?

**Mr Lewincamp**—Perhaps I can go back a little bit. As I just indicated, SDSS consists of the hardware, the software, the business processes and the policies related to use, the data that is on the system, the training, the audit and the investigation. It consists of all of those functions. The hardware we have been using is to do with Defence systems, such as the Defence restricted network. The software has been version 4, and that has basically been working very well but it is a clunky system, it is not web enabled and it needs to be updated to more modern technology. It also has the Julian date problem.

**Miss JACKIE KELLY**—It is not web enabled or it is web enabled?

**Mr Lewincamp**—It is not. We are trying to replace version 4 with the new Ellipse version which meets a lot of those shortcomings. In addition to that, because of the operational demands that the ADF places upon the system, we are increasing the deployability and the in-transit visibility. In addition, because of the administrative management demands, we are putting in place a new financial package on it to improve its interface with ROMAN and to increase our capacity to meet the demands of audits and other things.

**Ms GRIERSON**—Challenge me if I am wrong, but we are saying we want to move to the Ellipse system, the Mincom system. Was there any choice in the awarding of this system?

**Mr Lewincamp**—There were choices but it is a question of how much we were prepared to spend and the value for money to be obtained. Over the period of the last two to three years we have had three separate consultants' investigations into what is available elsewhere around the world in terms of logistics information systems. All three of them have suggested to us that the best value for money is an upgrade to the MIMS software.

**Ms GRIERSON**—In the first phase, when you put it to cabinet and it approved it, were some clear targets and outcomes that would be achieved, including when they would be achieved, part of the cabinet submission?

**Mr Lewincamp**—They were. They are the four things that I have just mentioned. The reason we now have first and second pass approval is that we will now go back to government with a very carefully defined, scoped and costed proposal for each of those four, and government will have a look at them again before second pass approval.

**Miss JACKIE KELLY**—I think the SDS upgrade in 2000 was poorly written, poorly tendered and ended up in a bit of a cluster. You then went to the Get-Well Program and, to quote your own presentation of this morning, the deliverables were asset-tracking visibility—which we are now going to get out of JP2077—deployable capability—which we are now going to get out of JP2077 again, so we are paying twice for the same thing—decision support, system access and availability.

**Brig. McGahey**—We are talking about the fidelity of the system, and, yes, we do have them. The current asset tracking system, the cargo visibility system, is an old generation of cargo visibility system. It certainly does not meet the demands of modern agile logistics systems in support of operations. In terms of the deployables, we have a deployable system at the moment but it orbits around being connected to a communications node, either by satellite or terrestrial communication. The issue is that what we have a need for is the ability to deploy that system and to be able to lose communication but continue to run the system. Then, when we get a link back to our mainframe system in Australia, we can actually synchronise and continue to use it. That is world standard, and a number of other Western militaries are seeking that very same system—a deployable system that can operate in a communications interrupted environment.

**Miss JACKIE KELLY**—How is that different from when a ship goes to sea with AIMS or your other system on it and then links back in anyway?

**Brig. McGahey**—When the ship goes to sea, the aim of the deployables that we would send with them is to continue to run the system in an isolated mode. As you are aware, ships



communicate when they want to communicate. When they communicate, we are able to upload that data, download the next iteration of data and continually refresh the system while they are at sea. But the advantage of them going onto a full deployable system is that we do not have to work through an interface and do not have additional training issues, like we have at the moment with the current on-board systems, because everyone is then truly on a fully standard system.

**Miss JACKIE KELLY**—So when you let the contract in 2001 the replacement of your ship-board systems was not something you considered?

**Brig. McGahey**—No, it was not in scope at that time. We were operating through an interface but, as I said earlier this morning, it has been an iterative process, so the next iteration will include the replacement of the on-board ship systems.

**Miss JACKIE KELLY**—I am just concerned about your scoping of what you need. It is clear to me that since accrual accounting came in there were some financial outcomes that you could have put in. It is clear in Defence, since whenever, that your stocktaking was always more than five to 10 per cent out, so there were things to go. There are some very clear statements of requirements that you could have written into things so that you already had all these things after you had spent \$50 million on the SDSS upgrade then a further \$38 million and another \$15 million on JP2077. That is not to mention the Get-Well program—how much was that?

**Brig. McGahey**—It was \$11 million.

**Miss JACKIE KELLY**—Wayne is the only person this committee has actually met in the area who uses this system. We are now about to spend \$10 million finding out what Wayne needs to operate before we go and spend another \$150 million. Can you understand why this committee is just a little bit nervous about that, given the track record on just this project?

**Mr Lewincamp**—Perhaps I can go back to some basic points. This logistic information system is an ongoing system that needs continual sustainment and upgrade. We will always operate such a system. A lot of the improvements to the system are done through sustainment funding—the Get-Well program is a good example of that—and then there will be occasions where there will be a requirement of capital injection of some sort to improve or enhance the capability of the system. That is an ongoing process. We spend \$20 million a year sustaining SDSS at the moment, so you can add that to the cost calculus as well. But technology develops, new capabilities—

**CHAIR**—Where do you spend your \$20 million in sustaining it?

**Mr Lewincamp**—In personnel, training, help desks, rewriting codes, increasing functionality, putting new tools on the system. For example, a lot of the tools that we are using within DMO at the moment to measure our performance, in terms of monitoring projects and whatever, are developed and put on that system. There is a constant process of upgrading and developing the system to increase its functionality and, as new capabilities come on hand, we try and install them on the system.

I am not surprised by this level of expenditure. I acknowledge, as the department has done, that the SDSS upgrade did not deliver everything that we wanted it to. I am quite happy with the

outcomes of the Get-Well program. I think that delivered very well against its objectives. We are now managing JP2077 2B in accordance with all of the agreed standards and the findings that the Audit Office made on the upgrade program. I am confident that we will deliver against this.

**Ms GRIERSON**—Who is project management, and who is head of the project for this?

**Mr Lewincamp**—I oversee the division which is responsible. David McGahey works to me and oversees that area and he will have a project manager, working directly to him, responsible for the delivery of the program.

**Ms GRIERSON**—And you said the project manager was KPMG?

**Mr Lewincamp**—No, that is the consultant advising us. One of the issues that came up from the upgrade is that we do not contract out project management.

**Ms GRIERSON**—So you are not going to have a contracted out project manager this time. That will save us a bit.

**Mr Lewincamp**—We will have an employee of the Defence Materiel Organisation as the program manager.

**Ms GRIERSON**—We will not have to have quite as big a group here next time.

**Miss JACKIE KELLY**—One of the ANAO recommendations, recommendation No. 4a) from Audit Report No. 5 was to:

develop specific policy to define, and manage effectively, actual and perceived conflicts of interest arising from the engagement of a Contractor to conduct the scoping phase of a project that provides ...

It sounds like you have again gone outside Defence to people who do not use the system, and who do not talk to the Waynes of this world, to write your scoping requirement. It was KPMG this time.

**Mr Lewincamp**—I do not agree that that is an accurate characterisation of what we have done. We have gone to the private sector to seek specific technical expertise to support our decision-making process. The company that has provided that to us is not engaged in the subsequent phases of the project, so is not in that conflict of interest situation.

**Miss JACKIE KELLY**—How do you know that now?

**Brig. McGahey**—Because there is an air gap between those two.

**Miss JACKIE KELLY**—This is a specific policy. Do you have a policy that you are working towards?

**Mr Lewincamp**—Yes.

**Ms GRIERSON**—But at previous meetings we have stressed the importance of having focus groups, reference groups, at all hierarchies of use that will be involved and consulted. Are you going to manage it in that way?

**Brig. McGahey**—Absolutely. We will have much stronger stakeholder input to ensure that both the stakeholders and the business processes are aligned and that we get the cultural change that we need in terms of the equipment.

**Mr Lewincamp**—We already have that. This is not future tense; it is already in place.

**Ms GRIERSON**—It is obviously something that we will come back to.

**Miss JACKIE KELLY**—KPMG is scoping the project for you. So for our \$10 million, KPMG scopes the project and then there is a project team within Defence—or is it just one project officer?

**Mr Lewincamp**—A project team.

**Miss JACKIE KELLY**—And the project team is made up of?

**Mr Lewincamp**—It is made up of Defence professionals, project managers and—

**Miss JACKIE KELLY**—Such as who? Who would be in that project team—would Peter Purcell be a part?

**Brig. McGahey**—He would certainly oversight that in terms of the governance board activities. He would oversight the activities. Do you mean in terms of individuals?

**Miss JACKIE KELLY**—Individuals who would have experience in everything that had gone wrong in the history to this point, or are we just pulling in people on rotation in the short-term in this job?

**Brig. McGahey**—No, we are not pulling people in on rotation. We have just recruited a project manager external to Defence who has extensive experience in managing the rollout.

**Ms GRIERSON**—Who would that be?

**Brig. McGahey**—His contract is for three years.

**Ms GRIERSON**—Is that an individual or a company?

**Brig. McGahey**—He is an individual but he is a Defence employee now.

**Miss JACKIE KELLY**—So we do not have anyone from Tenix or Toll. We just have someone from the defence department on civilian contract.

**Mr Lewincamp**—He has been employed on contract by the defence organisation with a long history of private sector project management experience. He will be working within the organisation to Brigadier McGahey and they will be working to me. I will chair the project management—

**Miss JACKIE KELLY**—Who is that?

**Mr Lewincamp**—Should we name the person here? His name is Hans Salsmann.

**Miss JACKIE KELLY**—Has he had previous involvement in the other projects we have talked about today?

**Mr Lewincamp**—No, he comes from overseas.

**Ms GRIERSON**—Was that tendered?

**Mr Lewincamp**—No, it is open competition.

**Dr Gumley**—Under the Kinnaird reforms, one of the things we had to do was to improve the quality of project management right through the DMO. So what we are doing is going out to the marketplace to find the best project managers we can to do some of these major projects. We have done it with ships and some of the other projects and now we are doing it with this one because it is of critical importance to the whole department.

**Ms GRIERSON**—Were there expressions of interest or did you just select someone?

**Mr Lewincamp**—Yes, there were. It was an open job selection process and nobody had been involved with the project before. I took the view that clean blood in this was very important.

**Mr Smith**—While we are on Kinnaird, I should say, in response to a point Miss Kelly made earlier, that the relatively large figure of upfront spending, \$13.4 million, is consistent with another recommendation of Kinnaird. That is as in the private sector so in DMO we should spend more at the preliminary stage of a project rather than launch into the full project and scope it as we go along. We should spend more upfront scoping it properly.

**CHAIR**—Knowing what you want.

**Miss JACKIE KELLY**—Accurately defining your deliverables—absolutely firm, all the way.

**Mr Lewincamp**—That is what first pass means.

**Dr Gumley**—That is probably what happened with the version 4 upgrade. It was the thing that went wrong the most. It was not adequately scoped. This is in hindsight, of course.

**Miss JACKIE KELLY**—But it is in every project. If you go back through the history of defence contracts that have gone over time and over budget, you can almost go straight back to the fact that they were not scoped properly.

**Mr Smith**—And that is what the Kinnaird first pass process is about. We now have that. It enables us to get money upfront.

**Miss JACKIE KELLY**—From Defence I am looking for a response to the ANAO in terms of setting up very robust policies. Defence has not even got a policy written about conflicts of interest as to the people you are tendering out to. There is no written policy, as recommended by the ANAO, on that, as I understand it. The ANAO have not ticked and flicked that requirement, yet you are still heading down the track confident that you are going to get the statement of requirement accurate, rather than drawing on the huge amount of corporate knowledge that we have paid for. It is no individual thing; it is a systemic thing that Defence keeps repeating. You have contracted in from outside someone who does not have an Australian defence contracting background. Why didn't you go with some of the majors and head-hunt, within Australian contexts, the people on the other side of contracts whom we have been dealing with, who would have a conceptual knowledge of the Australian defence organisation and would bring that to bear? Was there a price limit on your head-hunting? Did you have to stay within a cap, so that you only got Hans Salsmann?

**Mr Lewincamp**—There is an enormous level of expertise available within the DMO to apply to all aspects of this project, from contracting right through to the project management. We will be applying that expertise. What we have done is employ an individual to be the project manager for this. There was no limit. We had independent advice from the market about comparable rates in the private sector. This individual has been employed on a non senior-executive-service Australian workplace agreement directly with the CEO of the DMO at a mutually agreed level of remuneration.

**Dr Gumley**—The individual is an Australian.

**Miss JACKIE KELLY**—Within the rest of that project we have got one civilian person who has worked with contractors outside of Defence—so there is some experience there—and we have got Peter Purcell, who is remaining chair of your board. How hands on would that be? His is the only name we have mentioned so far of a person who has longevity with this project.

**Mr Lewincamp**—There are different people involved here. Our materiel governance boards are boards that were set up within the Defence Materiel Organisation to give independent advice and assurances to the chief executive officer about the conduct of projects, so they have the capacity to call in project managers and any other individuals to explain the progress in their project. They are able to offer those projects advice and mentoring as well. Peter Purcell chairs the relevant governance board. That is an independent level of assurance that the CEO has about the oversight of a broad range of projects.

**Miss JACKIE KELLY**—I want to go back to the Ellipse system. Clearly it has been used elsewhere by other organisations. So after all of this time with the SDSS, is it only now coming to the point where the recognition is that rather than persevering we should move to the Ellipse system?

**Mr Lewincamp**—We have to move to the Ellipse system now because version 4 has shortcomings in functionality and has the Julian date problem. When we looked at this issue back in 2001, the recommendation made at that time was to go with version 4 because Ellipse

was not yet a tried system. As you said in your question, Ellipse is now in use in some 150 different companies around the world. It is a proven system and so we are quite confident in going to that as an upgrade.

**CHAIR**—So Ellipse is a financial and stock manager.

**Mr Lewincamp**—It is a MIMS software product. No, it is the core transactional system for handling the inventory.

**Miss JACKIE KELLY**—The IP is not Mincom's.

**Ms GRIERSON**—Ellipse is Mincom.

**Brig. McGahey**—The IP of Ellipse is Mincom's. But it is an ERP so it covers supply chain maintenance, human resources and financials.

**Miss JACKIE KELLY**—I am pretty sure that Woolies has been scanning my groceries since the early nineties. Have you never considered that type of scanner? You are only just now introducing your data scanners.

**Brig. McGahey**—They are transaction processors.

**Miss JACKIE KELLY**—Yes. Why leave it till now before that would become a requirement in a contract like this? I am presuming that JP2077 has a requirement for scanners.

**Brig. McGahey**—It will use the same base level of functionality that we have but we will build on it. Really the issue is about rolling out the bar coding and the contact memory buttons across all the inventory and assets so they are able to be scanned in. Then the work that we have done under the data transaction processor will actually migrate straight into Ellipse. We built it with it in the back of our mind that potentially it might have to, so it has that functionality in it.

**Ms GRIERSON**—Have you checked that the financial controls so far are in place to make sure that there is a better outcome?

**Mr Moore**—No, we have not and that is part of the work as phase 2B works its way up to second pass approval by government. The CFO group has to maintain a very close relationship with the project office to ensure that the scope of the work does take account of all our financial information requirements.

**Ms GRIERSON**—So you would have had no involvement so far?

**Mr Moore**—We have been involved in clearing the project through various internal processes and we are satisfied with what went to government of course.

**Ms GRIERSON**—So you did tick off on what went to government?

**Mr Moore**—Yes, we did. But in terms of the functionality to be delivered, as DMO develops the project now that they have got first pass approval from government to go to industry, from

my perspective I need financial information from a whole range of corporate systems including SDSS. So I have an interest in sourcing financial information from everywhere in Defence. For example, I have to be satisfied that Ellipse is AEIFRS compliant because it has to fit the general legislation. Mincom is saying that it is, so we really have to get a greater understanding of that as we go—

**Ms GRIERSON**—Does your section have a representative on the team?

**Mr Lewincamp**—We have a small team that is now looking at the financial package and the CFO group is represented, yes.

**Ms GRIERSON**—Do you know who that person is?

**Mr Moore**—Not off the top of my head.

**Mr Lewincamp**—Lorraine Watt.

**Ms GRIERSON**—I am sure that the National Audit Office would like to be on the team. I think it is really important that there be some financial controls—

**Mr Lewincamp**—There is a finance systems officer on the team. ANAO might like to be but I am not sure that they would want to be—

**Ms GRIERSON**—Do you know who that person is?

**Mr Lewincamp**—Lorraine Watt—we just named her. She is a branch head working in the CFO area.

**Ms GRIERSON**—And has she got experience with all this previous—

**Mr Moore**—Yes. She is one of my branch heads who is responsible for the financial systems—basically the ROMAN system and what we call the BORIS system. She would be my point of contact. I thought it was the person who would be actually embedded in the team. It would probably be one of her officers—

**Ms GRIERSON**—Did you select that person?

**Mr Moore**—No, not personally.

**Ms GRIERSON**—Did you recommend that person?

**Mr Moore**—It happened before my time. I have only been here for a couple months.

**Miss JACKIE KELLY**—Does Lorraine have experience with the history of this project?

**Mr Moore**—No.

**Miss JACKIE KELLY**—This is a very critical issue. We keep making mistakes throughout defence contracting and instead of going back to these people who know what went wrong with that one and using them again we tend to wipe that lot who know everything that went wrong with that project and then move on to a fresh bunch who make a whole lot of fresh mistakes.

**CHAIR**—I think that is more the issue than individual names of the individual people involved in processes.

**Miss JACKIE KELLY**—We do not need to know the names but we need to know that someone knows.

**Mr Lewincamp**—Chair, I cannot allow that to go unremarked. We are not wiping out the experience previous people have had. There is extensive involvement of people with a long history in this project and in the further development of it.

**Miss JACKIE KELLY**—Who are they?

**Mr Lewincamp**—Would you like a list of names?

**Miss JACKIE KELLY**—I would love a list of names.

**CHAIR**—Perhaps you could provide that on notice. Could you provide a submission to this committee outlining what experience you are carrying forward into the new project? Rather than getting into names—I do not think that we need to know individual names—could you outline the people and their positions and the experience carried forward; otherwise, some people are going to turn up in transcripts and feel awfully bad in the morning, unnecessarily.

**Ms GRIERSON**—And the indicators for those stages in this project?

**Mr Lewincamp**—We would be delighted to do so.

**CHAIR**—Members of this committee have asked for a copy of the JP2077 and the project stages and indicators to be provided to the committee.

**Miss JACKIE KELLY**—If you can provide that for the JP2077, which has got to be at a very sensitive stage at the moment, surely you can provide that for the upgrade, the Get Well project, the original SDSS, and we can see some systemic recurring features in this that we are trying to get to the bottom of and provide solutions for so that we just do not keep repeating into the future but we do haul together really good corporate project management teams with a lot of corporate knowledge and stand up to the Tenixes of the world and get value for money.

**CHAIR**—I want to move on to the Defence Materiel Organisation. In a few days there will be established, as a prescribed agency, the DMO. What are the implications of the DMO's establishment as a prescribed agency for the financial management problems of defence? What is your future audit program for the DMO?

**Mr Cochrane**—In the broad context, the DMO will be subject to the same level of financial auditing as every single other organisation in the Commonwealth. We will establish an ongoing



annual audit program for the DMO with the same standards and with the same approach that we use in all our other financial statement auditing.

**CHAIR**—Dr Gumley, how comfortable do you feel about the fact that, in a couple of days time, you start the prescribed agency? Do you feel as though all of the preparation—the paperwork, the figures—has been done for you to start with a base? Or do you have misgivings that things are still not accurate enough for you to prescribe directions to go forward with?

**Dr Gumley**—I am comfortable we will be entering the new life of the DMO as a prescribed agency with the same form of audit qualifications as Defence has. It is obviously not an ideal position to be in; everyone would love to have a clean audit going into a demerger of this type. However, when you look at the benefits of where we are taking the DMO and trying to get our projects done on time and on budget and so on, the benefits far outweigh the wrinkles of having audited initial financial balance sheets and so on.

**CHAIR**—Given that you are required to establish your own books and records and prepare your own financial statements, how will that cut across if the quality of information being provided to you by Defence is not accurate or correct?

**Dr Gumley**—In the first year I am going to have exactly the same difficulties as the secretary has with Defence—that is, if you do not know precisely your opening balance sheet position, it is very hard to get an accurate statement of your financial performance in that first year. I would imagine that whatever level of qualifications Defence gets at 30 June 2006, we will probably have much the same, because we are both starting off at the same point on the balance sheet.

**Ms GRIERSON**—What will the financial management framework be for the DMO?

**Dr Gumley**—It is a mirror of what Defence is doing. We have though, as required, been setting up our own materiel audit committee, which is an independent audit committee chaired by Jennifer Clark. It is an advisory committee that advises me. It will be investigating very carefully all the financial issues around the DMO and giving me advice on how to manage it. We will be acquiring from Defence the services of MAB, which is the internal auditor. At this stage, it is a free-of-charge service to the DMO and we will be using it for issues relating to fraud or anything of that type as well as the main financial statements. The Chief Operating Officer, Mr Lewincamp, is responsible for getting corporate governance in place for the DMO. He has a branch set aside doing that. We are pretty well prepared, but we do have this big wrinkle of no opinion accounts at the starting point.

**Ms GRIERSON**—Mr Moore, does your section interact with the DMO? Or will it be completely separate?

**Mr Moore**—It absolutely has a close working relationship with the CFO of the DMO already, and it will continue to do so in the future.

**Miss JACKIE KELLY**—And you will move into Ellipse as well as the monitoring?

**Dr Gumley**—Yes. The SDSS is right across the whole Defence portfolio.

**Ms GRIERSON**—Dr Gumley, did you have much to do with Mincom’s Ellipse system before you came to the DMO?

**Dr Gumley**—No, I have not had responsibility or experience with Mincom Ellipse.

**Ms GRIERSON**—Not even at an operation level?

**Dr Gumley**—No.

**Ms GRIERSON**—I would particularly like to know what you think the main challenges are for the new prescribed agency in the next 12 months.

**Dr Gumley**—Getting our projects in on time and on budget is clearly the major job. Making sure that the sustainment, which is the whole-of-life maintenance of the fleets, is kept at its current good levels. We have got some very good performance metrics of what we have got to do to achieve our budgets. A big part of that is spending the government’s capital program responsibly and on time, because if we—

**Ms GRIERSON**—It saves a lot of money if it is done on time, doesn’t it?

**Mr Smith**—It is all about schedule.

**Dr Gumley**—It is all about schedule. If we get the schedule right, the cost problem seems to pretty much look after itself. So getting the schedule right is very important. To make that happen, we are lifting the work rate of both ourselves and industry by 30 per cent. That is a big task, and that gets into the whole issue of whether we have enough skills in the country to do the job and so on. We are working on that very hard too. My biggest challenge for DMO going forward is one of capacity, which I think goes strongly to affecting us, rather than efficiency. It does not mean we do not have to be efficient—of course we do—but effectiveness is going to be the thing that we either win or lose on over the 12 months.

**Ms GRIERSON**—Have you had much influence over capacity in terms of recruitment, personnel or deploying people to your sections?

**Dr Gumley**—Most of our capacity is, of course, done by industry; so we are working very closely with industry so they can lift their capacity.

**Ms GRIERSON**—So you have an industry liaison team that works across Defence.

**Dr Gumley**—We have an industry division, with about 100 people in it, who look after the industry relationship matters.

**Mr Smith**—As DMO will be a prescribed agency, I will remain responsible for personnel management under the Public Service Act, but I have devolved most of those powers to Dr Gumley—some of which he exercises in consultation but most of which he has himself and which he has used creatively.

**Miss JACKIE KELLY**—In your dealings with contractors, do you ever identify individuals that you would like to headhunt for Defence?

**Dr Gumley**—Yes.

**Miss JACKIE KELLY**—What is the process for doing that? Can you match those salaries?

**Dr Gumley**—Yes. We have been having Australian workplace agreements at both SES and non-SES level to get good project managers and key staff into the DMO. I actually think one of the more important things we are doing is getting some of the experience in the private sector into DMO so that we better understand the private sector as they understand us. There has been asymmetry going for a long time; many people in the private sector are ex-Defence, but there has not been much of a flow the other way. So we are trying to even up the information analysis.

**Miss JACKIE KELLY**—Are you getting much HR support in terms of being able to match salaries to headhunt in that way? Or is it still problematic?

**Dr Gumley**—We have still got a way to go. At no time with a key job have we found that salary has become the thing that has stopped us getting the person we want.

**Mr Smith**—So far we have always been able to work out a figure that we can afford and that is within reason. We get people who, ideally, might have had 10 to 15 years in Defence and 10 to 15 years in the private sector. The two of those things will come together, and that is a terrific product, from our point of view.

**CHAIR**—Mr Smith, given the findings of Audit Office reports No. 21 and No. 5 regarding the SDSS upgrade, how can Defence assure the committee, and therefore the broader Australian public, that it will be able to support a major operation either in Australia or overseas if required?

**Mr Smith**—I think the answer to that is the evidence of this report that we have provided for major operations, particularly since 1999, in which the operational tempo has been higher than at any time since the Vietnam War; and the effectiveness of our support for those operations has not been in question at any time, including logistics delivery. There were, I understand, some issues about logistics delivery at the time of East Timor. Lessons were learned and they have been implemented. I think the sort of issues that we have talked about today do not go very much to the question of effective support for operations. They go much more, frankly, to the questions of efficiency and the use of money.

**CHAIR**—Given that you have quoted Timor, to satisfy my own quest for information, in stock control you have a deployment to Timor. Do they take computing systems offshore, set up a base camp and then interact either on time cycle or live?

**Air Vice Marshal Spence**—Absolutely. In fact, we have made a particular point, on things like Sumatra Assist and with Iraq and the more recent activities, to ensure that we have both the communications and the information systems in place right up front so that we can manage very closely the support that goes to those areas.

**CHAIR**—Were they available in Iraq and Afghanistan?

**Air Vice Marshal Spence**—We have had those, certainly.

**Mr Smith**—You see the soldiers up there with laptops working these systems.

**Miss JACKIE KELLY**—But they have to have the ComsLink up before they are operational. So this new upgrade is going to let them—

**Mr Smith**—It will make it much more easily deployable.

**Air Vice Marshal Spence**—And I guess I would make the point that our demand satisfaction rate presently is running at around 90 per cent for those operations.

**Miss JACKIE KELLY**—And is the data entry something that you are going to see continually improving, or do you think it is just human error and lack of training?

**Mr Smith**—We are constantly seeking to improve that. The investments are only as good as the skills, abilities and willingness that people have to use them. It is a constant effort to keep the skills up and develop them.

**Miss JACKIE KELLY**—And the price of that training is in the JP2077 price tag?

**Mr Smith**—Is that included in that?

**Brig. McGahey**—Yes—in terms of sustainability.

**Miss JACKIE KELLY**—So you have learned a lot. When a project gets to \$150 million, you seem to put a lot of effort into it, but if it is under \$20 million, it seems to fly under the radar until it is problematic. Is there any move to get some systemic change, DI written up, policy et cetera that runs right throughout defence contracting so that we do not see similar problems to SDSS?

**Dr Gumley**—The Kinnaird reforms were around the major projects initially. Through the Defence Procurement Advisory Board, we will be taking papers in the next six to 12 months about how we are going to handle the minor projects better. The minors are those around the \$10 million mark. I actually agree that we need to tighten up a bit on those and we will be developing some better processes on that going forward.

**Ms GRIERSON**—I will probably get this from the information that is going to come to us, but I am just curious as to whether the minister's office has a representative on the project management board.

**Dr Gumley**—No, he doesn't.

**Ms GRIERSON**—No liaison person?

**Mr Smith**—His office does not, but he has someone in his office who monitors this project and who, apart from formal submissions which would go to the minister, would stay in touch with Mr Lewincamp and Brigadier McGahey.

**Ms GRIERSON**—Does the Defence Capability Branch have any involvement in projects like this?

**Mr Smith**—The Defence Capability Group actually develops the submission that goes to cabinet. We treat this, as I said before, as a capability like tanks or aircraft.

**Ms GRIERSON**—Do they stay involved in it or do they just do that initial part?

**Mr Lewincamp**—They certainly stay involved.

**Ms GRIERSON**—Formally?

**Mr Lewincamp**—Yes. The proposal for second pass approval will be written by them. We will be providing advice to them and they will need to be satisfied with the proposal before it goes forward.

**Miss JACKIE KELLY**—Do the guys at the coalface have a significant input?

**Mr Smith**—Yes.

**Miss JACKIE KELLY**—You have?

**Mr Smith**—I would not say that everyone who uses it will have input. I do not know how you could conduct such a process.

**Miss JACKIE KELLY**—But the people who have the most gripes about it are.

**Mr Smith**—Yes, they are engaged.

**CHAIR**—Is it the wish of the committee that the report ‘The Overview from a Standard Defence Supply System’ by Brigadier General David McGahey, Director, General Materiel Information Systems Branch be accepted as a submission to this committee? There being no objection, it is so ordered.

I express my appreciation to all those that have given up their time today to come and give evidence to the committee. From what I have gleaned, we have learned a hell of a lot in areas that perhaps we thought we knew a lot about. It has been very constructive. The committee is just about at the process at the moment where it will review all of the information that has been provided to it and determine its future direction—whether we seek any more information at this point in time at this level of committee hearing or actually finalise this hearing and then go to a broader public hearing. That will be a determination of the committee and we will be meeting in a matter of weeks to discuss that.

**Mr Cochrane**—Could I just add that the Audit Office is doing as much as possible to get a pass mark. I do not know about being champion in the ultimate, but we would be happy with a pass mark.

**CHAIR**—We will see how we go on that. Again, our appreciation to everyone and we wish you well with the future implementation of various aspects of the upgrades.

Resolved (on motion by **Miss Jackie Kelly**):

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

**Committee adjourned at 3.24 pm**