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JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

Reference: Review of Auditor-General's reports Nos 43 (2004-05) to 6 (2005-06)

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

Thursday, 9 February 2006

Members: Mr Anthony Smith (*Chair*), Ms Grierson (*Deputy Chair*), Senators Hogg, Humphries, Moore, Murray, Nash and Watson and Mrs Bronwyn Bishop, Mr Broadbent, Dr Emerson, Miss Jackie Kelly, Ms King, Mr Laming, Mr Tanner and Mr Ticehurst

Members in attendance: Senators Hogg and Watson, Mrs Bronwyn Bishop, Dr Emerson, Miss Jackie Kelly, Ms Grierson, Mr Anthony Smith, Mr Tanner and Mr Ticehurst

Terms of reference for the inquiry:

To inquire into and report on:

Review of Auditor-General's reports Nos 43 (2004-05) to 6 (2005-06)

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Committee met at 11.35 am

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

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

McKINNIE, Ms Shireane, Head, Electronic and Weapon Systems Division, Defence Materiel Organisation, Department of Defence

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SMITH, Ms Danielle, Performance Analyst, Performance Audit Services Group, Australian National Audit Office

CHAIR (Mr Anthony Smith)—I declare open today's public hearing, which examines two reports tabled by the Auditor-General in financial years 2004-05 and 2005-06. Today we will be taking evidence on Audit report No. 45 2004-05: *Management of selected defence system program offices* and Audit report No. 3 2005-06: *Management of the M113 armoured personnel carrier upgrade project*. I welcome to the hearing representatives from the Audit Office, the Department of Defence and the Defence Materiel Organisation.

I ask participants to remember that only members of the committee can put questions to witnesses if this hearing is to constitute formal proceedings of the parliament and therefore attract parliamentary privilege. If other participants wish to raise issues for discussion, I would ask them to direct comments to the committee. It will not be possible for participants to respond

directly to each other. Secondly, given the short time available today, statements and comments by witnesses should be relevant and succinct. I remind witnesses that the hearings today are legal proceedings of the parliament and warrant the same respect as proceeding of the houses themselves. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of parliament. The evidence today will be recorded by Hansard and will attract parliamentary privilege. I invite you to make a brief opening statement, and then we will proceed to questions.

Dr Gumley—I would like to acknowledge the efforts of ANAO in producing comprehensive reports on the four SPOs and the M113 project. Many of the comments in the report do relate to history. Many of these projects in difficult areas came from the nineties, and of course a lot of improvements have been made since. I think that, in the distinctions which the Audit Office has brought out—and I am treating the SPOs as a group rather than one by one—the common theme is that there is improvement on the way.

I comment from DMO's perspective that the four divisions—a SPO was picked from each of the four divisions—were at a different stage of their maturity in the improvement program when the audits were done. For example, we saw from air division that they were pretty mature and sophisticated and going well, and some of the other divisions are still catching up with some of the change program. In our view, we need to anchor the SPOs at a point of time and just recognise that we are on a path to improvement right throughout.

CHAIR—As there are no further opening statements, I will open it to questions.

Ms GRIERSON—Dr Gumley, I guess you are in a position to be optimistic. We are not in that position. I think the Audit Office has done an excellent job of finding the problems. We hope you are finding the solutions, but we certainly need to know just how that is being put in place. The failure of project management and contract management does seem to be a general characteristic. I know that there are staff problems, in that project managers around Australia at the moment are very busy with the resource boom, but what is the reality for you in your SPOs having people with expertise?

Dr Gumley—We could handle the problems by putting out a series of bushfires one by one, but instead of that DMO is taking a more systematic approach to it. About 18 months ago, for example, we had 10 qualified project management people in the organisation. We have gone on a very big reskilling upgrade and now we have over 400 doing the courses in project management. About 270 have already got their interim certificates in project management. That gets a large body of people in DMO up to the basic level to be able to do level 4 projects, which are the smaller ones. We are now working with the Australian Institute of Project Management to lift the standards and the training standards, not just for our project managers but for project managers in the private sector as well.

The industry supply companies have just as many issues as we do with project management skill and resource. It has been pleasing that a number of the companies are following the Defence lead in this. For example, BAE Systems have got over 100 of their people engaged in project management and scheduling-improvement courses. Companies like Raytheon and Tenix and so on are also putting more and more people through the formal disciplines. So we could have kept going on for another five or 10 years just putting out spot bushfires but instead we are

taking a systematic training approach to it. The people are just not out in the community to go and hire. We are training them instead.

Ms GRIERSON—I have been looking at some individual projects. The FFG upgrade is one that I think is of great concern. When we have a report that says the ANAO has found that the SPO paid \$5 million to \$11.7 million on unsigned invoices from the contractor then we are seriously alarmed at process and practice in that SPO. Can you shed some light on that for us?

Rear Adm. Ruting—Certainly. The activities that were identified by the ANAO demonstrated that, in the early days of that project, there was not sufficient rigour in a lot of processes that were being followed. Documentation subsequently could not be readily found that linked a lot of these activities together. But, as the ANAO went through their review, they found in fact that new processes that had been put into place progressively over the 2003-04 period had in fact identified exactly these issues and had put in place good process that would, for the future, do the very best to ensure that such poor practices would not continue into the future. In fact, at paragraph 7.64 of the report, they recognised that ‘the improved practices and procedures adopted by the FFGSPO to record and assess the basis of payments to the contractor’ since 2003 are ‘generally satisfactory’.

Ms GRIERSON—Dr Gumley says we are talking history, but it is not ancient history. Good financial management has been around for a long, long time and you are basically managing the Australian people’s money. I find it very hard to understand why contract payments would be made without any link to contract milestones or to delivery of a certain stage of a project. How has that happened?

Rear Adm. Ruting—In fact I would contend that many of those payments were linked to relevant activities. The difficulty was in demonstrating the documentation or certification that they were linked to. With the earned value management system, there is a very good set of linkages back to the identified stages, activities of work or milestones. One of the things we have learnt with the FFG contract, put into place quite rapidly in the middle of 1999, is the challenges of working to a very high percentage of earned value management payments as distinct from milestones. So that FFG contract, which was put into place in 1999, did not have a lot of milestones in a lot of the earlier activity. A lot more milestones existed when the contractor started into physical work on board the ships, installing equipment and then delivering software upgrades et cetera. It was a difficulty in the early phases of that contract. There was a lot more design work going on at that point in time and there were not as well defined milestones. We have changed that DMO process now to require a much greater number of milestones to be incorporated into our new contracts.

Ms GRIERSON—If I accept what you say then I would expect the project to be running really well at the moment, and I do not understand that to be true.

Rear Adm. Ruting—I think one has to differentiate between the Commonwealth management of the activities, our recording of documentation, our linking of payments clearly to activities, to value achieved and to milestones achieved, and the contractor’s performance against the contract.

Ms GRIERSON—So what is the interaction? I would have thought a close relationship and interaction would be essential to getting the best outcomes between Defence and the contractor.

Rear Adm. Ruting—There is a very close working relationship and there are very frequent program review meetings, between the FFGSPO director, who is the project manager for the upgrade, and his equivalent in the prime contractor. They meet weekly. They have formal meetings; there are formal program reviews. So there is a very good, active arrangement there. But actual delivery of the capability does depend on the contractor's ability to do the engineering, to do the trials, to be able to demonstrate the outcomes; so we do need to separate—

Ms GRIERSON—How much of the contractor's ability to do that has been affected by the fact that you share the same dock that they would be doing work in? Is that right—that Navy requires that dock to be available to them a certain number of days a year et cetera?

Rear Adm. Ruting—The availability of the dock has not impacted on the conduct of the FFG upgrade program.

Mrs BRONWYN BISHOP—I might continue in that vein for a moment; then I want to ask about the process that we go through for letting a new contract for work. In the Auditor-General's report he points out with respect to earned value payments:

... only two per cent of milestone payments have occurred since mid-2003 when the ANAO found that payment processes were based on signed invoices; signed and completed Defence Claims for Local or Overseas Payment forms; internal FFGSPO developed sign-off sheets ...

But, with all that in place, only two milestones have been reached.

Rear Adm. Ruting—The achievement of milestones depends entirely on the contractor's performance.

Mrs BRONWYN BISHOP—That brings me to the question of contracts. Who negotiates the contracts on behalf of the Commonwealth?

Dr Gumley—DMO does.

Mrs BRONWYN BISHOP—What is the level of expertise? Do you use outside lawyers or do you use in-house lawyers?

Dr Gumley—We have a mix of both. We reconstituted a general counsel division in DMO about 15 months ago. We could argue, and I have found, that we probably outsource too much legal work, so some of the corporate memory and learning was being lost because too much work was being outsourced. We now have a general counsel division which is made up of about 12 or 15 lawyers in-house. Increasingly, they are going to be the quality control over the contract formation process.

Mrs BRONWYN BISHOP—Who are the outsourced lawyers you have been using?

Dr Gumley—Those on the legal panel.

Mrs BRONWYN BISHOP—And they are?

Dr Gumley—I do not have all the names, but you have Clayton Utz—

Mrs BRONWYN BISHOP—Could you take on notice and let us know who was used to negotiate the contract for each of the FFGs. We will compare that for efficiency purposes—this is going back in your corporate memory—with the Hawk contract. That was a good contract—good performance, good outcomes. Then I would like to know how many variations to the contract have occurred in the life of the FFG contract, who initiated the changes to the contract and what process was used to agree to the changes to the contract. The reason I ask that goes back to the time that I was minister, when that figure of 80 per cent of money being paid for 20 per cent of the work being done came up time and again—and it is still coming up.

It seems to me that that has to go back to a legal problem. I asked Audit, when we were having our briefing from them earlier, whether or not it would be sensible to have within the management team a lawyer who was attached to a task force for that contract through the life of the contract—that is, a constant person who would be an in-house person. I did get an answer that perhaps what was needed was a good commercial manager. The problem with that is that there was no agreed definition of what is a good commercial manager; you are one because you say you are. A lawyer who is attached, or who at least has a piece of paper that says, ‘I’m qualified to do this,’ might stop some of the perhaps unnecessary changes that might occur from time to time. I know that we always want the best and we are always moving forward. I know all those answers. In the Auditor-General reports on the FFG contract, \$76 million of taxpayers’ money cannot be accounted for. I cannot be sanguine about that.

CHAIR—Perhaps you might refer the Defence witnesses to the page.

Mrs BRONWYN BISHOP—We are looking at page 87. It reads:

7.66 The ANAO analysis of the basis of milestone payments pre mid-2003 reveal:

- on 15 occasions invoices do not exist or cannot be found in respect of reported payments; and
- Defence Claims for Local or Overseas Payment forms not signed by any or both the approver and certifying officers on 34 occasions involving claims for \$15 million.

I asked the Audit Office what the cumulative amount was for which no proper records can be pieced together, despite what they have done in piecing together an audit trail. The answer given to me was \$76.9 million.

Mr Cronin—Mrs Bishop, that relates to just one value. There are two separate parts. Paragraph 7.63 outlines the payment regime in terms of earned value. Paragraphs 7.65 and 7.66 relate to the other aspect of payments, which relates to milestone payments. So there are actually two different arms.

Mrs BRONWYN BISHOP—There are two different arms but a lot of money.

Mr Cronin—A significant amount of money.

Mrs BRONWYN BISHOP—How can we in all honesty justify that?

Rear Adm. Ruting—As the ANAO has identified, there in fact were a number of practices being employed in the system program office in the early days of that contract that relied heavily on computer based information for a range of the payments rather than on having a formal sign-off sheet for each of these activities. As I have identified, the SPO director recognised a number of these deficiencies in 2003 and started a whole range of much improved processes over that period of time from 2003 onwards.

Mrs BRONWYN BISHOP—Who was in charge while all of that was happening?

Rear Adm. Ruting—The previous system program office director ran the activities in 2000 and 2001.

Mrs BRONWYN BISHOP—Without identifying who the person was, did the person who was responsible for the failure identified in the Auditor-General's report leave the Defence Force, get promoted or get demoted?

Rear Adm. Ruting—In fact the finance manager who was involved in this earlier phase of activities left the Australian Public Service.

Mrs BRONWYN BISHOP—We have more than one person who is involved in project management, don't we? What happened to the whole bunch of them?

Rear Adm. Ruting—I do not know where all—

Mrs BRONWYN BISHOP—We found out about the public servant. What about the rest of the team?

CHAIR—Do you have to take that on notice?

Rear Adm. Ruting—The initial SPO director was, subsequent to that particular employment—that is, several years later—promoted in the Navy and has been running another part of DMO business. But the finance manager is a very important person with respect to the compliance with all of these detailed procedures and the keeping of all of the records.

Mrs BRONWYN BISHOP—You cannot shift all the blame onto the poor old finance manager who got the flick while the other one got promoted.

Rear Adm. Ruting—That was some time after.

Mrs BRONWYN BISHOP—Did we have a problem with that?

Rear Adm. Ruting—I think it is always one of those areas where you need to look at where the detailed activities are, who was overseeing it and who has access to all of the information. I believe that the SPO director at the time believed that a whole range of procedures quite a few levels down in his system program office were working and that there was documentation

available. I think the difficulty is when you come in a number of years later and attempt to define and restore that information when the people involved in doing it were no longer present.

Mrs BRONWYN BISHOP—I would like to accept that but I cannot. You cannot tell me that someone who is a director and who loses \$76 million can be promoted and be trusted to run something else and you can blame it all on some poor bloke who got the flick. You cannot do that. Dr Gumley, there used to be a process called the pink book, which flagged in advance what sort of defence industry acquisitions were going to be around. Firms would look at the pink book and pick what they were going to pitch for. Tendering is a very expensive business. What mechanism do we use now? What is your integration point, now that you are hiving off, for being told what the forward requirements for the ADF are going to be? How do you then notify that to industry generally? How do you then make the decision about which things are going to tender, which are going to the preferred list and which are going to be sole sourced?

Dr Gumley—The defence capability plan is issued by government from time to time. That gives the detail of the projects that are coming up; a range of the dollars that it is going to cost to do the project—we deliberately do not give a precise number because that gives too much guidance to tenderers as to what we will accept for a price, so we give a range; an approximate time when we will go out to solicitation; and an approximate in-service date for when we would expect to see the equipment in service. Of course, the date we actually go out depends on the new processes following the Kinnaird review, where you go through the National Security Committee of cabinet twice. Once is for first-pass approval. Then we spend money between first- and second-pass approval de-risking the project. Then we go for second-pass approval for the project itself to continue. We conduct tender activities sometimes before first pass, sometimes before second pass and sometimes afterwards, depending upon the nature of the work. For instance, if there is to be a study done to take risk out of a project then you would tender the studies between first and second pass. The main expenditure on the project, though, only starts once second-pass approval has been agreed by government. The gap between first- and second-pass approval is typically somewhere between six and 24 months. Industry gets a fairly good understanding of what is coming down the pipeline, and they marshal their resources accordingly.

Mrs BRONWYN BISHOP—How do they get that? Is there the equivalent of a pink book anymore?

Dr Gumley—That is effectively the defence capability plan. They get to see what is coming in that—that is, the unclassified version. Industry does not get access to the classified version.

Mrs BRONWYN BISHOP—What about small business? There is a lot of small business involved in the defence industry, which is a particular concern of mine—hence the sixth of the Bishop six points.

Dr Gumley—The SMEs are very important to us because they are still our primary source of innovation in the industry. We network with them extensively. For example, in the last year we have taken up going around each of the main regional centres in turn and having sessions and functions with the SME community where we can explain what Defence's forward procurement plans look like. There is an industry division within DMO whose job it is to network with the SME community. On the whole we are not finding any complaints from the SMEs about not

knowing what is going on. Obviously they would all like a little bit more work than they have got, but we do not find complaints about them not knowing.

Mrs BRONWYN BISHOP—What about the R&D side for Australian small firms, where they might have, as they usually do, an excellent idea and sometimes you might send it off to the DSTO and say, ‘We will work with you in a partnership’? Are we still doing partnerships?

Dr Gumley—Yes, and we have the capability and technology demonstrators as well, where the government funds—I do not have exact figure, but it is quite a lot of money—people who come up with a good idea. If we think it has a business case and it is feasible, we will either wholly or partially fund the development of that idea.

Mrs BRONWYN BISHOP—Project Bushranger has turned out to be a very good acquisition—it has been very useful—despite the history of that particular project. When the first specifications went out, it was not required to be able to withstand any landmine intensity. It certainly did not have a specification to have an automatic gearbox. After the project had come quite a long way and you had three contenders with quite a lot of money spent by the firms, suddenly we changed our mind and said that it had to withstand a landmine and we also insisted on an automatic gearbox. Is that sort of thing still happening or are we better at projecting the real need?

Mr Sharp—I think that we are better, but only time will tell. We have the processes in place. I am confident with the first and second pass process. For example, LAND 121, the vehicle process, is quite robust. The three RFTs that are going out are going to have costed data. They will have RFT quality data and will almost be at source selection by the time it gets to second pass. We have resisted strongly and have worked hard with Capability Development Group and Army to pin down those requirements. This is quite difficult for both the agent—CCDG—and Army, because operational tempo has ramped up and requirements are changing with experience overseas. Nevertheless, from our experience, we have to draw the line somewhere. I am quite confident that LAND 121, as an example of the new process, will work.

Bushranger, yes, you are right, did have changes in requirement. It is going quite well now since that has been pinned down. The monocoque hull—the V shape—was a natural design feature for mine blast protection. It is certainly the best vehicle we will have in our inventory for mine blast protection. With certain requirements, ADI are doing well with that.

Dr Gumley—It would be nice to pin down capability precisely, but, given that many of these projects are five and 10 years or even longer, operational experience means sometimes you have to change course midway. Blast protection is obviously a far bigger deal now than it might have been before the Iraq and Afghanistan experiences.

Mrs BRONWYN BISHOP—Yes, but that change was made in about 1997.

Dr Gumley—True, but there are examples. On LAND 121, the tender that is out at the moment, we have had to upgrade the blast protection specifications based on experience.

Mrs BRONWYN BISHOP—Okay. Thank you.

Senator HOGG—I have a couple of brief questions that go back to the points being made by Mrs Bishop in respect of the management of the SPO. In respect of the personnel responsible in that SPO where that \$76 million was not accounted for, how many of the people in that SPO would have received a performance payment for the work done during that period of time? The one thing that always amazes me is that people seem to make stuff-ups and they seem to get performance payments. Are you able to tell me?

Dr Gumley—I do not have that information.

Senator HOGG—Will you take that on notice and get back to the committee on it, please? I want to know if anyone did receive performance payments, whether it be the leader of the project and/or other people, and if that happens in any of the other areas where there have been failures within DMO as well. What are performance payments based on? I do not want to know the names of the people and I do not want to know the amounts. Some people seem to get rewarded for being incompetent. The second thing I want to find out goes to, again, the process issue. The process issue was described, I believe, by you, Rear Admiral, as being a poor process that might have existed. A poor process also means that there was probably a very poor audit process in place because, in my view, if there was a competent audit process in place it would have picked up the normal process issues. I am asking: what has changed in the internal audit processes that will identify where processes within either that particular SPO or others will be picked up if there are deficiencies?

Rear Adm. Ruting—I am certainly happy to go through a fair degree of what we have done. Cognisant of some of the deficiencies that we found and uncertainties in the early phase, combined with the good work done by the Audit Office in this area, I put in place a very thorough set of financial management improvement program activities in the Maritime Systems Division to cover the whole of the division. That included in the case of the FFG system program office bringing in external accountants to assist in not only looking at the practices that we were using but also looking more thoroughly at our compliance with best accounting practices under the Australian international financial regulations. That team has been helping me over most of the last 12 months in the FFG system program office. Not only have they helped in going through a very comprehensive due diligence practice review of all of the payment regimes but they have put in place now and developed quite comprehensive draft instruction procedures that are being worked in the system program office at the present moment.

I think the SPO director has to go back to Sydney this Friday for the next review of those practices to look at those detailed instruction guidelines so that we will have learnt the lessons in FFG and we can then roll that program out across all of our other maritime system division areas. The head of aerospace division's team are also looking at these practices documents as well so that once we have refined them in the application and in the FFG project and system program office we can then look at the benefits of those practices across other areas in DMO.

Senator HOGG—That is the establishment of good practice. My question goes to the actual audit of the process. It is the audit of the process, in my view, which is particularly important because if there is not a rigorous external audit being done of the process then people will say there are a stack of practices that exist in a book, they probably hold a door open somewhere and that is as far as they go. I am interested in someone digging deep into your processes to ensure that the processes are being delivered in terms of the deficiencies identified by the ANAO. I am

not looking to the ANAO, because they cannot be on your doorstep all the time. I am looking to your committee.

Rear Adm. Ruting—I have put in place a whole range of activities here to do this. An underpinning of this is having a good quality management system in place that is not just, as you suggested, having a doorstep thickness book but having all of the people following those practices consistently. We have external ISO9000 accreditors come in and review all of the processes of the system program office, not just the financial ones.

Senator HOGG—How often does that happen?

Rear Adm. Ruting—Every six months. They come in and review all the practices. As I said, this is an important part of both the financial and technical performance and the consistency of practices.

Senator HOGG—How often do they identify deficiencies?

Rear Adm. Ruting—Every six months they do this thorough review. Overall, there has been maintenance of the accreditation. Some small items have been identified as areas for improvement in those reviews. But the system program office has maintained its ISO 9000 accreditation. It has also received a full authorised engineering organisation accreditation on the technical management over that period of time. Independent of those, I have also brought in WalterTurnbull to do detailed financial audits and reviews of our practices and also of the actual data of tracking each individual data element through those processes.

Senator HOGG—Whom do they report to in Defence?

Rear Adm. Ruting—They report to me.

Senator HOGG—Is there any central audit committee that they report to?

Rear Adm. Ruting—Not these two internal ones. The CEO reviewed the results of my financial due diligence work for the 2004-05 year. In that, he had his own team from the chief finance officer's division go and have a look at the work that my team had done and the work that these independent people from WalterTurnbull had done, and they independently provided assurance to the CEO on the 2004-05 accounts.

Dr Gumley—As a prescribed agency, I have the responsibility to sign off the accounts each year, and I am getting independent assurances. Each of the four big domain division heads have to give the assurances to me, and I personally go through an interview process with them about how good their data is.

Senator HOGG—I had better stop there; we are running out of time.

Mr Lewincamp—We have put in place revised governance arrangements within the DMO partly as a consequence of being a prescribed agency. So we now have an established Materiel Audit Committee. It has been in operation since July last year. We have material assurance boards, which oversee each of the divisions that you see here in terms of providing independent

assurance to DMO management about the performance of both the projects and the sustainment area. We have developed our own enterprise risk management plan, which was finalised in October last year. Our Materiel Audit Committee is now using that as a basis for putting in place a revised audit strategy. Up until now, we have relied on the audit branch of the Inspector-General of Defence to provide internal audit services to us. They will now do that on a defined basis with a certain number of hours, and we will direct more carefully their audit activity against the key risks that we in the DMO identify. In addition to that, we are setting up an internal auditor separately who can work directly to the Materiel Audit Committee and to the chief executive officer. On top of that, of course, we have the external auditors from the National Audit Office who investigate these issues.

Senator HOGG—Could you give us a thumbnail sketch, a blueprint, of this so we have some idea.

Mr Lewincamp—I can certainly do that.

Miss JACKIE KELLY—Following up on the Materiel Audit Committee that you have just described as being in place since July last year, how many people are involved? You talked about the number of hours. Is it a part-time job?

Mr Lewincamp—The audit committee is chaired by an independent person and has two independent external members. They are all very experienced people in the private sector. It also has two internal defence members, and the General Counsel for the DMO, Gillian Marks, is a member of the committee.

Miss JACKIE KELLY—Does she have legal training? She is a lawyer?

Mr Lewincamp—Yes. The two principal advisers for that committee are me, as the Chief Operating Officer, and Dr Ian Williams, as the Chief Financial Officer for the DMO.

Miss JACKIE KELLY—On page 36 of the Audit report, it says:

From July 2001 to April 2004, some 11,301 DMO personnel participated in procurement training, while 366 more have been sponsored by the DMO to undertake non-tertiary project management courses.

Is there a doubling-up there in the amount of training people are getting? Are they different courses for people?

Dr Gumley—I am not aware of the origin of those two numbers. I will have to come back to you.

Miss JACKIE KELLY—Audit Office? Warren?

CHAIR—Perhaps the Audit Office could help out in dissecting their own report.

Miss JACKIE KELLY—You are obviously giving a lot of training to people. Those could be the same persons being retrained and retrained—I think that is the most likely scenario. There are only 6,500 people in DMO?

Mr McNally—I believe that would be individual courses, so one person would most probably do more than one course. I guess that is where those figures have come from.

Miss JACKIE KELLY—Or is it a churn of personnel? You have 6,500 people in DMO—about 1,600 are ADF and about 4,800 are civilian. In that period, what was the churn rate? Also, you are currently running at 1,700 vacancies, so there are actually a lot fewer people than that. So either they are getting a lot of training or you have a high churn rate. Can I get some clarification on that. On your staff: of the 46 SPOs managing 250 projects, how big is each SPO on average? That will obviously depend on the size of the project, but what is the average make-up of a SPO?

Dr Gumley—That varies by division. Some of the SPOs are a lot larger than the others. Perhaps I could just ask the division heads to comment on that.

Air Vice Marshal Rossiter—The typical size we have in Aerospace would vary from about 100, potentially up to just over 200. In the SPO organisation with 200, you are talking about multiple weapons systems, so they would be managing three, four or five weapons systems. In a single weapons systems SPO undergoing a major upgrade program, you would be down around the 100 or low hundred mark, so it does vary with the volume of responsibility that they have and how much project activity is going on in that organisation at that point in time. The sustainment side of the business is pretty steady state. The thing that varies with the size is how much project activity is going through that organisation at that point in time. It goes up and down.

Miss JACKIE KELLY—So, for the FFG—it would have been a large project with a number of weapons systems—you would have had about 200 in the FFG SPO?

Rear Adm. Ruting—The FFG SPO has about 85 people in it, and that is relatively typical of most of the bigger Maritime Systems Division system program offices—although some of mine have as few as five, for looking after the Pacific patrol boats. The Armidale class-Fremantle class patrol boat system program office with two weapons systems and one major project running in that area has about 30 people.

Miss JACKIE KELLY—Going back to the FFG SPO, how many of those 85 would have been defence personnel and how many civilians, over the period we are talking about—July 2001 to April 2004?

Rear Adm. Ruting—The figures here, which are actually out of paragraph 6.4 of Audit report No. 45, indicate that, at that time, there were 64 civilian personnel and 27 service personnel.

Miss JACKIE KELLY—What were the ranks of the 27 service personnel?

Rear Adm. Ruting—They varied from the commander rank, of which there are quite a number, down through lieutenant commander to senior sailors.

CHAIR—Could you provide that more easily on notice with some more specific information?

Rear Adm. Ruting—We can give you a break-up of the rank distribution.

Miss JACKIE KELLY—What rank would your engineer on the SPO be and what sort of service experience would they have?

Rear Adm. Ruting—The engineer is in fact an executive level 2 APS officer. He has a commander who is looking after the combat system, for example.

Miss JACKIE KELLY—Does he have a background in the private sector or Defence?

Rear Adm. Ruting—They both have backgrounds in Defence.

Miss JACKIE KELLY—How many people in the SPO would have had come from a contractor's background? There is a provision, obviously, to buy-in personnel but you only had about 300 professional service providers in your whole organisation. How many in your own team would have experience from the civilian side of the contracts?

Rear Adm. Ruting—As in worked in industry?

Miss JACKIE KELLY—In the FFG project in SPO.

Rear Adm. Ruting—I would not have access to all of that information for all the people who have worked in the FFG system program office since 1999—how many of them may have had previous experience outside the Department of Defence compared to those who only had experience inside the Department of Defence. But the FFG SPO is one where we have a number of professional service providers who have been assisting us to bring in specific experience, particularly in some of the more complex areas of combat systems and software. We brought those in from industry specifically to assist the system program office director.

Miss JACKIE KELLY—How many do you have?

Rear Adm. Ruting—I think we have 11 professional service providers at the moment. It has varied up and down in numbers over the period of time.

Miss JACKIE KELLY—How long do they stay with the project?

Rear Adm. Ruting—Quite a number of those have actually been with the project since the start of that particular upgrade project.

Miss JACKIE KELLY—Did any of them leave disgruntled?

Rear Adm. Ruting—Not that I am aware of.

Miss JACKIE KELLY—So are these people looking forward to future contracts with Defence?

Rear Adm. Ruting—The CEO has a program to progressively reduced our reliance on professional service providers by, as he mentioned at the start, looking at professionalising and improving our own staff and bringing new people into DMO, both at the graduate level and at the more senior levels, pulled horizontally in from industry. It is our intention to rely, as we can,

less on external experience where appropriate. But a range of areas, some of the more detailed software development areas, are such that there is a very high demand for people with those skills outside, so we use a combination of training our own people and bringing in some expertise externally.

Miss JACKIE KELLY—So if you train up the defence personnel or our own civilians to get this type of experience, we would still stay with the same career structure and posting cycles?

Rear Adm. Ruting—That varies depending on the particular individuals. With some of them, particularly the graduates, we in fact arrange for them to go out and have six-month rotation into industry. We have been running that graduate program for some five years now under that concept. Some of our uniformed personnel may well have had experience in industry as, say, a part of a Navy sponsored program. Some of those people have spent some time in the reserves and so have worked in outside industry and then come back inside, into Navy, into full- or part-time service.

Miss JACKIE KELLY—I would be very interested in getting further information on the 85 personnel involved on the FFG project, given that the average military posting to DMO is 2.17 years. What was their average posting as they managed that project? What were their ranks, levels, degree of experience and background and what were the differences in background in civilian experience, military experience and public service?

CHAIR—You can take that on notice.

Ms GRIERSON—Have all SPOs reached ISO accreditation?

Mr Sharp—Not yet.

Ms GRIERSON—Which ones have and which ones have not?

Air Vice Marshal Rossiter—All of the ones in Aerospace Systems Division have had ISO9000 certification for some years, but we started that process over a decade ago. It takes quite a bit of time to get there.

Ms GRIERSON—So, Dr Gumley, are you satisfied with your SPOs' progress to achieving that?

Dr Gumley—Yes, it is a steady progress. It normally takes three, four or five years to get to ISO9001; that was certainly my experience when I was doing it with my companies in the private sector. Different divisions started it in a different order. Air Division started first.

Ms GRIERSON—Can you give me a time line for each one? Are you setting targets for them all?

Dr Gumley—I have not set formal targets. There has been a steady progression.

Ms GRIERSON—I would suggest you set some targets. It seems we are coming off a rather low base and I think there have to be some goals to achieve if we are going to get the outcomes

in projects that we are looking for. I turn now to quality management systems. Have all your quality management systems reached—

Dr Gumley—Can I just qualify my previous answer?

Ms GRIERSON—Yes.

Dr Gumley—The division managers each have their own targets for their divisions.

Ms GRIERSON—Good; yes, I would have thought so. Have the quality management systems you are using—QEMS et cetera—reached accreditation yet?

Dr Gumley—QEMS is well away from accreditation. We had the first quality audit on it in December. We did not get the whole way there. Rectification work is required to bring it up to standard and we are working on that at the moment.

Ms GRIERSON—You are working on getting those systems up to date and you are working on getting personnel up to scratch; therefore, hopefully, if you get all those things done all the SPOs will get accredited as well. I think that is a really important target for Defence and for DMO at the moment. The other thing is the projects themselves. Going back to the FFGs: what is the delivery of ships upgraded at this stage?

Rear Adm. Ruting—HMAS *Sydney* is currently undertaking a range of trials at sea. She undertook some of those trials throughout the latter part of last year, after we had finished off some other work on the ship that was not related to the upgrade. She is currently out at sea doing trials on the combat system, the Mark 92 fire control system, radars, the guided missile launcher system and a number of other electronic systems that were upgraded. She had a very successful gun-firing trial this week, so her gun is now certified and back into operation. She is doing sonar trials as well.

These trials continue through February and March. She will go over to Western Australia and do a number of trials over there using some of our Collins class submarines and our very sophisticated underwater tracking range in Western Australia to be able to demonstrate alignment of the FFG systems. Those trials will, overall, continue through April, culminating in final missile-firing trials in the April time frame.

Ms GRIERSON—And *Sydney* is the first, isn't it?

Rear Adm. Ruting—*Sydney* is the first.

Ms GRIERSON—So we are still waiting to see a successful outcome there and, having been on the *Sydney*, we look forward to it. Does that mean your slippage will be even greater than projected in the audit report on the other figured upgrades?

Rear Adm. Ruting—The arrangement in the contract was in fact for the second ship to not go into upgrade until after the first ship had been delivered and we had provisionally accepted it. However, we are working with ADI presently on an alternative arrangement—

Ms GRIERSON—So are you suggesting that some of the trials have shown that you can tick off some areas and then get started on them straightaway?

Rear Adm. Ruting—We can get started on the second ship and, in fact, HMAS *Melbourne* is in dock at the present moment and a whole range of preparatory work that needed to be done before the installation of the new equipment has already started.

Ms GRIERSON—Has the Hawk radar simulation and program been completed?

Air Vice Marshal Rossiter—No, it is still in progress. We expect it to be completed within the first half of this year.

Ms GRIERSON—There are obviously more questions, and we did not even get to the M113 unfortunately.

CHAIR—Well, there is always more time for more hearings like this but, before we wrap up, I know that Mrs Bishop has one more question on notice.

Mrs BRONWYN BISHOP—This question is to take on notice when dealing with those other questions. The audit report on page 20 also says:

... ANAO has not been provided with documentation from Defence that supports the basis of earlier value payments prior to the approval of the EVMS—

Earned Value Management System—

Performance Measurement Baseline. There is no evidence of a contract changes proposal being executed that would enable these earned value payments to be made.

That is a pretty serious finding. It then becomes even more serious. It says:

The Contractor's EVMS did not receive compliance certification until November 2001, by which time more than \$200 million had been paid in earned value payments.

That is a hell of a lot of taxpayers' money. What are we doing about that? Could you take that on notice? I also go to page 21. The Auditor-General concludes:

The FFG Upgrade Project is not proceeding satisfactorily ... further slippage is likely on the lead ship, HMAS Sydney, which will have flow on effects for overall Navy capability.

In that paragraph the Auditor-General says that the project requires:

... continued Defence Senior Executive attention, in order to prevent further loss of Navy capability.

Could you please advise the committee what has been put in place to address that conclusion of the Auditor-General by way of senior executive attention and the loss of capability?

CHAIR—A written answer will be fine. You can take it on notice, unless you—

Rear Adm. Ruting—I can give a short answer. Certainly the Shipbuilding Materiel Governance Board has been reviewing this project quite frequently from before the audit, and its frequency of review through 2004 and 2005 stepped up. I think on average the governance board was looking at it about every two months. Throughout that time the CEO has been conducting very frequent reviews of the program, both with me and also with my team. He visited Garden Island to go through it with ADI independently of our team so he could see for himself where activities were at, and the minister, Senator Hill, also visited ADI last year to review progress against the delivery arrangements.

Dr Gumley—I think it is important to recognise that this project was in difficulty and it is a hard one to recover and to get working fairly well. I have had extensive consultation and negotiations with ADI. I have insisted that ADI beef up its management team. Ultimately, although we are in charge of the contract and we are never going to run away from that responsibility and accountability, the contractor still has to do the work on time. ADI had in my view insufficient engineers and skilled people to do the work. I have worked with the senior management of ADI, and they have lifted the performance of their team. I do not think the scheduled delays that we have incurred will ever be recovered, but I am hopeful we are not going to have further schedule slippage from where we are now. ADI have put a new manager into the project. A lot of work has been done at senior levels to try and improve the performance. In this one, we have a responsibility and we are doing as much as we can to improve, but the contractor is also showing signs that it is willing to improve.

Ms GRIERSON—I am pleased to hear you say all those things. Going to Tenix and the other one that we are looking at, the M113, have the debt and the compensation payments been recovered on that project?

Mr Sharp—Are you talking about the \$3.3 million?

Ms GRIERSON—Yes.

Mr Sharp—Yes, it has been. That audit action has been completed and we have recovered it from Tenix.

Ms GRIERSON—What about the damages?

Mr Sharp—The liquidated damages relating to the current performance, the current contract?

Ms GRIERSON—Yes.

Mr Sharp—Yes, we have claimed liquidated damages and we are exercising that.

Miss JACKIE KELLY—Can I put some written questions because we have run out of time?

CHAIR—Please, yes. You have received a number of questions today and Miss Kelly will give you some more. It would be appreciated if we could get some answers to those in the next few days. I know there is a little bit of work involved, but most of them are simply

administrative in nature. The secretariat will be in contact with you about that, but we would like to have those early next week for distribution to the members before we have further consideration. We may well have another public hearing to flesh some of that out.

Resolved (on motion by **Miss 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 12.35 pm