

## Audit Report No. 3, 2002–2003

# Facilities Management at HMAS *Cerberus*

## Introduction

### Background

- 3.1 HMAS *Cerberus* is a navy base situated south-east of Melbourne, Victoria. It is a major Navy training establishment that conducts initial recruit training as well as specialist category training in areas such as communications and engineering. Also located on site are the Australian Defence Force Schools of Catering and Physical Training and a major health centre for operational and training needs. In 1994, redevelopment commenced of the facilities at HMAS *Cerberus* including the construction of a new health centre.
- 3.2 In 2000, Defence's Inspector-General Division (IGD) conducted an investigation following allegations about Defence Estate Organisation's (DEO) facilities management at HMAS *Cerberus* and other Defence bases in Victoria.
- 3.3 IGD found that there were procedural and managerial deficiencies in certain DEO activities and that 'approximately half the allegations

investigated were either proven or at least supported by the available evidence'.<sup>1</sup>

3.4 The main issues concerning facilities management at HMAS *Cerberus* were:

- problems with the design, and defects in construction, of the health centre that were not fixed by the designer or builder and were rectified largely at Defence cost;
- unresolved facilities problems, particularly those that pose health and safety concerns;
- inconsistencies in holding contractors accountable for performance, and adequate documentation and recordkeeping; and
- breaches of procurement requirements and guidelines.<sup>2</sup>

## The audit

3.5 The audit was undertaken following a request to the Auditor-General from the then Minister of Defence, the Hon Peter Reith MP, to conduct an independent investigation into facilities management at HMAS *Cerberus*. The objective of the audit was to clarify issues of concern and to ensure that lessons would be learnt to assist Defence facilities management generally.<sup>3</sup>

## Audit findings

3.6 Key findings from *Audit Report No. 3, 2002–2003, Facilities Management at HMAS Cerberus*, were:

- there was inadequate contract management and a lack of consistency in ensuring contractor accountability;
- poor documentation management had been a contributing factor in the problems experienced at HMAS *Cerberus*;
- management of fire safety issues had been appropriate and the electrical problems appear to have been resolved and were not an ongoing concern;

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1 Inspector-General Division, Management Audit Branch, Report No. 200169, *Investigation of Allegations Made About the Defence Estate Organisation*, 13 February 2001, p. 3.

2 Auditor-General, *Audit Report No. 3, Facilities Management at HMAS Cerberus, 2002-2003*, Canberra, July 2002, p. 9.

3 Auditor-General, *Audit Report No. 3, 2002–2003*, p. 19.

- blue water<sup>4</sup> had been a problem from approximately 6 months after the construction of the health centre in 1996—Defence should have taken more decisive action to address the problem earlier;
- there was no evidence to support claims of bias in awarding the Comprehensive Maintenance Contract (CMC) but that the process could have been improved to reflect better practice; and
- the Infrastructure Division (ID) did not have a formal, systemic approach to risk management in contracting.<sup>5</sup>

3.7 The audit also confirmed the findings from the IGD investigation.

## The Committee's review

3.8 As part of its ongoing review of audit reports, the Committee decided to review *Audit Report No. 3, 2002-2003*.

3.9 At a public hearing on 28 March 2003, the Committee took evidence on the following issues:

- tender contract and management;
- follow-up of recommendations from previous reviews;
- recordkeeping;
- blue water; and
- performance reporting.

## Tender contract and management

### Comprehensive Maintenance Contract tendering process

3.10 In 1997, when DEO was formed, a new contract strategy was introduced to replace the existing arrangements of separate managing contractors for general building and facilities maintenance, and for fixed plant and equipment maintenance. DEO devised regional CMCs with a single managing contractor.

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4 Blue water is a blue-green discolouration of water which can occur in plumbing systems. Although the cause of blue water is unclear, the corrosion of copper water pipes can result in blue water.

5 Auditor-General, *Audit Report No. 3, 2002-2003*, pp. 12-13.

- 3.11 Following allegations that DEO and a tenderer colluded during the CMC tender process, the IGD reviewed the tender process for the CMC in Victoria. Although the IGD found no evidence to support this allegation, it was clear that the tender process did not equate with best practice. Major criticisms were that:
- there was no weighting given between technical criteria and price for each tender; and
  - that tender assessments did not meet appropriate standards of probity and equity.<sup>6</sup>
- 3.12 In its audit, the ANAO revisited the issue and examined whether there was any evidence of bias in awarding the tender. While the ANAO also found no evidence to support the claim of biased tendering, it recommended the use of a probity adviser on future tenders for contracts of significant value. Defence agreed that \$20 million be the trigger for the use of a probity adviser.
- 3.13 At the public hearing, the Committee asked Defence what progress had been made in implementing this recommendation.
- 3.14 Defence responded that it had implemented the recommendation in two stages:

We are on the verge of introducing a new suite of contracts which will have behind it a whole new through-life tender evaluation process which will have probity as one of the check mechanisms. That is due to come on line in the middle part of this year.

However, that said, since the ANAO report ... we have been employing legal advisors on tender evaluation processes for all projects, whether \$20 million or above, and indeed for all disposal activity and major refurbishment activities as well. ... we have legal advisors who provide advice on probity and the steps that have been undertaken by our officers during the tender evaluation and negotiation process.<sup>7</sup>

## Tender evaluation

- 3.15 In its audit, the ANAO found that the qualitative means of assessing the relative merits of the tendered prices in conjunction with quality were not

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<sup>6</sup> Auditor-General, *Audit Report No. 3, 2002–2003*, p. 44.

<sup>7</sup> Mr Michael Pezzullo, *Transcript*, 28 March 2003, p. 30.

clear and left scope for uncertainty concerning the reasons for the final decision.<sup>8</sup>

3.16 The ANAO recommended that that Defence use a suitable methodology for assessing contract tenders to ensure that technical and pricing factors are appropriately combined to achieve an objective decision and best value for money.<sup>9</sup>

3.17 In response, Defence agreed with qualification to this recommendation. It commented:

Facilities contracts are relatively simple and are usually fixed price lump sum contracts, with schedules of rates where necessary. Therefore, there are very few occasions requiring extensive pricing comparison of multiple components of a tender.<sup>10</sup>

3.18 The Committee sought comments from ANAO as to whether it accepted this qualification.

3.19 The ANAO stated:

As [the audit] report points out, in the assessing of this tender it was quite difficult to come along subsequently and understand just how the tender evaluation group made its decisions. It would have been much better to have a refined methodology that the tender group could follow easily and that [the ANAO] could audit easily.<sup>11</sup>

3.20 However, Defence responded:

The tender evaluation plans for major construction developments of this nature as well as tender evaluation plans for ongoing comprehensive maintenance contract would ... be unrecognisable from the sort of documentation that would have been available from 1994-95 onwards ...

[The tender evaluation plans and reports] have a far more auditable quality about them ... I would contend that there is a pretty strong auditable trail these days that eight or nine years ago, as the auditors have found, would be very hard to reconstruct.<sup>12</sup>

3.21 The ANAO conceded that:

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8 Auditor-General, *Audit Report No. 3, 2002–2003*, p. 13.

9 Auditor-General, *Audit Report No. 3, 2002–2003*, p. 47.

10 Auditor-General, *Audit Report No. 3, 2002–2003*, p. 47.

11 Mr Warren Cochrane, *Transcript*, 28 March 2003, p. 35.

12 Mr Michael Pezzullo, *Transcript*, 28 March 2003, p. 35.

... the system is getting better and there is more strategy in the way that the now Infrastructure Division is approaching its contracting. [The ANAO] would not say that everything is perfect yet, but it has come a long way since 1994–95.<sup>13</sup>

### Committee comment

- 3.22 The Committee notes the improvement made by Defence in improving its tender evaluation documentation. However, the Committee considers that the tender evaluation process would be enhanced by a consistent tender evaluation methodology as recommended by the ANAO.

## Follow-up recommendations from previous reviews

- 3.23 On numerous occasions, the Committee has expressed concern about Defence's follow-up of IGD, ANAO and JCPAA recommendations. In 2001, the Committee noted that Defence is:

... putting in place controls to ensure that recommendations made by the ANAO, Defence internal audit and the JCPAA are routinely monitored. The Committee expects the implementation of follow-up mechanisms to systematically report on outstanding recommendations which have not been implemented.<sup>14</sup>

- 3.24 The IGD has established the Audit Recommendations Management System (ARMS) in order to monitor the implementation of recommendations.

- 3.25 However, the audit found that recommendations from the IGD investigation of facilities management in 2000 had not been placed on ARMS. The audit report noted that:

... their absence from ARMS made it more difficult to establish their status and to track the progress in their implementation.<sup>15</sup>

- 3.26 The audit report also noted that:

... better practice would indicate that the recommendations [including ANAO and JCPAA recommendations] should be formally recorded on a system such as ARMS to ensure that their

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13 Mr Warren Cochrane, *Transcript*, 28 March 2003, pp.35–6.

14 JCPAA, *Report 385, Review of Auditor-General's Reports 2000–2001, Second and Third Quarters*, August 2001, p. 38.

15 Auditor-General, *Audit Report No. 3, 2002–2003*, p. 36.

implementation is kept under review by senior management and the Defence Audit Committee.<sup>16</sup>

3.27 The Committee sought confirmation from the Inspector-General as to the formal mechanisms in place to respond to recommendations and whether there was a system of monitoring to ensure that Defence was acting on what had been agreed.

3.28 The Inspector-General told the Committee that recommendations are placed on ARMS by his auditors. In relation to monitoring, the Inspector-General advised the Committee that:

The defence audit committee ... regularly takes a snapshot of active recommendations and the recommendations that have been completed. It does that pretty much every six weeks ... it meets about 10 times a year.<sup>17</sup>

3.29 The Committee was also advised that a sample check of high priority recommendations (including ANAO and JCPAA recommendations) had been carried out to ensure that those recommendations that are marked as 'complete' on the system had been in fact implemented.<sup>18</sup>

3.30 The Inspector-General discovered that:

... people were marking things 'complete' simply because the due date was coming up, not because they had actually completed them.<sup>19</sup>

3.31 As well, there were instances of problems when implementation of a recommendation involved several parties. Sometimes one party marked the recommendation as 'complete' on ARMS because it had completed its contribution and forwarded responsibility for completion of the recommendation to the next party. Consequently, certain stages of implementation were complete, but the overall intent of the recommendation was not.<sup>20</sup>

## Committee comment

3.32 Although Defence has introduced ARMS to record progress in implementing the recommendations to which Defence had agreed, it is clear that the system is not being used appropriately.

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16 Auditor-General, *Audit Report No. 3, 2002–2003*, p. 36.

17 Mr Claude Neumann, Inspector-General Defence, *Transcript*, 28 March 2003, p. 31.

18 Inspector-General Defence, *Transcript*, 28 March 2003, p. 32.

19 Inspector-General Defence, *Transcript*, 28 March 2003, p. 32.

20 Inspector-General Defence, *Transcript*, 28 March 2003, p. 32.

## Recommendation 2

- 3.33 **The Department of Defence should immediately update its Audit Recommendations Management System and provide the Committee and the Australian National Audit Office with a report on the current status of all Committee and Audit Office recommendations.**
- 3.34 The Committee expects Defence to review its instructions concerning the use of ARMS and its monitoring arrangements to ensure that the system is being correctly used to monitor Defence's progress in completing the requirements of the recommendations to which it has agreed.

## Recordkeeping

- 3.35 In recent years, recordkeeping in Commonwealth organisations has been a recurring issue in ANAO audits. Many audits have noted an absence of, or only limited, ongoing documentation or records. In some instances, the level of documentation available was insufficient to evidence and support administrative actions and decision-making processes.<sup>21</sup>
- 3.36 A recent ANAO audit into recordkeeping noted that  
... recordkeeping is an essential enabler in any organisation's corporate governance and critical to accountability.<sup>22</sup>
- 3.37 In its internal investigation, the IGD found that DEO Project Delivery officers were unable to provide IGD with the complete set of relevant files for projects at HMAS *Cerberus* and therefore the IGD could not reach a detailed conclusion in regard to the criticisms. IGD also found that there was no efficient system in place to locate contract documentation.<sup>23</sup>
- 3.38 The ANAO, in its audit, agreed that poor documentation management in DEO contributed to facilities management problems at HMAS *Cerberus* and had made it difficult for IGD to investigate the issues.<sup>24</sup>

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21 Auditor-General, *Audit Report No. 45, 2001–2002, Recordkeeping*, Canberra, May 2002, p. 11.

22 Auditor-General, *Audit Report No. 45, 2001–2002*, p. 11.

23 Auditor-General, *Audit Report No. 3, 2002–2003*, p. 32.

24 Auditor-General, *Audit Report No. 3, 2002–2003*, p. 32.



- 3.39 The Committee asked Defence what had been done to improve document handling and file management procedures as recommended by the IGD.
- 3.40 Defence told the Committee that there was now a requirement for all documents to be cross-referenced into the electronic database system, Defence Estate Management System (DEMS). Defence had also begun to explore the feasibility of integrating DEMS and the Defence Records Management System to create a paperless office system. As Defence explained:

The DEMS system ... is fully functional in tracking works against invoices ... The next stage in that process is enabling the reference system to open the document itself, so that everyone will be able to operate in a fully paperless way ... That is part of a bigger Defence-wide project.<sup>25</sup>

### Committee comment

- 3.41 The Committee notes the progress that Defence has made with regards to its recordkeeping and expects Defence to maintain momentum in this area.

### Blue water

- 3.42 Blue water is a blue-green discolouration of water which can occur in plumbing systems. Although the cause of blue water is unclear, the corrosion of copper water pipes can result in blue water.<sup>26</sup>
- 3.43 Blue water was first observed at the health centre approximately six months after the completion of construction in 1996. While attempts to rectify the problem had begun in December 1996, there was no action taken between June 1997 and April 1999. At the time of the audit, it was still a problem.
- 3.44 In its internal audit, the IGD investigated allegations that DEO did not hold contractors accountable for poor performance on facilities project work at HMAS *Cerberus* including concerns with blue water affecting the health centre's water.
- 3.45 In its audit, the ANAO found that as the cause of blue water was unclear, and it was difficult to apportion the cause of the problem at the health centre to poor contractor performance. This was particularly so, because

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25 Mr Michael Pezzullo, *Transcript*, 28 March 2003, p. 34.

26 ActewAGL, *Blue Water and Copper Corrosion*, [www.actewagl.com.au]

blue water had been found in other buildings at HMAS *Cerberus* where the contractors of the health centre had not been working.<sup>27</sup>

3.46 The audit also found no firm evidence of advice to staff on the blue water problem prior to August 2001, although anecdotal evidence indicated that the staff were aware of the problem.<sup>28</sup>

3.47 The ANAO concluded that more decisive action should have been taken by Defence to remedy the problem earlier.<sup>29</sup>

3.48 During the public hearing, the Committee raised various issues with Defence including:

- the length of time it had taken to respond to the issue of blue water at HMAS *Cerberus*;
- the health risk associated with drinking blue water and whether advice had been given to personnel not to consume the water; and
- why the action that was taken in the end to rectify the blue water problem (i.e. replacing of the pipes) was not taken in the first place.

3.49 In respect to these three issues, Defence responded:

- the blue water had been tested at length by various engineering consultants and the problem was not as simple as first assumed;<sup>30</sup>
- that once the defect became apparent, immediate action was taken to notify the staff and bottled drinking water was provided at the health centre;<sup>31</sup> and
- from an audit and value-for-money view, it was felt necessary to attempt to identify any localised source of the problem before replacing all the plumbing—in the event testing had proved inconclusive.<sup>32</sup>

3.50 The Inspector-General supported the comments made by Defence with regards to the remedial action taken; commenting that the problem was easier to deal with in hindsight.<sup>33</sup>

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27 Auditor-General, *Audit Report No. 3, 2002–2003*, p. 26.

28 Auditor-General, *Audit Report No. 3, 2002–2003*, p. 41.

29 Auditor-General, *Audit Report No. 3, 2002–2003*, p. 42.

30 Mr Michael Pezzullo, *Transcript*, 28 March 2003, pp. 30, 34.

31 Mr Michael Pezzullo, *Transcript*, 28 March 2003, p. 34.

32 Mr Michael Pezzullo, *Transcript*, 28 March 2003, p. 34.

33 Inspector-General Defence, *Transcript*, 28 March 2003, p. 34.

## Committee comment

- 3.51 The Committee notes that at the time of the audit, the copper pipes in the health centre as well as in the accommodation buildings affected by blue water were being replaced.
- 3.52 The Committee notes there was a significant delay between June 1997 and April 1999 in addressing the problem. The Committee considers that such a delay where health issues are concerned is not acceptable and should not be repeated.

## Performance monitoring

- 3.53 In its audit report, ANAO recommended that Defence put in place a timetable for the implementation of appropriate performance monitoring devices for plant and equipment that service buildings. These devices should be activated at the earliest practical date.<sup>34</sup>
- 3.54 The Committee sought clarification with regards to this recommendation.
- 3.55 Defence stated that there were two sub disciplines within facilities management:
- ... there is what is called fixed plant and equipment ... that helps your run a building, such as the power systems, the elevator systems and the air conditioning etc. General building maintenance and upgrades relate to the physical fabric of the building, such as broken windows that are replaced and the replacement of casings for lighting systems etc. Fixed plant and equipment, if not regularly monitored, obviously creates a cost down the line in terms of major overhauls of your air conditioning system, your elevator systems and the fuel installations that are associated with your facilities.<sup>35</sup>
- 3.56 Defence advised the Committee that it had begun implementing the ANAO's recommendation:
- The way we are accomplishing [the recommendation] is to introduce performance monitoring requirements for our comprehensive maintenance contractors ... we monitor them by

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34 Auditor-General, *Audit Report No. 3, 2002–2003*, p. 50.

35 Mr Michael Pezzullo, *Transcript*, 28 March 2003, p. 36.

having [key performance indicators] over the top of them that they are required to comply with.<sup>36</sup>

## Asset management

3.57 During the hearing, the Committee expressed concern over Defence's ability to manage its assets. This view has arisen due to Defence's performance in this area which had been exposed by previous Committee inquiries.

3.58 In response, Defence stated that with regards to the estate, the Defence Estate Management System (DEMS) was a fully IT enabled system which could capture fixtures and structures on the estate as well as providing details such as room sizes and the number of chairs and tables in each room. Defence added:

... whilst [DEMS] is not as mature as the technology probably allows, I suspect it is probably better than most public bureaucracies around the world, to the extent that we have embedded UK [Ministry of Defence] officers trying to learn from us how we have pulled that together.<sup>37</sup>

3.59 The Committee sought comment from the Inspector-General. He responded:

I think it is about management issues rather than simply systems issues. I think [the ANAO] was right in saying that the changeover in management to Infrastructure Division from Defence Estate has made a whole lot of things different. The whole approach is different.<sup>38</sup>

## Committee comment

3.60 The Committee acknowledges the change in approach to asset management since the changeover from Defence Estate to the Infrastructure Division. However, the Committee considers there remains scope for continuous improvement.

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36 Mr Michael Pezzullo, *Transcript*, 28 March 2003, p. 36.

37 Comments made at the public hearing by Defence were in regards to Estate Management only. Weapons equipment and systems are managed by DMO. See Defence, *Transcript*, 28 March 2003, pp. 36–7.

38 Inspector-General Defence, *Transcript*, 28 March 2003, p. 37.