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CEO DMO/OUT/2012/016

Mr Rob Oakeshott
Chair
Joint Committee on Public Accounts & Audit
PO Box 6021
Parliament House
CANBERRA ACT 2600

Dear Mr Oakeshott

DMO MPR Financial Performance Reporting Proposal

This letter is provided in connection with the Government Response to the JCPAA Report 422: Review of the 2009-10 Defence Materiel Organisation Major Projects Report, specifically, Recommendation 7, which sought a proposal for a revised financial performance reporting methodology.

Acknowledging the advice in your letter of 7 December 2011 to the Minister for Defence, a proposal is attached for the Committee's consideration ahead of the JCPAA meeting on 8 February 2012. The proposal was developed by the DMO in consultation with the ANAO and is intended to resolve the issue that has been the sole basis for qualifications of the Auditor General's assurance of project data each year since the inaugural MPR tabled in 2008.

I look forward to discussing the proposal at the 8 February 2012 meeting. Also, I would like to advise that I will be accompanied by DMO's General Manager Systems (Ms Shireane McKinnie), DMO's Chief Finance Officer (Mr Steve Wearn) and DMO's Acting Chief Audit Executive (Mr Paul Way).

Yours sincerely,

Warren King

Mr Warren King
A/ Chief Executive Officer

23 **January 2012**

Australian Government
Department of Defence
Defence Materiel Organisation

A FINANCIAL PERFORMANCE REPORTING PROPOSAL FOR THE DEFENCE MATERIEL ORGANISATION MAJOR PROJECTS REPORT

A response to Recommendation 7 of the Joint Committee of Public Accounts and Audit *Report 422: Review of the 2009-10 Defence Materiel Organisation Major Projects Report*

EXECUTIVE SUMMARY

1. In August 2006, the Joint Committee of Public Accounts and Audit (JCPAA) supported the development and submission to Parliament of an annual report – the Major Projects Report (MPR) – on major capital equipment projects. The guidelines for producing the MPR included a requirement for contract values and project expenditure to be shown in *current* dollar and *base date* terms[1]. However, Defence has managed its internal budgets in *out-turned*[2] dollars since 2009-10 and from 2010-11 the Defence Materiel Organisation (DMO) followed suit and now manages project budgets in out-turned dollars. Consequently, the 2010-11 MPR disclosed project budgets in *out-turned* and, where possible, *base date* terms.

2. Since the inaugural MPR was tabled in November 2008, the Auditor-General has qualified its assurance of project financial data due to a "departure from the guidelines" in relation to disclosures, in *base date* terms, of: prime contract progress payments (2007-08 and 2008-09); and prime contract details and other project expenditures (2009-10 and 2010-11).

3. The DMO has consistently held the view that the *base date* dollar requirement provides limited value as a measurement of project performance and that it would be time consuming and costly to implement the systemic changes that would enable all projects to fully comply with this requirement. That is, there is no added benefit for Defence or the DMO in amending financial reporting systems to report solely for the MPR *base date* dollar calculations. The *base date* figures are only calculated for the MPR and are not used in other financial publications (including: Portfolio Budget Statements, Portfolio Additional Estimates Statements or Annual Report).

4. Fortunately, and recognising the difficulties encountered since 2007-08, the JCPAA, in Recommendation 7 of the JCPAA's Report 422: Review of the 2009-10 Major Projects Report provided the DMO with an opportunity to review and provide a submission to adjust the MPR financial performance reporting.

Brief Description of the Financial Reporting Options

5. In essence, there are three options for reporting project cost performance and budget that could be considered by the JCPAA. They are:

[1] In the 2007-08 and 2008-09 Major Projects Reports, the *base date* value requirement only applied to the prime contract details provided in Table 2.7. The "*base date*" was taken as the date of contract signature unless otherwise specified in the contract. For the later MPRs, the term "*base date*" has not been defined and has been variously taken to mean prime contract signature date, Government Approval date and Government Second Pass Approval date.

[2] Method used to present forward looking cost estimates for Government consideration.

a. In *base date* terms - removing price effects (indexation and exchange) from expenditure;

- In simple terms, *base date* dollars attempts to 'track' all expenditures back to a particular point in time (i.e. considering financial management with the benefit of hindsight and knowledge of price indexation, foreign exchange rate fluctuations that have occurred), and recognising that a dollar in this financial year is normally worth less than a dollar last year.

b. In *current dollar* terms - applying known price effects (indexation and exchange) up to the current period to the current approved budget; or

- Current day dollars would present expenditure in the current financial year. That is, a dollar today is worth the value of a dollar today as we have catered for price indices and adjusted budgets accordingly. Although, the MPR does not escalate past actual historical expenditure to current year figures.

c. In *out-turned* dollars - apply known and expected price effects (indexation and exchange) over the life of the project. This is the methodology currently used by Government when approving Budget Measures or any New Policy Proposals, including Defence's major capital acquisitions.

- Out-turned dollars methodology recognises that the dollar is worth less over time. Out-turning a project budget takes into account the planned increases in overall Defence spending due to inflationary pressures. This also provides greater surety to Government regarding expenditure estimated in the 'outer-years'.

Preferred Method

6. Noting that Defence and the DMO receive major acquisition approvals in out-turned dollars and subsequently report progress against budget in out-turned dollars, the preferred option is to also present the MPR financial reporting in this manner. The major benefit of this change would be that all remaining financial data in the Project Data Summary Sheets can be sourced from, and subsequently verified with, existing financial management and reporting systems currently used in the DMO. There would be no need to manipulate project cost.

7. DMO is of the view that this presentation will assist the JCPAA to assess the likely cost outcome for projects. The out-turned budget presentation is consistent with the Commonwealth budget framework and historical cost accounting conventions. Furthermore, this presentation is a cost effective means of reporting budget and expenditure in like terms across all projects.

Comparison Year

8. Recommendation 7 of the JCPAA Report 422 also requests a "comprehensive proposal for transition towards the proposed new arrangement". As a comparison arrangement for the 2011-12 MPR only, DMO proposes that the *base date* column in Tables 2.1 and 2.2 of the PDSS be retained in the PDSS for the 14 projects that were able to provide *base date* data in the 2010-11 MPR, but removed from the PDSS for the remaining projects.

9. For style purposes, DMO also proposes to combine the table headings for 2.1 and 2.2 as 'Table 2.1 Project Budget and Expenditure History' and re-number the subsequent tables of section 2 appropriately.

A FINANCIAL PERFORMANCE REPORTING PROPOSAL FOR THE DEFENCE MATERIEL ORGANISATION MAJOR PROJECTS REPORT
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Background

1. In August 2006, the Joint Committee of Public Accounts and Audit (JCPAA) supported the development and submission to Parliament of an annual report on major capital equipment projects. The content of this report was jointly proposed by the Defence Materiel Organisation (DMO) and Australian National Audit Office (ANAO) and accepted by the JCPAA in September 2007. The 'pilot' report, tabled in November 2008, was developed with the intention of providing information that was not only timely, but useful in improving transparency and accountability surrounding major Defence acquisition projects.

2. The initial guidelines for producing the Major Projects Report (MPR) included, inter alia, a requirement to disclose in the Project Data Summary Sheets (PDSS):

a. in Table 2.1, project budget approval history, including variations for price indexation, foreign currency exchange rate variations and real cost increases and decreases[3] in *current* terms;

b. in Table 2.3, project budget, expenditure and remaining budget as at the end of the financial year being reported in *current* terms; and

c. in Table 2.7, prime acquisition contract(s) price and progress payments to be "expressed in *base date* terms".

3. The initial guidelines and PDSS template were followed for the 2007-08 and 2008-09 MPRs. The Auditor-General's review of the first MPR was qualified due to the "uncertainty in relation to the reported information on prime contract expenditure at *base date* price" presented in Table 2.7. In the second MPR of 2008-09, the Auditor-General's review was again qualified because "contract *base date* figures" were not provided for three projects in Table 2.6 – Prime Acquisition Contractor(s) Real Price Increases and Capital Equipment Quantities Required and for 11 of 15 projects in Table 2.7 – Prime Acquisition Contractor(s) Price and Progress Payments.

4. Up until 2008-09, the generic term '*base date* dollars' referred to the value of a contract at signature and this requirement was included in order to present contract costs in real[4] terms at the time of contract signature. However, since the inaugural MPR, in which projects attempted to present *base date* dollars for the prime contracts only, the Auditor-General has provided a qualified opinion on each MPR due to non-compliance with the requirement to report project (as opposed to contract) expenditure in *base date* dollars.

5. For the 2009-10 MPR the JCPAA endorsed a revised template which was intended to improve the presentation of the financial data. The revision attempted to combine tables 2.1

[3] Defence Materiel Organisation – Major Projects Report 2007-08 ANAO Report No. 9 2008-09, p. 96
[4] excluding the effect of inflation and exchange variation from the date of signature

(budget history), 2.2 (project expenditure history) and 2.3 (remaining budget) with table 2.7 (prime contract(s) data). This resulted in an implied requirement to report all project budget and expenditure data in both *current* and *base date* terms. The Auditor-General's review of the 2009-10 MPR was again qualified due to the departure from the guidelines, specifically a failure to report contract details in *base date* terms (in the new Table 2.3) for the Collins and Hornet projects, and a failure to report all or some project expenditure in *base date* terms for 19 of the 22 projects in the revised Table 2.2. This situation has endured and, despite only being required to report *base date* data for 11 of 28 projects in the 2010-11 MPR, the Auditor-General's review again provides a qualified conclusion based on a lack of disclosure, by three of those 11 projects, of *base date* information.

6. DMO's response to the qualification in the 2009-10 and 2010-11 reports reaffirmed that the qualification does not imply deficiencies in DMO's management of the projects or non-compliance with any accounting standards. The *base date* requirement is unique to the MPR report and, apart from variable price contracts, it requires the development of data by no defined methodology. The DMO has consistently maintained (since the 2007-08 MPR 'pilot' program and through successive MPRs) that this requirement is time consuming, costly and provides very limited value in relation to project management outcomes. Likewise, there is no justifiable benefit to amending the DMO's financial reporting systems to present this information purely for the MPR.

7. Consequently, Recommendation 7 of the JCPAA's *Report 422: Review of the 2009-10 Major Projects Report* provides the DMO with an opportunity to review and provide recommendations to adjust the financial performance reporting methodology for the 2011-12 MPR Program. Recommendation 7 states:

> *The committee recommends that the Defence Materiel Organisation present the findings of its examination of the presentation of financial data on all possible methods for project expenditure information (Eg. Base date dollars, outturned dollars and current dollars) to the Joint Committee of Public Accounts and Audit (JCPAA) as soon as it is completed and no later than 31 August 2011.*
> *This examination should include a:*
> *(1) preferred method, and*
> *(2) comprehensive proposal for transition towards the proposed new arrangement. In addition, the proposed examination should be reviewed by the Australian National Audit Office before it is submitted to the JCPAA for consideration and recommendation prior to inclusion in the MPR.*

8. In addressing this recommendation, the DMO, in consultation with ANAO, has developed this paper to propose a revised MPR financial performance presentation which is congruent with the DMO's existing financial management framework, policy, reporting and supporting systems. Other options previously considered included Assets Under Construction (AUC) and statistical information analysis. However, for AUC this option was rejected because it captured only a proportion of the projects overall expenditure and related to the building of tangible assets. For the statistical analysis option, this was also rejected due to the concerns with the potential volatility of using averages for varying levels of expenditure throughout the year, and the potential for the relevant individual indices being materially different from any broad-based

indice. This paper describes the three approaches suggested in Recommendation 7 as options for presenting the Project Data Summary Sheets (PDSS) financial information and seeks the JCPAA's endorsement of the out-turned budget presentation as the preferred method.

9. **Scope**. This paper will argue that:

a. the financial information presented in the PDSSs of the MPR should assist the JCPAA to assess whether there is risk that the DMO would not deliver the materiel equipment required by Government within budget;

b. the key measures that need to be considered in this assessment are the project's budget, its expenditure to date and what is yet to be acquired with its remaining budget;

c. the difficulty in comparing these measures stem from price effects (inflation) and foreign exchange rates during the life of the project;

d. the out-turned budget presentation is consistent with the Commonwealth budget framework, the Department of Finance and Deregulation's costing principles, financial accounting standards and the way that DMO manages project finances;

e. the out-turned budget presentation is a simple and objective method for presenting project financial information which allows the JCPAA to assess the likely cost performance of projects by including the effect of inflation in both the actual and budget amounts;

f. a comparison or transition year would enable DMO and the ANAO to agree new criteria for the ANAO review of PDSS financial information and for the ANAO to develop an appropriate strategy for future MPR reviews;

g. for only those materially significant variable price contracts that are managed in *base date* terms, it would be appropriate for those projects to report expenditure in *base date* dollars, in the 2011-12 MPR, in a separate 'Prime Contract Details' table; and

h. the requirement for reporting financial data in *base date* terms should be removed from future MPRs.

JCPAA Assessment

10. Through the MPR, the JCPAA should be able to gain insight into a project's progress and assess whether Defence projects remain on-track and, in particular, whether the DMO is able to deliver the materiel elements of capability specified by Government on-time, within budget and to the required standard. In forming a view as to whether a project is likely to experience future cost pressure prior to completion, the JCPAA may wish to consider the following questions:

a. does the expenditure on the project to date seem reasonable considering the total project budget and what has been achieved to date by the project?

b. What is the likely cost for the project to be completed, in particular,

i. what expenditure obligations exist?

ii. what assumptions have been made about future price escalation?

c. most importantly, does the project have sufficient remaining budget to deliver the required scope?

11. The MPR should provide relevant and reliable information to answer these questions. In particular, the MPR should provide the JCPAA with:

a. assurance that project cost and budget information is accurate and that project approval, budget and cost records are maintained appropriately by DMO;

b. visibility of how much of a project's budget has been spent which can be aligned with the project's progress in delivering equipment;

c. a view on the likely cost to complete the project taking into account future expenditure plans, contractual commitments and estimated price escalation; and

d. an appreciation of the financial risk faced by the project based on the above performance information.

Kinnaird Review – Cost Estimating

12. The approved value for a project can be expressed legitimately in 'real' or 'nominal' terms (i.e. excluding or including the effects of inflation). Through the two-pass approval process for major projects which was established following the Kinnaird Review, Government approves the scope and estimated cost for each project following consideration of the project approval submission. The Cabinet Handbook requires that the cost estimates for second-pass consideration are presented in out-turned dollars.

13. Before June 2010, post-approval expenditure budgets for DMO acquisition projects were priced in 'current' year dollars. At budget milestones,project budgets were updated based on prevailing indices and were updated to the new budget year price basis with each new financial year. Up to the 2009-10 MPR, the total budget in the PDSSs were expressed in 'current prices' which reflected the prevailing DMO and Defence budget management approach at the time.

14. In July 2010, DMO commenced financially managing all its budgets (including Acquisition Program budgets) on an out-turned price basis. The reason for this change was to ensure consistency with Defence and Commonwealth budgets which are managed on an out-turned basis. An exercise was undertaken during May and June 2010 to identify those projects that had been transferred to DMO with approved prices expressed in current year prices and to out-turn their remaining budgets. In the 2010-11 MPR, the total budget was expressed in out-turned dollars to reflect the change to out-turned budgeting.

Defence and DMO Funding Model.

15. Once a project is approved by Government, the Government decision provides a limit on project expenditure apart from variations for price indexation, foreign exchange adjustments and other subsequent approval decisions. The funding for the project however, flows through the normal Defence budget process and the subsequent annual payment to DMO by Defence for the estimated project expenditure that has occurred that year. In summary, the Government project approval decision is a governance measure, not a funding mechanism.

MPR Financial Information

16. The financial information in the PDSSs shows the budget and expenditure positions as at 30 June each year. This information enables judgements to be made about project cost performance as described above. Given the variables, there will be uncertainty as to whether the project's deliverables will be achieved at or below approved cost until close to project completion; however, a level of confidence can be achieved by considering the current approved project value (i.e. Total Budget in the PDSS), the expenditure incurred by the project to date (i.e. Total Expenditure in the PDSS), the difference between the Budget and Expenditure (i.e. Remaining Budget in the PDSS), and then evaluating whether the project can be completed with the Remaining Budget.

17. A simple comparison of these measures has the potential to be misleading because of the effect of inflation and foreign exchange movements. The financial information in the PDSS can be expressed in several ways, including:

a. In *base date* terms - removing price effects (indexation and exchange) from expenditure;

b. In *current* dollar terms - applying known price effects (indexation and exchange) up to the current period to the approved budget; or

c. In *out-turned* dollars - apply known and expected price effects (indexation and exchange) over the life of the project.

18. The method used must provide a satisfactory outcome to enable the JCPAA to determine whether a project is likely to be completed within approved cost using a 'like-for-like' comparison between budgeted and expended amounts with regard to the effect of inflation.

An example

19. To illustrate how the three approaches would be applied, a simple example is used. A project with a planned spend spread of eight years is approved by Government in Year 1 with a total cost estimate of $169 in current dollars at the time of approval. If inflation is estimated to be five per cent per annum (effective from year 2 onwards), this would produce an out-turned project cost estimate of $200 – Table 1 refers. Once approved by Government, this becomes the project Budget.

Table 1. Sample Project Estimated Cost and Spend Spread.

	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**	**Year 8**	**Total**
Estimate	$10	$19	$27	$35	$33	$24	$15	$7	**$169**
Out-turned	$10	$20	$30	$40	$40	$30	$20	$10	**$200**

20. Table 2 below shows the budget and actual amounts after year 4 that would apply under each method.

Table 2. Financial Performance at end Year 4

Year	Expenditure (*Base date*)	Expenditure* (Current)	Expenditure* (Out-turned)
1	$10	$10	$10
2	$19	$20	$20
3	$27	$30	$30
4 (present year)	$35	$40	$40
Total	**$91**	**$100**	**$100**
Original Budget	**$169**	**$191**	**$200**
Remaining Budget	**$78**	**$91**	**$100**

*for simplicity, it is assumed that pre-approval estimates for cost and inflation were accurate and did eventuate.

Base date dollar presentation

21. In *base date* terms, we would compare project expenditure to the original Government approval by manipulating the actual expenditure records to account for the effects of inflation. In short, we would report that the project's expenditure to date was equivalent to $91 in *base date* dollars and we would compare this to a manipulated Government project approval value of $169 (the Government would have approved a $200 out-turned amount) and as such we can determine that the remaining budget is $78 in *base date* terms. Budget, expenditure and remaining budget are all compared in like terms, albeit some have been calculated.

Advantages.

- In addition to the 'in like terms' comparison for a project's finances, *base date* analysis attempts to compare cumulative project costs with a calculated project approval that is exclusive of inflation and foreign exchange.

Disadvantages.

- The *base date* presentation requires a single *base date* to be determined and agreement on which indices should be used in the 'de-escalation' to the *base date*. The use of multiple *base dates*, or differing indexes, would introduce discrepancies that reduce the utility of the resulting *base date* values in any analysis.
- The *base date* values in one project can only be used in the analysis of the financial performance of that particular project because the various projects were approved at different times. That is the *base date* values for older projects (HF Mod) would not be 'in like terms' with *base date* values of a newer project (SATCOM).
- DMO financial management and information systems are not designed to produce project financial data in *base date* terms.

22. The key problem with *base date* dollars, which stems from the first dot point above, is the arbitrary nature that is introduced when the price escalation component has to be selected because the purchasing arrangements for the project are not all through variable price contracts. This introduces a level of subjectivity, and likely inaccuracy, which undermines the certainty and confidence that can be placed upon the calculated values when making judgements. Furthermore, the *base date* presentation of project approval presents the project budget as it may have been at a particular point in time without regard for changes in economic relativities and the impact of subsequent Government decisions. Comparing costs adjusted to *base date* dollars

becomes less relevant when the original Government approval has been varied for subsequent decisions by Government.

23. In the 2010-11 MPR the materially significant price contracts that feature in the project have been examined to determine what payments were due to contractual price variation (indexation). These payments were then excluded from the actual expenditure calculations against the contract(s) to produce the '*base date*' value of expenditure against the contract. This is a reasonable determination. However, the average percentage by which the significant contract(s) actual and base price expenditures differed was applied to other expenditures in order to determine a "*base date* dollar" value for those other expenditures. This is where the subjectivity and likely inaccuracy is introduced. For example, a single firm price prime contract produces a percentage of zero, i.e. other expenditure is not de-escalated, multiple variable price contracts produce an average percentage, i.e. other expenditure is 'de-escalated' at a rate different to all contract expenditures.

24. Given the divergence between approval and contract signature dates and the varying contract dates, durations and percentages it is unlikely that the resultant *base date* dollars could be considered accurately representative of the financial status of any of those projects.

Current dollars presentation

25. Under the current dollar presentation, project actual expenditure to date is presented without modification and the project budget for the current years is updated to the prevailing price and foreign exchange rates. The unspent project budget in future years is updated using current year inflation and exchange rates.

26. In the simplified example above, the actual expenditure after 4 years was $100, the project budget has received supplementation of $22, so far, applying the historical 5% inflation to remaining budget in each of Years 2 to 4 and the remaining budget would be $91 in *current* terms. In the MPR context, *current* dollar values have been used in the Cost Performance analysis of the first three MPRs.

Advantages.

- A broad cross-project cost performance analysis can be performed, because all projects' financial data are price adjusted to a common price basis. Current dollar analysis introduces the realities of what has happened since project approval. This lends a 'layman' understanding to the remaining budget figures which are presented in today's terms.
- Actual expenditures are readily available in DMO's current financial reporting systems.

Disadvantages.

- The current dollar presentation does not align with current Defence and DMO budgeting policy. Remaining budgets in *current* dollars are no longer readily available in DMO's financial reporting systems.
- All future inflation and exchange rates are assumed to remain constant with the current budget year.

Out-turned budget presentation

27. An alternative presentation for project cost and budget information in the PDSS is to present the actual costs as they are without manipulating them and compare them to the original Government approved budget, which is an out-turned amount. That is, both the actual and budget amounts include inflation and therefore, no arbitrary manipulation of financial information is required. In the example above, after year 4, the project expenditure to date would be reported as \$100 and the remaining budget would be reported as \$100, which added together reflect the Government project approval value.

Advantages.

- In addition to the 'in like terms' comparison for an individual project's finances, this method gives a sense of what the project is likely to cost at the end of the project, i.e. in future dollar terms. This method introduces allowances for price variation and budget policy out to the forecast end of the project.
- A key issue for assessing project cost risk and a significant advantage of the out-turned budget presentation over *base date* dollars is the immediate visibility at reporting date of a potential 'cost to complete' pressure. It highlights the difference between a project's known funding and the cost to complete.
- DMO's current financial budgeting and reporting systems align with the requirement to present estimates in out-turned dollars. Project budget and actual expenditure methodologies will not need to be adjusted.
- Consistency with accounting standards for reporting historical costs.
- Consistency with current methods for recording and reporting project budgets in public documents such as the Defence Annual Report, Portfolio Budget Statements and Portfolio Additional Estimates Standards, all of which are presented in out-turned dollars.

Disadvantages.

- This is a change from the previous way of reporting the MPR.

28. The chart below represents graphically the difference between stating financial data (budget and expenditure) in *out-turned*, *current* and *base date* terms over the life of the project. Ultimately, it demonstrates that all methods allow an analysis of a project's cost performance through a comparison of the project's budget and expenditure 'in like terms'. It also highlights the reducing impact of indexation with the passage of time or as projects approach completion.

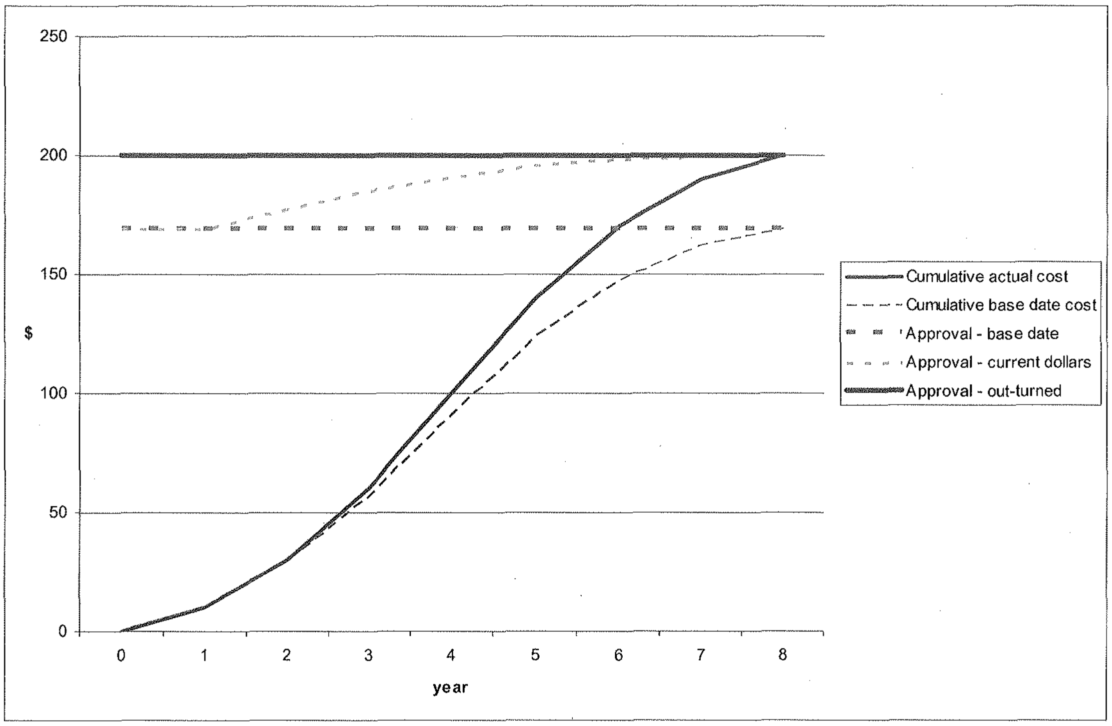

Chart 1. Demonstration of price effects for project budget and actual expenditure

The preferred method

29. Of the three methods for presenting PDSS financial information described above, the out-turned budget presentation is consistent with the Defence and Commonwealth budget framework and offers an objective and simple view of how a project is tracking within its approved budget. Furthermore, the JCPAA may wish to link the cost to complete view with the capability delivery (schedule) view. This is a paramount consideration and establishes clear visibility of financial and capability risk. The strengths of this approach and the limitations of the others, particularly *base date* dollars, are as follows:

a. **Consistency with accounting standards for reporting historical costs.** Historical cost is the basis of presenting financial transactions in financial statements. This means that actual cost information is presented without manipulation. Under this method project cost information is presented as it is in other Commonwealth Budget documentation. No adjustment is made based on applying an arbitrary, de-escalation rate.

b. **Consistency with the current method for recording and reporting project budgets.** Project approval amounts reported in all public documents, such as the Defence Annual Report, Portfolio Budget Statements and Portfolio Additional

Estimates Statements, are presented in out-turned dollars. All budgets in DMO are now managed in out-turned dollars and remaining budgets have been out-turned. When a project transfers from Defence to DMO, the approved price for the project (ie the agreed DMO element of the project approval) is also in out-turned dollars.

c. **Objectivity.** The approved Government out-turned budget and the subsequent expenditure do not require potentially inaccurate adjustment to arrive at legitimately comparable figures. Budget is stated up front and incorporates a consideration of price movement, and can be compared with ordinarily price affected expenditure as it occurs.

d. **Simplicity and ease of making judgements about likely project cost performance**. As demonstrated by the example above, the out-turned budget presentation provides a clear view as to whether a project is likely to be completed within its approved budget.

Transition proposal to remove base date information

30. The current presentation of data includes actual expenditure and out-turned budget as well as the same data in *base date* terms (where possible and required) all included in Tables 2.1 and 2.2. An example of the current presentation is at Annex A.

31. For style purposes, DMO proposes to combine the table headings for 2.1 and 2.2 as 'Table 2.1 Project Budget and Expenditure History' and re-number the subsequent tables of section 2 appropriately.

32. As a transitional arrangement for the 2011-12 MPR that would be discontinued for subsequent reports, DMO proposes to retain the *base date* column for the 14 projects that were able to provide *base date* data for the 2010-11 MPR. An example of the proposed Section 2 tables for the 14 projects is presented at Annex B.

33. The DMO proposes the *base date* column be removed from Tables 2.1 in the PDSS template for the remaining projects. An example of how this would look is in annex C.

Conclusion

34. The financial information presented in the PDSSs of the MPR should assist the JCPAA to assess whether each project is likely to deliver the equipment required by Government within its approved budget. The key measures that need to be considered in doing this are the project's estimated cost, its expenditure to date and what is yet to be spent. These data should be presented in like terms.

35. The current approach to making these measures comparable does not require reporting of financial data in *base date* terms, which has proven problematic to implement. Additionally, there is no Commonwealth approved policy and method for determination of a *base date* and calculation of *base date* dollars, and the transference of contractual indexation rates on to other project expenditure introduces a significant margin of error since a significant portion of project actual costs do not come from variable price contracts.

36. DMO has proposed that the actual expenditure and out-turned budget presentation is the preferred approach as:

a. allows cost objectivity and is consistent with the historical cost convention,

b. it is consistent with the way that Defence and DMO financially manage projects,

c. it is consistent with the way that project financial information is reported through other public documents, and

d. it allows the JCPAA to readily assess the past cost performance and make judgements about likely cost outcomes.

37. A comparison year would enable DMO and the ANAO to develop an appropriate review strategy for future MPRs. It would also assist the JCPAA and the MPR reader in the transition from *base date* dollar to out-turned reporting. In that regard, it would be appropriate for projects that can reliably report contract expenditure information in *base date* terms to do so in the 2011-12 MPR via a separate table. Those projects would report the expenditure under the prime contract or where there is no prime contract but more than one materially significant contract, up to five contracts. 'Materially significant contracts' being those with a value equivalent to at least 10 per cent of total project value and being at least $10 million in value.

Recommendations

38. It is recommended that the JCPAA agree that:

a. table headings 'Table 2.1 Project Budget History' and 'Table 2.2 Project Expenditure History' of the PDSS template be combined to become 'Table 2.1 Project Budget and Expenditure History' as a heading for the first table in Section 2 (subsequent tables to be re-numbered accordingly);

b. for the 2011-12 MPR, the requirement to report expenditure in *base date* terms, only apply to the 14 projects that were able to provide *base date* dollar information in 2010-11 and, for these 14 projects, the *base date* column be retained in Table 2.1;

c. for the remaining projects, the *base date* column be removed from Table 2.1; and

d. for the 2012-13 MPR and future MPRs, the requirement to report project budgets and expenditures in base date terms be removed.

Annexes:

A. Financial performance schedule used in 2010-11 PDSS

B. Proposed Financial Performance Schedule for Projects Required to Report Base Date dollars in 2011-12 MPR

C. Proposed Financial Performance Schedule for Projects Not Required to Report Base Date Dollars in 2011-12 MPR

ANNEX A

FINANCIAL PERFORMANCE SCHEDULE USED IN 2010-11 PDSS

Section 2 – Financial Performance

Date	Description	*Base date $m*	Current $m		Contractor	Notes
2.1 Project Budget History						
Nov 03	Original Approved	3.1	3.1	3.1		1
Aug 04	Real Variation – Budgetary Adjustments	(0.1)	(0.1)			2
Sep 04	Real Variation – Scope	4.8	4.8			3
Nov 05	Real Variation – Scope	29.6	29.6			4
Jun 07	**Government Second Pass Approval**	2,920.8	2,920.8			
Oct 08	Real Variation – Transfer	9.4	9.4			5
		2,964.5		2,964.5		
Jun 10	Price Indexation			428.4		
Jun 10	Exchange Variation			(264.9)		
Jun 10	**Total Budget**	2,967.6		3,131.0		
2.2 Project Expenditure History						
Prior to Jun10		868.2	952.1		BAE Systems	
		53.98	59.2		Other	
		922.18		1,011.3		
FY to Jun 11		303.0	344.3		BAE Systems	
		9.06	10.3		Other	6
		312.06		354.6		
Jun 11	Total Expenditure	1,234.24		1,365.9		
Jun 11	Remaining Budget	1,733.36		1,765.1		

Notes	
1	This project's original DMO budget amount is that prior to achieving Second Pass Government approval.
2	Administration savings harvest.
3	To fund a risk reduction activity for the Project to obtain design data and develop designs to meet Australian essential requirements.
4	First Pass approval.
5	Transfer of funding for technical studies from DSTO.
6	Other expenditure comprises: Operating Expenditure, Offer Definition, Consultants, Foreign Military Sales, Contractor Support and Minor Capital expenditure not attributable to the Prime contract.

2.3 In-year Budget Expenditure Variance

Estimate $m	Actual $m	Variance $m	Variance Factor	Explanation
			FMS	
			Overseas Industry	
			Local Industry	
			Brought Forward	
			Cost Savings	
			FOREX Variation	
			Commonwealth Delays	
500.7	500.0	(0.7)	**Total Variance**	

2.4 Details of Project Major Contracts

Contractor	Signature Date	Price (Base) at		Type (Price Basis)	Form of Contract	Notes
		Signature	30 Jun 11			
BAE Systems	Oct 07	2,268.1	2,287.7	Firm	ASDEFCON	1

Notes	
1	Contract Price at Revision 35

Contractor	Quantities as at		Scope	Notes
	Signature	30 Jun 11		
BAE Systems	2	2	LHD ships and integrated support systems	

Major equipment received and quantities to 30 Jun 11
Detailed Design Review achieved. Construction of main hull sections underway.

PROPOSED FINANCIAL PERFORMANCE SCHEDULE FOR PROJECTS REQUIRED TO REPORT BASE DATE DOLLARS IN 2011-12 MPR PDSS

Section 2 – Financial Performance

2.1 Project Budget and Expenditure History

Date	Description	$m (base date)	$m (out-turned)		Contractor	Notes
Nov 03	Original Approved	3.1	3.1	3.1		1
Aug 04	Real Variation – Budgetary Adjustments	(0.1)	(0.1)			2
Sep 04	Real Variation – Scope	4.8	4.8			3
Nov 05	Real Variation – Scope	29.6	29.6			4
Jun 07	**Government Second Pass Approval**	2,920.8	2,920.8			
Oct 08	Real Variation – Transfer	9.4	9.4			5
		2,964.5		2,964.5		
Jun 10	Price Indexation			428.4		
Jun 10	Exchange Variation			(264.9)		
Jun 10	**Total Budget**	2,967.6		3,131.0		
Prior to Jun10	Expenditure	(868.2)	(952.1)		BAE Systems	
		(53.98)	(59.2)		Other	
		(922.18)		(1,011.3)		
FY to Jun 11		(303.0)	(344.3)		BAE Systems	
		(9.06)	(10.3)		Other	6
		(312.06)		(354.6)		
Jun 11	**Total Expenditure**	(1,234.24)		(1,365.9)		
Jun 11	**Remaining Budget**	**1,733.36**		**1,765.1**		

Notes	
1	This project's original DMO budget amount is that prior to achieving Second Pass Government approval.
2	Administration savings harvest.
3	To fund a risk reduction activity for the Project to obtain design data and develop designs to meet Australian essential requirements.
4	First Pass approval.
5	Transfer of funding for technical studies from DSTO.
6	Other expenditure comprises: Operating Expenditure, Offer Definition, Consultants, Foreign Military Sales, Contractor Support and Minor Capital expenditure not attributable to the Prime contract.

2.2 In-year Budget Expenditure Variance

Estimate $m	Actual $m	Variance $m	Variance Factor	Explanation
			FMS	
			Overseas Industry	
			Local Industry	
			Brought Forward	
			Cost Savings	
			FOREX Variation	
			Commonwealth Delays	
500.7	500.0	(0.7)	**Total Variance**	

2.3 Details of Project Major Contracts

Contractor	Signature Date	Price (Base) at Signature	Price (Base) at 30 Jun 11	Type (Price Basis)	Form of Contract	Notes
BAE Systems	Oct 07	2,268.1	2,287.7	Firm	ASDEFCON	1

Notes	
1	Contract Price at Revision 35

Contractor	Quantities as at Signature	Quantities as at 30 Jun 11	Scope	Notes
BAE Systems	2	2	LHD ships and integrated support systems	

Major equipment received and quantities to 30 Jun 11
Detailed Design Review achieved. Construction of main hull sections underway.

Note: DMO suggests changes to numbering and labelling of tables.

PROPOSED FINANCIAL PERFORMANCE SCHEDULE FOR PROJECTS NOT REQUIRED TO REPORT BASE DATE DOLLARS IN 2011-12 MPR PDSS

Section 2 – Financial Performance

2.1 Project Budget and Expenditure History

Date	Description	$m (out-turned)		Contractor	Notes
Nov 03	Original Approved		3.1		1
Aug 04	Real Variation – Budgetary Adjustments	(0.1)			2
Sep 04	Real Variation – Scope	4.8			3
Nov 05	Real Variation – Scope	29.6			4
Jun 07	**Government Second Pass Approval**	2,920.8			
Oct 08	Real Variation – Transfer	9.4			5
			2,964.5		
Jun 10	Price Indexation	428.4			
Jun 10	Exchange Variation	(264.9)			
Jun 10	**Total Budget**		3,131.0		
Prior to Jun10	Expenditure	(952.1)		BAE Systems	
		(59.2)		Other	
			(1,011.3)		
FY to Jun 11		(344.3)		BAE Systems	
		(10.3)		Other	6
			(354.6)		
Jun 11	**Total Expenditure**		(1,365.9)		
Jun 11	**Remaining Budget**	**1,733.36**	**1,765.1**		

Notes	
1	This project's original DMO budget amount is that prior to achieving Second Pass Government approval.
2	Administration savings harvest.
3	To fund a risk reduction activity for the Project to obtain design data and develop designs to meet Australian essential requirements.
4	First Pass approval.
5	Transfer of funding for technical studies from DSTO.
6	Other expenditure comprises: Operating Expenditure, Offer Definition, Consultants, Foreign Military Sales, Contractor Support and Minor Capital expenditure not attributable to the Prime contract.

2.2 In-year Budget Expenditure Variance

Estimate $m	Actual $m	Variance $m	Variance Factor	Explanation
			FMS	
			Overseas Industry	
			Local Industry	
			Brought Forward	
			Cost Savings	
			FOREX Variation	
			Commonwealth Delays	
500.7	500.0	(0.7)	**Total Variance**	

2.3 Details of Project Major Contracts

Contractor	Signature Date	Price (Base) at		Type (Price Basis)	Form of Contract	Notes
		Signature	30 Jun 11			
BAE Systems	Oct 07	2,268.1	2,287.7	Firm	ASDEFCON	1

Notes	
1	Contract Price at Revision 35

Contractor	Quantities as at		Scope	Notes
	Signature	30 Jun 11		
BAE Systems	2	2	LHD ships and integrated support systems	

Major equipment received and quantities to 30 Jun 11
Detailed Design Review achieved. Construction of main hull sections underway.

Note: In addition to removal of Base Date column, DMO also suggests changes to numbering and labelling of tables.