

Committee review

Introduction

- 3.1 Although the Committee observed that there has been overall improvement in the preparation and presentation of data in the 2010-11 MPR, there are a number of ongoing issues that continue to require attention.
- 3.2 The Committee still has concerns over the presentation of financial data and the inconsistency of information across projects.
- 3.3 The ANAO has identified a steady increase in the schedule slippage experienced by the major projects being tracked in the report.¹ This slippage raises a number of issues with regard to budget implications and the overall performance of the DMO.
- 3.4 The MPR is now well established and is a useful tool to monitor Defence major acquisitions and capability. Given this, it is timely to consider its future over the longer term, including the exit criteria for projects and the role of parliamentary committees and other stakeholders.
- 3.5 This chapter covers these issues and, in addition, examines the government response to recommendations from the Committee's previous review of the 2009-10 MPR², particularly with regard to clarity and timeliness.

1 Australian National Audit Office (ANAO), *2010-11 Major Projects Report: Defence Materiel Organisation*, Australian National Audit Office, Canberra, pp. 68-69.

2 Joint Committee of Public Accounts and Audit (JCPAA), *Report 422: Review of the 2009-10 Defence Materiel Organisation Major Projects Report*, April 2011.

- 3.6 This chapter covers the following topics:
- presentation of financial data;
 - business processes;
 - slippage/budget;
 - exit criteria;
 - guidelines;
 - evaluation;
 - timeliness and quality of responses; and
 - MPR identified as a priority audit.

Presentation of financial data

- 3.7 Since the inception of the MPR, the Guidelines have required contract values and project expenditure be reported in 'base date' dollars. This requirement has not been met in the previous MPRs in 2007-08, 2008-09, 2009-10 or the current 2010-11 MPR, resulting in qualified audits for each of these MPRs.
- 3.8 This issue has been the focus of discussion between the Committee, DMO and ANAO in successive years. The DMO has argued that the original proposal for reporting in base date dollars is not workable.³ At one stage the DMO proposed to use Assets Under Construction (AUC) data however, it was unable to implement this approach.⁴ Other suggested reporting methods have included 'constant' dollars and 'out-turned' dollars.⁵

3 Australian National Audit Office (ANAO), *2008-09 Major Projects Report: Defence Materiel Organisation*, Australian National Audit Office, Canberra, pp. 56-58; ANAO, *2009-10 Major Projects Report: Defence Materiel Organisation*, Australian National Audit Office, Canberra, pp. 100-101.

4 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', p. 4. (See Appendix C)

5 For a definition of the various dollar types see 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', p. 2. (See Appendix C)

- 3.9 The Committee's primary concern is for 'project expenditure information to be reported on in a constant manner'.⁶ The Committee seeks accessibility of the information presented and increased transparency through an approach that allows:
- ... for a constant set of expenditure information to be presented, allowing for ease of comparison between years, identification of any project concerns and overall more effective and efficient scrutiny.⁷
- 3.10 In order to reach a final solution, the Committee recommended in its report on the 2009-10 MPR that DMO prepare a report for the Committee examining the possible methods for the presentation of financial information in base date dollars, out-turned dollars and current dollars. Further, the report from DMO should provide a comprehensive proposal for transitioning to the proposed new arrangement. The Committee requested that the ANAO review the final proposal.⁸
- 3.11 The DMO's response to this recommendation proposed that financial information in the PDSSs be presented in out-turned dollars. The DMO argues that presentation of financial information in out-turned dollars:
- allows cost objectivity and is consistent with the historical cost convention;
 - is consistent with the way that Defence and DMO financially manage projects;
 - is consistent with the way that project financial information is reported through other public documents; and
 - allows the JCPAA to readily assess the past cost performance and make judgements about likely cost outcomes.⁹
- 3.12 While supporting the proposal to move to an out-turned dollar presentation, the ANAO initially cautioned that care would need to be taken to ensure that 'sufficient disclosures are maintained to allow

6 JCPAA, *Report 422: Review of the 2009-10 Defence Materiel Organisation Major Projects Report*, p. 35.

7 JCPAA, *Report 422: Review of the 2009-10 Defence Materiel Organisation Major Projects Report*, p. 35.

8 JCPAA, *Report 422: Review of the 2009-10 Defence Materiel Organisation Major Projects Report*, p. 37.

9 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*, p. 13. (See Appendix C)

assessments to be made of project performance against budget'.¹⁰ The ANAO suggested that such disclosures should include:

- budget at first and second pass approval;
- indexation amounts; and
- foreign exchange and real adjustments.¹¹

- 3.13 The ANAO's primary concern was DMO's suggestion to 'report project indexation at an aggregated level, in both the budgetary and expenditure sections of the PDSSs'.¹² In the ANAO's opinion this would reduce the amount of information provided.
- 3.14 After consultation, the DMO and ANAO provided the Committee with an agreed modified proposal for the presentation of financial data consisting of two formats, one for projects that received Government Approval prior to July 2010 and one for projects that received Government Approval after June 2010.¹³
- 3.15 To offer further clarification, the DMO and ANAO proposed that a 'Project Assurance Statement' be made available in the PDSSs that would 'provide an overall assessment of the project's budgetary position'.¹⁴ The Statement would indicate 'whether there is sufficient budget remaining to deliver the materiel element of capability at the agreed Final Materiel Release (FMR) milestone'.¹⁵
- 3.16 At the public hearing on 21 March 2012, the Committee asked the Auditor-General if he was satisfied with the new financial reporting proposal. He told the Committee that he was satisfied and that the suggested Project Assurance Statement was a significant step forward:

... instead of readers having to make their own assessment about how the project is going, and they may still do that, DMO will be

10 Correspondence from Mr Ian McPhee, Auditor-General to Mr Robert Oakeshott, Chair, Joint Committee of Public Accounts and Audit. (See Appendix D)

11 Correspondence from Mr Ian McPhee, Auditor-General to Mr Robert Oakeshott, Chair, Joint Committee of Public Accounts and Audit. (See Appendix D)

12 Correspondence from Mr Ian McPhee, Auditor-General to Mr Robert Oakeshott, Chair, Joint Committee of Public Accounts and Audit. (See Appendix D)

13 Correspondence from Mr Warren King, Chief Executive Officer, Defence Materiel Organisation to Mr Robert Oakeshott, Chair, Joint Committee of Public Accounts and Audit. (See Appendix E)

14 Correspondence from Mr Warren King, Chief Executive Officer, Defence Materiel Organisation to Mr Robert Oakeshott, Chair, Joint Committee of Public Accounts and Audit. (See Appendix E)

15 Correspondence from Mr Warren King, Chief Executive Officer, Defence Materiel Organisation to Mr Robert Oakeshott, Chair, Joint Committee of Public Accounts and Audit. (See Appendix E)

providing an assessment from their perspective as to whether there is sufficient budget to complete this project to expectations.¹⁶

3.17 The Committee observed that, contrary to the Auditor-General's initial request, the proposed format for the presentation of financial data for post June 2010 projects did not contain any indication of price indexation figures. The DMO maintained that indexation was unnecessary to provide the clarity the Committee was looking for.

3.18 In the view of the DMO, indexation could be misleading as the DMO has to create indexation figures and it is therefore 'an artificial artefact of the pricing'.¹⁷ The DMO informed the Committee that predicting indexation figures is complex because of the number of factors involved, including labour and materials:

Sometimes there can be 50 or 60 indexes or just a global government indexation because you cannot break it apart.¹⁸

3.19 On the other hand, the DMO explained that the inclusion of the Project Assurance Statement would provide transparency regarding whether or not a project will be completed 'under the approved budget'.¹⁹ The DMO believe that the relevant information is 'whether we are doing it in the time frame that we said we would do it for government'.²⁰

3.20 With regard to the financial reporting framework, the DMO considers that identifying changes to the actual cost and the scope of a project are the most important information to be disclosed in the MPR.²¹ The DMO believe that the proposed format for financial reporting will:

... make it very clear to the committee what was approved by government, what the cost impacts and budgetary accumulations have been to date, and what in our judgement is our ability to complete that project inside the government approved funding.²²

3.21 To demonstrate the complexity and uncertainties of calculating indexation, the DMO provided the example of the Air Warfare Destroyer Build (SEA 4000 Ph 3) from the current MPR. This project went to contract

16 Mr Ian McPhee, Auditor-General, Australian National Audit Office (ANAO), *Committee Hansard*, Canberra, 21 March 2012, p. 2.

17 Mr Warren King, Chief Executive Officer (CEO), Defence Materiel Organisation (DMO), *Committee Hansard*, Canberra, 21 March 2012, p. 4.

18 Mr King, DMO, *Committee Hansard*, Canberra, 21 March 2012, p. 4.

19 Mr King, DMO, *Committee Hansard*, Canberra, 21 March 2012, p. 4.

20 Mr King, DMO, *Committee Hansard*, Canberra, 21 March 2012, p. 4.

21 Mr King, DMO, *Committee Hansard*, Canberra, 21 March 2012, p. 4.

22 Mr King, DMO, *Committee Hansard*, Canberra, 21 March 2012, p. 5.

in 2007 before the effects of the global financial crisis began to be felt. The DMO calculated the long-term cost demands for materiel and labour over a 10 year period across the economies of the countries that would contribute to the project, including Australia, Spain, America and Norway. However the DMO explained that the fluctuations caused by the onset of the global financial crisis severely affected the DMO's projections:

Early in the project, the world inflation indexes, just before the global financial crisis, were going very strongly and we were seeing demanding pressure coming in on a number of those indexes, which were outstripping what we had anticipated. Since then, the global financial crisis has had a significant slowing down on the impact of a lot of those indexes – prices for steel and copper, and a lot of copper pipework and labour was coming from overseas – so a lot of that pressure has gone away. Broadly, as reported in [the MPR], we are still operating inside what we projected.²³

- 3.22 While noting this argument, the Committee questioned why the information on indexation could not be made public considering that the DMO had made the calculations for each project. The DMO conceded that providing the information 'would not be impossible but it would be a considerable amount of work'.²⁴ The DMO told the Committee that there is a difference between calculating an estimated indexation figure at the beginning of a project and disaggregating that figure annually as invoices are paid:

The building up of the initial cost model ... – and it could be 60 or 70 indices ... – is only an estimate in terms of the total cost. That total cost is the approval value, not an itemised breakdown of the cost.²⁵

- 3.23 The Committee suggested that perhaps an approximate estimation of the indexation on a project could be publicly disclosed. However, the DMO reiterated that the information is not made public and is not part of the proposal that goes to government:

That information is not normally public. The cost model is normally signed off by the department of finance in terms of how those costs are developed but the breakdown – again, getting back

23 Mr King, DMO, *Committee Hansard*, Canberra, 21 March 2012, p. 5.

24 Mr Steve Wearn, Chief Finance Officer, Defence Material Organisation (DMO), *Committee Hansard*, Canberra, 21 March 2012, p. 5.

25 Mr Wearn, DMO, *Committee Hansard*, Canberra, 21 March 2012, p. 5.

to that itemisation – is not part of the proposal that goes to government. It is a total cost.²⁶

3.24 Asked again if he supported the DMO proposal, the Auditor-General told the Committee that, after robust discussions with the DMO, the ANAO has been persuaded that the proposal will provide the information required. The Auditor-General admitted that, as budgetary figures are now being presented in out-turned dollars, ‘any indexation figures that would be included would be notional’.²⁷ He also indicated that the ANAO had considered the administrative cost of providing the indexation figures.²⁸

3.25 In summary, the Auditor-General told the Committee that the ANAO accepted the strength of the DMO argument for the proposed financial reporting framework and that the Project Assurance Statement would provide:

... a more comprehensive and valuable statement for the committee to get than an additional notional line on what the indexation figure would be presented in an out-turn basis. I think it is a better figure for the committee to have, because you are interested in the big picture, not the detail, generally speaking.²⁹

Committee comment

3.26 The Committee appreciates the work that the DMO and the ANAO have undertaken to progress the ongoing issue of the presentation of financial data in the MPR, despite this work only occurring after pressure was applied by the Committee.

3.27 The Committee accepts the argument to move to out-turned dollars for the financial performance reporting in the MPR for all new projects. The Committee acknowledges that this method is consistent with the Commonwealth budgetary framework and accounting conventions.

3.28 The Committee therefore endorses the proposed out-turned presentation for future MPRs.

3.29 Further, the Committee accepts the Auditor-General’s recommendation that there is no need for a transitional arrangement for the 2011-12 MPR

26 Mr Wearn, DMO, *Committee Hansard*, Canberra, 21 March 2012, p. 5.

27 Mr McPhee, ANAO, *Committee Hansard*, Canberra, 21 March 2012, p. 5.

28 Mr McPhee, ANAO, *Committee Hansard*, Canberra, 21 March 2012, p. 5.

29 Mr McPhee, ANAO, *Committee Hansard*, Canberra, 21 March 2012, p. 6.

showing both base date dollars and out-turned dollars for the 11 projects previously providing information in base date dollars.

- 3.30 Some Members of the Committee remain concerned that the lack of indexation information will hinder appropriate scrutiny. However, the Committee accepts the Auditor-General's assurance that the proposed format for financial reporting for the MPR will provide sufficient information on projects to satisfy transparency and accountability requirements.
- 3.31 The Committee therefore endorses the proposed format, including the inclusion of a Project Assurance Statement for each project.
- 3.32 However, the Committee expects the DMO to work constructively with the ANAO to ensure that Project Assurance Statements provide a level of scrutiny and commentary on a project that the ANAO, and subsequently the Committee, deems appropriate for maintaining transparency and accountability.
- 3.33 In this regard, the Committee will closely monitor the reliability of Project Assurance Statements over time and will revisit the issue if needed.
- 3.34 During the inquiry the Committee was given the impression that the DMO did not actively monitor and manage project budget risks due to indexation effects. This is of concern to the Committee, considering that indexation represents a major budget component.
- 3.35 Nevertheless, the Committee notes that the move to out-turned dollar budgeting puts the onus on the DMO to manage indexation within existing budgets. Therefore, overall the Committee acknowledges that the DMO will be compelled to proactively manage indexation risk and anticipates that the approved new format for financial reporting will be sufficient for the time being.

Business processes

- 3.36 As in previous MPRs, the ANAO found inconsistency of information recorded across projects, however, it acknowledged that the DMO is taking steps to address the issue.³⁰ In particular the ANAO identified

30 ANAO, *2010-11 Major Projects Report: Defence Materiel Organisation*, pp. 84-85.

difficulties resulting from ongoing inconsistency with regard to financial management, risk management and document management systems.³¹

- 3.37 With regard to risk management, the ANAO noted that corporate awareness of the issue had improved. However, the ANAO found that little progress had been made at project level to improve the 'consistency of risk management across the Major Projects'.³²
- 3.38 This is a concern shared by others. In his submission to the review, Mr E.J. Bushell, Air Commodore, RAAF, Retired, informed the Committee that the ongoing poor standard of risk management can be traced to the continuing use of a commercial model of project management. Mr Bushell maintains that the 'primary cause of project risk lies in the operational and technical areas of the project'.³³ He advocates a return to what he calls 'engineering management' to combat the problems and refocus on achieving capability:
- Effective capability management requires that all capability functions – operational, systems and equipment engineering, test and acceptance functions and support requirements, including their associated risks, must come under tight Project and Systems Engineering management, and that commercial management must be constrained to contract management that supports project management objectives.³⁴
- 3.39 The DMO was asked by the Committee to provide further information on progress regarding the rationalisation of its business systems and improvements to risk management training for staff in questions on notice.
- 3.40 The DMO's response focused on risk management only, stating that DMO is working to reduce the number of risk management tools used and is currently developing a risk categorisation framework for dissemination in 2012. DMO has also been undertaking risk management training, including using online learning initiatives.³⁵

31 ANAO, *2010-11 Major Projects Report: Defence Materiel Organisation*, p. 84.

32 ANAO, *2010-11 Major Projects Report: Defence Materiel Organisation*, p. 40.

33 Mr E.J. Bushell, Air Commodore, RAAF, Rtd, *Submission 1*, p. 11.

34 Mr Bushell, *Submission 1*, p. 11.

35 Defence Materiel Organisation, *Submission 3, Answer to Question on Notice, Question 5*.

Committee comment

- 3.41 The Committee is concerned with the continuing inconsistency of information across projects as it affects the reliability of the information in the PDSSs and ultimately lowers the quality of the MPR.
- 3.42 The Committee is concerned that despite some action being taken to improve consistency of information the expected improvements have not yet been achieved. Previous evidence to the Committee indicated that the problem dates back to around 2000 and that it would take time to resolve.³⁶ However, the Committee believes that, after some 12 years, more progress should have been made to address the issue.
- 3.43 The Committee understands that some improvement has been made, and notes the work underway on risk management practices. The Committee is encouraged to by the additional risk management training (in particular the use of online training approaches), and the development of a risk categorisation framework.
- 3.44 However, it was not clear what efforts were being made on financial management or document management systems. As such, the Committee expects to see concrete evidence of results and progress to achieve consistency of information across projects reported in the next MPR.

Slippage/budget

- 3.45 The ANAO found that of the 28 major projects in the 2010-11 MPR, 14 projects have experienced schedule slippage.³⁷ Total slippage across the major projects is 760 months, a 31 per cent increase on the original planned schedule for achieving Final Operational Capability (FOC).³⁸ ANAO analysis shows that the DMO received a total of an additional \$295 million in price indexation (up to 30 June 2011) to account for this slippage.³⁹
- 3.46 Although the ANAO review found that none of the major projects have 'exceeded their approved budgeted cost'⁴⁰, the ANAO indicate that

36 JCPAA, *Report 422: Review of the 2009-10 Defence Materiel Organisation Major Projects Report*, p. 30.

37 ANAO, *2010-11 Major Projects Report: Defence Materiel Organisation*, p. 22.

38 ANAO, *2010-11 Major Projects Report: Defence Materiel Organisation*, p. 22.

39 ANAO, *2010-11 Major Projects Report: Defence Materiel Organisation*, p. 51.

40 ANAO, *2010-11 Major Projects Report: Defence Materiel Organisation*, p. 51.

schedule delays do increase the overall costs as both staffing and administrative resources are 'tied up for longer than planned'.⁴¹

- 3.47 The DMO classify acquisition projects as either Military-Off-The-Shelf (MOTS), Commercial-Off-The-Shelf (COTS), Australianised MOTS, or Developmental.⁴² While the ANAO identified a number of reasons for schedule slippage, it singled out misclassification of projects under this procurement system as Off-The-Shelf (OTS) instead of Developmental as a significant contributor to slippage.⁴³
- 3.48 The Committee asked the DMO to provide additional information on the possible drivers for slippage, what is being done to improve the classification of projects, and the cost impacts of slippage.
- 3.49 DMO listed the possible drivers of slippage as:
- initial optimism;
 - the realisation of emergent risks;
 - platform availability and higher priority operational requirements;
 - stability and clarity of requirements; and
 - technical regulatory compliance.⁴⁴
- 3.50 DMO suggested that the move to the Two Pass Process, Gate Reviews and several other initiatives, are expected to reduce these drivers of slippage.
- 3.51 Regarding the misclassification of projects, the DMO listed several initiatives they are taking to improve outcomes and to be more realistic about project delivery times. In addition to the Gate Reviews, these included:
- the use of Emerging Project Teams – where DMO works with the Defence Capability Development Group to ensure the process for first pass approval is more robust and DMO expertise is engaged earlier in the process;
 - offer Definition Activities – where DMO works with shortlisted tenderers to ensure risks and schedules are more realistic; and
 - the planned use of Implementation Risk Categories –to be introduced in 2012 to assist project teams in the initiation phases with the

41 ANAO, *2010-11 Major Projects Report: Defence Materiel Organisation*, p. 62.

42 ANAO, *2010-11 Major Projects Report: Defence Materiel Organisation*, p. 118.

43 ANAO, *2010-11 Major Projects Report: Defence Materiel Organisation*, pp. 62-63.

44 Defence Materiel Organisation, *Submission 3, Answer to Question on Notice, Question 1*.

classification, early identification, and comprehensive assessment of technical and implementation risks.⁴⁵

- 3.52 Regarding the costs of slippage, the DMO contended that there are several factors which mitigate the costs of slippage, including: that price indexation is factored into project budgets; that contractor caused slippage costs are claimed by DMO through liquidated damages; and that slippage caused by Defence is covered by a project's contingency budget in the first instance.⁴⁶
- 3.53 DMO acknowledged that where 'a project's contingency budget is estimated to be insufficient to cover any additional costs ... then the Project must seek approval for a Real Cost Increase or a reduction in scope.'⁴⁷ DMO's submission shows that only two projects since July 2005 have required real cost increases.
- 3.54 However, DMO also acknowledged that several slippage related costs are not part of the project budget, such as those associated with sustainment of legacy platforms, or needing to lease capability systems from other countries in order to fill temporary capability gaps. Furthermore, additional costs associated with prolongation of DMO workforce are funded through DMO's direct appropriation.⁴⁸

Committee comment

- 3.55 The steady increase in schedule slippage over the life of the MPRs is of major concern to the Committee, both in terms of timely delivery of capability to the ADF and in budgetary terms.
- 3.56 The Committee finds the narrow focus on claiming that project budgets are not exceeded despite significant slippage unhelpful. The Committee acknowledges that there are several factors that minimise the risk of cost blowouts to government above a project's initial budget approval, but it is clear that there are additional cost impacts which are possibly significant.
- 3.57 It is the Committee's understanding that indexation is only factored in to a project's budget for projects commencing after 2010 and that indexation is a separate line item for projects commencing before this date. Therefore, poorly estimated or unmanaged indexation risks for pre-2010 projects

45 Defence Materiel Organisation, *Submission 3*, Answer to Question on Notice, Question 3.

46 Defence Materiel Organisation, *Submission 3*, Answer to Question on Notice, Question 2.

47 Defence Materiel Organisation, *Submission 3*, Answer to Question on Notice, Question 2.

48 Defence Materiel Organisation, *Submission 3*, Answer to Question on Notice, Question 2.

have a real effect on Government expenditure, which is not acknowledged in DMO's submission.

- 3.58 Furthermore, the broader impacts of sustaining legacy platforms, possibility leasing capability, and ongoing administration costs are all 'off project' increases of the total cost to Government. Given the duration of slippage these costs may be significant.
- 3.59 The reality is that projects which take longer to complete cost the Australian taxpayer more, even if the project is technically within budget.
- 3.60 Although DMO now have some mechanisms in place to improve the initial classification of projects and to reduce slippage, the Committee emphasises the importance of focused action in this area.
- 3.61 The Committee believes that the transparency of initial classification decisions could still be improved. Specifically, the Committee wants to see that MOTS and COTS options have been explicitly considered and eliminated for particular reasons before final procurement decisions have been made. The Committee wishes to see this information included in the MPR for all new projects.
- 3.62 The Committee notes the planned 2012 introduction of the Implementation Risk Category process and hopes this supports teams during the initial project planning phases. To complement this and other DMO initiatives the Committee suggests that the DMO consider additional staff training regarding the classification of projects.
- 3.63 The Committee acknowledges that the evidence suggests the majority of the schedule slippage is made up of legacy projects and indicates that initiatives to improve processes are having an effect on minimising slippage. However, the Committee recommends that a section be included in future MPRs that specifically provides explicit information on the activities being undertaken to minimise schedule slippage and the tangible results of these initiatives - so that these can be explicitly monitored and scrutinised over time.

Recommendation 1

The Joint Committee of Public Accounts and Audit recommends that the Defence Materiel Organisation include in the 2011-12 Major Projects Report a section specifically providing information on the activities being undertaken to minimise schedule slippage and the results of those activities.

Exit criteria

- 3.64 In its report on the 2009-10 MPR the Committee recommended that the exit criteria be the point at which both Final Materiel Release (FMR) and Final Operational Capability (FOC) is achieved.⁴⁹ Additionally the Committee asked the DMO to provide a report to the JCPAA on an assessment of the difference in scale, size and incidence of requirements to be completed between FMR and FOC in order that the appropriateness of these exit criteria be further examined.⁵⁰
- 3.65 In its initial response to the Committee, the DMO indicated that it considered that FMR was the 'logical end point to trigger the removal of a project from the MPR' as it is the 'point in time at which the DMO has satisfied its responsibility for acquisition of the materiel element of capability'.⁵¹
- 3.66 The DMO explained that FMR relates to the materiel element of capability, which is only one of the eight Fundamental Inputs to Capability (FIC).⁵² As a project must attain all eight elements of FIC to reach FOC and these elements are managed by various Defence agencies, the DMO argues that FMR is the reasonable point at which to remove a project from the MPR.⁵³

49 JCPAA, *Report 422: Review of the 2009-10 Defence Materiel Organisation Major Projects Report*, p. 20.

50 JCPAA, *Report 422: Review of the 2009-10 Defence Materiel Organisation Major Projects Report*, p. 20.

51 Department of Defence, 'Government Response to *Report 422: Review of the 2009-10 Defence Materiel Organisation Major Projects Report*'. (See Appendix F)

52 The Fundamental Inputs to Capability (FIC) are: organisation, personnel, collective training, materiel systems, supplies, facilities, support, command, and management. See ANAO, *2010-11 Major Projects Report: Defence Materiel Organisation*, p. 111.

53 Department of Defence, 'Government Response to *Report 422: Review of the 2009-10 Defence Materiel Organisation Major Projects Report*'. (See Appendix F)

3.67 In an additional response to the Committee the DMO proposed the following approach:

- DMO reports progress to FMR through full disclosure in the PDSSs. The PDSS is then assured by the ANAO:
 - ⇒ the DMO's delivery to FMR is the materiel element of the mature capability, which accounts for approximately 95% (range of 85% - 100%) of the Government approved funding and normally the majority of project schedule.
- Defence (through the relevant Capability Manager) reports progress to FOC 'post-FMR'. This report would not be subject to ANAO assurance. The Defence reports would be an addendum in the MPR, and separate to the PDSS.⁵⁴

3.68 The Committee asked the DMO for an assurance that the proposed reporting format would be simple and explicit and allow stakeholders to compare and contrast information. The DMO assured the Committee that the process would conform to the current format and be transparent:

The detailed PDSSs will be up to FMR. Once FMR is declared, we will then move the projects into an addendum to the report, where we will report the activities from FMR to FOC that is looking at the fundamental inputs to capability, additionally to the materiel components.⁵⁵

3.69 The Committee asked the Auditor-General if he would be able to supply an assurance audit on the proposed new reporting format, particularly for the FOC 'post-FMR' reporting. The Auditor-General explained that as a range of parties would be involved in 'providing support to the provision of the final capability', he would only be able to provide limited assurance:

We can modify our report to make it clear what we are giving assurance around, but I would foreshadow that some of these other functions that have to be provided would be problematic for us to give assurance around.⁵⁶

3.70 The Committee asked the DMO to provide further clarification of the proposed changes to the exit criteria for projects from the MPR in

54 Department of Defence - Defence Materiel Organisation, 'Proposal to establish exit criteria (sic) for projects in the Defence Materiel Organisation Major Projects Report: Additional submission to *'Government Response to the JCPAA Report 422: Review of the 2009-10 Defence Materiel Organisation Major Projects Report'* of 8 November 2011, regarding Recommendations 3 and 4. (See Appendix G)

55 Ms Shireane McKinnie, General Manager Systems, Defence Materiel Organisation (DMO), *Committee Hansard*, Canberra, 21 March 2012, p. 2.

56 Mr McPhee, ANAO, *Committee Hansard*, Canberra, 21 March 2012, p. 2.

questions on notice, including what consultation had been undertaken with Defence and the ANAO on the proposal.

- 3.71 DMO's Question on Notice responses clarify that the Defence Capability Managers have been consulted in the development of the proposal and have raised no objections⁵⁷. However, no information was provided on consultation with the ANAO.
- 3.72 As part of their Question on Notice response the DMO also provided a worked example of the format for the proposed post-FMR report and clarified that in their opinion the achievement of FMR is a single point in time that is auditable.

Committee comment

- 3.73 The Committee has reservations about the proposed changes to exit criteria for projects from the MPR. The Committee wishes to see more detail of any proposed new reporting format; to be assured that the ANAO has been consulted on and is supportive of the proposal; and believes that the practicalities of the proposed change warrant further consideration before making a decision to move away from the current exit criteria arrangements.
- 3.74 The Committee notes that the DMO estimates that delivery to FMR accounts for approximately 95% of the Government approved funding for a project and that a project 'post-FMR' largely becomes the responsibility of the relevant Capability Manger. However, the Committee also notes that evidence from MPRs to date suggests that some projects experience considerable difficulties 'post-FMR', and that the DMO continues to share responsibility for these projects. This indicates to the Committee that schedule slippage and budget could both be affected to some degree, in the 'post-FMR' period. Therefore, although there may be a technically clear distinction between DMO's achievement FMR and subsequent FOC initiatives, in reality the process is more complex and involved.
- 3.75 The Committee is aware that changes to the exit criteria for projects from the MPR have substantial implications for the purpose and aim of the MPR, and hence should be approached with caution.
- 3.76 Therefore, the Committee believes that the type and amount of information provided in any 'post-FMR' reporting format will have to be more carefully considered to maintain visibility of cost and scheduling as well as capability. The Committee also believes that any future 'post-FMR'

57 Defence Materiel Organisation, *Submission 3*, Answer to Question on Notice, Question 6.

reporting format should also be included in the MPR Guidelines endorsed by the Committee, even if separate to the PDSSs, in order to maintain an appropriate level of transparency and accountability.

- 3.77 Therefore the Committee retains its previous opinion and believes that reporting on both FMR and FOC should be included in the MPR and in the PDSSs for the time being.

Guidelines

- 3.78 Historically, the Guidelines for the PDSSs have been developed by the DMO in consultation with the ANAO. The Guidelines are then endorsed by the JCPAA and form a base for the ANAO review of the major projects report.
- 3.79 The Committee considers that the Guidelines are now a stable document, reflecting the requirements of the MPR. The Committee believes that the Guidelines should continue to be developed jointly by the DMO and ANAO. However, as the Guidelines provide the basis for the ANAO audit, the Committee recommends that, in the interests of administrative efficiency, the ANAO should take administrative responsibility for updating the Guidelines and their submission to the JCPAA for endorsement.

Recommendation 2

The Joint Committee of Public Accounts and Audit recommends that the Defence Materiel Organisation and the Australian National Audit Office continue to develop the Major Project Report Guidelines jointly but that the Australian National Audit Office take administrative responsibility for updating the Guidelines and submitting them to the Joint Committee of Public Accounts and Audit annually.

Evaluation

- 3.80 The JCPAA was instrumental in instigating the development of the MPR to provide both the Parliament and the wider Australian community with accessible, transparent and accurate information about the status of

Defence's major acquisition projects. The original aim was to encourage transparency and accountability by providing a basis for longitudinal analysis of project performance.

3.81 The Committee was interested to know if the MPR was useful to the DMO in terms of an overarching project management resource. The DMO notes in the 2010-11 MPR that the Report provides a valuable 'organisational perspective' on major project work and performance for the DMO, as well as enhancing the quality of trend analysis.⁵⁸

3.82 In his opening statement to the public hearing, the CEO of the DMO confirmed the benefit of the MPR to the DMO:

... I hold a firm belief that the major projects report provides my organisation with an ideal opportunity to demonstrate a high level of accountability and transparency to government, parliament and the Australian public on DMO's performance in managing the acquisition of Defence's largest and most technically challenging projects.⁵⁹

3.83 In a question on notice the Committee asked the DMO how the MPR is used by other agencies or groups, and if any evaluation had been done of the use of the MPR by external stakeholders.

3.84 DMO's response reaffirmed the internal value of the MRP, as well as its use by Defence, other parliamentary committees, and potentially the United Kingdom Minister of Defence. DMO noted that to date they have not evaluated the use of the MPR by other Government agencies, and by default other external stakeholders.⁶⁰

Committee comment

3.85 The Committee is pleased to hear that the MPR is providing a useful organisational resource for the DMO and within Defence.

3.86 The Committee is satisfied that the current format of the MPR is largely achieving the original goal for the Report, of increasing the transparency and accountability of major defence procurements. Therefore, it is now timely to consider the future direction of parliamentary scrutiny of the MPR.

58 ANAO, *2010-11 Major Projects Report: Defence Materiel Organisation*, p. 95.

59 Mr King, DMO, *Committee Hansard*, Canberra, 21 March 2012, p. 1.

60 Defence Materiel Organisation, *Submission 3*, Answer to Question on Notice, Question 4.

- 3.87 As part of this consideration, the Committee intends to consult broadly with other relevant parliamentary committees, and potentially other users of the report, regarding their use of the MPR. This consultation will focus on how the various parliamentary committees can work more effectively together to sustain, and indeed improve, the scrutiny of the MPR and related defence capability development projects.
- 3.88 Despite the Committee considering the future parliamentary scrutiny of the MPR, the Committee stresses that the MPR is and will continue to be a critical resource into the future. There are further improvements still to be made to the report itself, as well as improvements on the issues the report exposes.
- 3.89 To assist it in its deliberations the Committee is interested in gauging how extensively the MPR is utilised by external stakeholders. Therefore, the Committee recommends that the DMO include a discussion on the use by, and value of, the MPR by external stakeholders, such as private companies or industry associations, in the 2011-12 MPR.

Recommendation 3

The Joint Committee of Public Accounts and Audit recommends that the Defence Materiel Organisation includes a discussion on the use by, and value of, the Major Projects Report by external stakeholders in the 2011-12 Major Projects Report.

Timeliness and quality of responses

- 3.90 In order to streamline the MPR process, the Committee recommended that the DMO provide the proposed MPR Work Plan, including the MPR Guidelines, to the Committee by 31 August each year for its endorsement.
- 3.91 The Committee also requested the response to recommendation 7 for *Report 422: Review of the 2009-10 Defence Materiel Organisation Major Projects Report* by 31 August 2012.
- 3.92 The DMO was unable to meet these deadlines.
- 3.93 Additionally, the 2010-11 MPR which was expected to be tabled in November 2011, was not tabled in the Parliament until December 2011, after the Parliamentary sitting period had finished.

- 3.94 As well as issues with the timeliness of providing responses and information to the Committee, there has been some difficulty with the clarity and quality of information.
- 3.95 The initial Government response to the Committee's recommendations for *Report 422: Review of the 2009-10 Defence Materiel Organisation Major Projects Report* included a number of anomalies, compelling the Committee to seek clarification on several ambiguous and incomplete answers.
- 3.96 Furthermore, the responses to the Committee's Questions on Notice were delivered several weeks late, hindering the Committee's inquiry.

Committee comment

- 3.97 The Committee is disappointed at the repeated failure by the DMO and the Government to provide timely and complete responses to its reports and requests. These delays and incomplete responses have hindered the inquiry and ultimately also hinder improvements to the quality of the MPR.
- 3.98 The Committee set the proposed deadlines for the receipt of information from the DMO in an attempt to ensure that the MPR process would proceed in a timely manner. The suggested deadlines would have afforded the Committee more time to scrutinise the information and provide a more considered response, or allowed additional discussion of the issues as needed.
- 3.99 In the case of the questions on notice following the public hearing, the Committee understands that it set a tight timeframe for the responses. However, this was unavoidable given the previous delays by the DMO which resulted in issues remaining unresolved during the year.
- 3.100 Regarding the quality of responses, the Committee believes that the initial Government response could have been clearer, more precise and more complete. In future, the Committee expects the DMO and the Government to provide considered, relevant, and appropriately detailed responses to Committee recommendations and requests, in order to minimise the need for subsequent clarification.
- 3.101 Finally, if there is continued evidence that DMO may not be respecting the Parliament and its committees the JCPAA will look on this extremely unfavourably.

MPR identified as a priority audit

- 3.102 Under the recent amendments to the *Auditor-General's Act 1997*, the Committee may identify an assurance audit as a priority for the Auditor-General. The provision allows the Auditor-General to use the information gathering process under the Act rather than relying on the agreement of the entity being audited. In effect, this circumvents delays and provides for a quicker auditing process.
- 3.103 Considering the importance of the MPR and the tight timeframe that it operates in, the Committee has identified future MPRs as priority assurance reviews to the Auditor-General.

Robert Oakeshott MP
Committee Chair
May 2012

