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Stephen Smith MP
Minister for Defence

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Mr Robert Oakeshott MP
Chair
Joint Committee on Public Accounts and Audit
Parliament House
CANBERRA ACT 2600

Rob

Dear Mr Oakeshott

I write concerning the 422nd Report of the Joint Committee on Public Accounts and Audit - *Report 422: Review of the 2009-10 Defence Materiel Organisation Major Projects Report*.

I enclose a copy of Defence's Government Response to the Report's recommendations and a minute from the Secretary of the Department of Defence, Mr Duncan Lewis AO DSC CSC to Mr David Brunoro, Committee Secretary, which advises that the Report's recommendations are administrative in nature.

Yours sincerely

Best wishes

Stephen Smith

JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT
REPORT 422: REVIEW OF THE 2009-10 DEFENCE MATERIEL
ORGANISATION MAJOR PROJECTS REPORT

RECOMMENDATIONS FOR DEFENCE

Major Projects Report Work Program

Recommendation 1

That the Major Projects Report (MPR) Work Plan (which contains the MPR Guidelines) be provided to the Joint Committee of Public Accounts and Audit (JCPAA) concurrently with the list of proposed projects for inclusion and exclusion in the following year's MPR, not later than 31 August each year.

Response: Agree (administrative)

The JCPAA's requirement that it be consulted by no later than 31 August each year provides sufficient lead time to: undertake preparations for the following year's MPR Program; develop the proposed list of DMO projects for MPR inclusion in the following year (in accordance with the JCPAA endorsed project entry criteria); and provide a draft 'DMO MPR Work Plan' that will detail key management aspects planned for the following year's MPR Program.

After Parliamentary Tabling of the DMO MPR each November, the DMO and ANAO will be able to review the previous year's MPR Program and incorporate identified improvements into a redrafted DMO MPR Work Plan. The DMO and ANAO would then seek JCPAA endorsement of the revised DMO MPR Work Plan at the JCPAA Committee Hearing in February/March of the next year.

Recommendation 2

That Projects of Concern (PoC) not be specifically included in the selection criteria for projects to be reported on in the MPR, but where projects reported on in the MPR are also PoC, that they continue to be identified as such.

Response: Agree (administrative)

The DMO MPR places a strong emphasis on longitudinal analysis on all projects selected as per the endorsed JCPAA selection criteria. The DMO believes that the current JCPAA endorsed selection criteria provide a robust mechanism for project selection that ensures an appropriate level of transparency and reporting over the DMO's largest acquisition projects.

Projects reported in the DMO MPR that are also a PoC will continue to be identified as such.

Recommendation 3

That the exit criteria for projects reported on in the Major Projects Report be the point at which both Final Materiel Release and Final Operational Capability (as currently defined by the Defence Materiel Organisation and Department of Defence respectively) is achieved.

Response: Agree in Principle (administrative)

In January 2010, the Defence Committee endorsed the concept of Initial Materiel Release (IMR) and Final Materiel Release (FMR) milestones. The IMR-FMR construct is designed to clearly define the points at which the DMO is to meet its responsibilities for the acquisition of materiel supplies – the materiel element of capability. The materiel element of capability is but one element of a number of Fundamental Inputs to Capability (FIC). The Capability Manager is responsible for integrating the FICs to achieve a capability state that can be operationally deployed by the Capability Manager. Other FICs that are managed by various Defence Agencies would typically include, but are not limited to, operator training (Capability Manager), facilities and infrastructure (Defence Support Group), IT infrastructure (Chief Information Officer Group) - achievement of all FICs would then provide the trigger point for Capability Manager endorsement of either an Initial Operational Capability (IOC) state or Final Operational Capability (FOC) state.

The DMO MPR provides a valuable insight to the DMO's management performance on the materiel element of capability from Government Second Pass Approval to achievement of FMR. The DMO considers achievement of FMR (the point in time at which the DMO has satisfied its responsibility for acquisition of the materiel element of capability) as the logical end point to trigger the removal of a project from the MPR.

Recommendation 4

That in determining whether the exit criteria is appropriate for future Major Projects Reports (MPRs), that the Defence Materiel Organisation's assessment of the difference in scale, size and incidence of requirements to be completed between Final Materiel Release and Final Operational Capability be provided to the Joint Committee of Public Accounts and Audit as soon as possible to allow for the implementation of any changes to occur for the 2011-12 MPR. In conducting its analysis, the DMO should consult with the three services, the Department of Defence, the Australian National Audit Office and industry representatives.

Response: Agree (administrative)

To formally establish the IMR and FMR milestones, all DMO projects are required to transition to a new Materiel Acquisition Agreement (MAA) for joint signature by Chief Capability Development Group, Chief Executive Officer Defence Materiel Organisation and the relevant Capability Manager by December 2011. Notwithstanding, the 28 DMO projects involved in the 2010-11 MPR Program have, as a priority, transitioned to the new MAA.

Consequently, for the 2010-11 MPR, DMO will be in a position to introduce additional analysis which will aim to identify the schedule lead-times, and scale, size and incidence of requirements between DMO project achievement of FMR (delivery of the materiel element of capability) and the Capability Manager's planned endorsement of FOC (upon successful delivery of all FIC).

For the 2011-12 MPR Program, the DMO will seek to engage with Capability Development Group and Capability Managers to analyse post FMR delivery of FIC requirements needed to achieve an endorsed FOC state.

Recommendation 5

That once projects have met the exit criteria, they be removed from the Major Projects Report (MPR) and for each project which has been removed, the lessons learned at both the project level and the whole-of-organisation level are included as a separate section in the following MPR.

Response: Agree (administrative)

The DMO introduced analysis of project lessons learned in the 2008-09 MPR and further strengthened this analysis in the 2009-10 MPR. Project lessons learned are analysed to identify systemic issues and the measures being taken by DMO to address these systemic issues to foster ongoing business improvement. For future DMO MPRs, as projects are removed from the MPR Program, the project and enterprise level lessons learned will continue to be reported in an annex to the DMO MPR.

Auditor-General's Review

Recommendation 6

That the Defence Materiel Organisation include in the format of a comparison table, for the listed eleven projects included in the Major Projects Report, columns appearing side by side showing base date dollars, out-turned dollars and current dollars for expenditure information.

Response: Agree (administrative)

The Project Data Summary Sheet (PDSS) template, endorsed by the JCPAA (at the 28 February 2011 Hearing) for the 2010-11 DMO MPR Program, provides the structure to inform a comparison between base date dollar, out-turned dollar and current day dollar expenditures for the eleven projects identified in the 2010-11 MPR Work Plan.

Recommendation 7

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, out-turned 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.

Response: Agree (administrative)

The DMO has developed a proposal which details the revised methodology for Financial Performance Reporting, in the construct of the PDSS, for implementation in the 2011-12 DMO MPR Program. The DMO proposal will be circulated for consultation with the ANAO and will be ready for JCPAA consideration prior to the next JCPAA Hearing.

In order to effectively establish and maintain a sustainable approach to reporting project financial performance (via the revised PDSS Financial Performance Reporting methodology), the DMO proposal will address the following key considerations:

- Consistency with other published documents, including: Portfolio Budget Statements; Portfolio Additional Estimates Statements; and the Defence Annual Report.
- Consistency with the accepted method for managing project budgets in accordance with the Commonwealth's budgeting framework.
- Ensuring all financial data produced in the PDSS at the transactional level is verifiable with Defence and DMO's existing financial management systems.

In addressing the above considerations, the DMO proposal will present at least three financial performance reporting methodologies and will advise the preferred methodology for implementation in the 2011-12 DMO MPR Program.

Recommendation 8

That the way that Measures of Effectiveness data is presented in the Major Projects Report not be changed until a thorough analysis outlining the reasons for and implications of the change has been undertaken and presented to the Joint Committee of Public Accounts and Audit for consideration and endorsement.

Response: Agree in Principle (administrative)

Since the DMO Prescription in July 2005, acquisition and sustainment support to capability has been managed through the DMO agreements framework. The principal agreement for all DMO acquisition projects is the MAA, signed between the DMO and Capability Development Group (CDG). The MAA defines the acquisition services to be delivered by DMO to Defence for all major and minor equipment acquisition projects and defines each DMO project in terms of budget, scope and schedule. The former Measures of Effectiveness (MOEs) construct under the original MAA framework assessed the likelihood of delivering the defined materiel element of the capability.

As part of the Mortimer reforms, the MAA framework has been further developed and strengthened by two key initiatives: including the relevant Capability Manager as a signatory to the MAA, along with the DMO and CDG; and introducing the new milestones of IMR and FMR as replacements for MOEs. The introduction of IMR and FMR milestones has a threefold effect: it provides greater clarity of responsibilities between the DMO, CDG and Capability Managers; sets the two key milestones for delivering the materiel elements of capability to the Capability Manager; and provides for a very direct and more effective measurement of DMO performance.

In accordance with the direction provided by the Defence Committee on 21 January 2010, all DMO projects are to transition to the new MAA framework by December 2011. As at 30 June 2011, all 28 DMO MPR projects had transitioned to the new MAA template. Consequently, these projects have ceased to formally report against the former MOE construct and have commenced reporting on their performance in delivering the materiel element of capability to Capability Managers to the required scope approved by Government in order to satisfy achievement of IMR and FMR.

Consequently, for the 2010-11 MPR, DMO will provide additional analysis which will aim to explain the introduction of IMR and FMR milestones under the strengthened MAA framework.

Recommendation 9

In line with the previous Committee's recommendation, that the Defence Materiel Organisation in conjunction with the Australian National Audit Office develop a standardised graphical representation of each project's cost and schedule variance for inclusion in the Project Data Summary Sheets for the 2011-12 Major Projects Report Guidelines.

Response: Agree (administrative)

Fundamental to the achievement of the DMO business is the use of standardised financial management and schedule management systems. These systems already produce data metrics to track the progress and performance of projects (which underpins DMO's monthly reporting process), and will readily provide the data required to produce a graphical representation of project performance against cost and schedule, and variances between planned and actual performance.

DMO believes that this additional disclosure will add significant value to future DMO MPRs by providing the reader with an easy to understand and consolidated reference point detailing each project's cost and schedule performance.



Australian Government
Department of Defence

Mr Duncan Lewis AO, DSC, CSC
Secretary

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Mr David Brunoro
Committee Secretary
Joint Committee on
Public Accounts and Audit
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Parliament House
CANBERRA ACT 2600

Dear Mr Brunoro

I am writing to you in response to the Joint Committee on Public Accounts and Audit –
Report 422: Review of the 2009-10 Defence Materiel Organisation Major Projects Report.

The Report contains nine recommendations that relate to matters which are the responsibility of the Defence Materiel Organisation. In accordance with the guidance from the Department of Finance and Deregulation, I can advise you that I consider all nine recommendations can be categorised as ‘administrative’ rather than ‘policy’ in nature.

Should you require further information on this matter my point of contact is
Assistant Secretary Ministerial and Executive Support, who can be contacted on

Yours sincerely

Duncan Lewis
13 October 2011