

Introduction and summary

The Senate Foreign Affairs, Defence and Trade References Committee embarked upon its inquiry into defence materiel matters in the light of a long history of failed or troubled acquisition projects, and at a time of significant structural reform within Defence that included the creation of the Defence Materiel Organisation.

Background

On 6 December 2000 the Government released its White Paper *Defence 2000: Our Future Defence Force*. This document confirmed the reform and restructure of DMO:

To be fully effective, the new Defence Materiel Organisation requires organisation and in some cases cultural reorientation away from Canberra towards its operation base in the operational units. As part of this, the Government will improve support of its materiel personnel through a range of initiatives including improved conditions of service in keeping with changed mobility requirements, a stronger focus on selecting for and developing individual competencies, and improved usage of military personnel. Changes will go hand in hand with the clarification of personal responsibilities and accountabilities. Such improvements will facilitate a smarter and more focused use of external professionals and industry. Industry will be engaged earlier, through simplified process, which in combination with other measures will lead to reduction in unnecessary industry cost and improved project turnaround times.¹

On 27 February 2001 the Secretary of Defence provided an update on the reform and restructure of DMO.² Dr Hawke reported:

- The basic DMO structure is complete and in place.
- The two-pass Government approval process has been adopted in the form of the Defence Capability Management Cycle.
- A new SMART 2000 tendering and contracting proforma has been implemented for use on major projects.
- A standardised Project Management Methodology has been adopted to replace the centralised committee process for acquisition.

On 5 June 2001 the DMO's Head of Change Materiel Management provided an update to the Senate Foreign Affairs, Defence and Trade Legislation Committee on

¹ Australian Government *Defence 2000: Our Future Defence Force*, Canberra December 2000, p. 105

²² Dr Allan Hawke, Secretary of Department of Defence, *One Year On—Address to Defence Watch Seminar*, 27 February 2001, p. 2

the reform and restructure of DMO.³ On 25 October 2001 Major General Dunn provided a briefing to Defence personnel in Canberra on the progress of that reform.⁴ Major General Dunn stated, among other things, that:

- DMO expends 32% of the Defence budget and employs 8,568 Defence personnel.
- Project management staff were in the process of being re-located to 49 System Program Offices (SPOs) in Washington, London and all states of Australia.
- 42 percent of Australian Public Service staff in DMO had accepted the invitation to re-locate to SPOs.

The nature of the Senate inquiry

The Committee's approach to its inquiry into the acquisition and management of materiel was influenced by several considerations:

- the expenditure on Defence materiel was a major component of the Defence budget, and project delay or failure had already led to considerable waste of public money;
- the DMO was barely eighteen months into its reform program when the inquiry commenced;
- the Australian National Audit Office had, in recent years, undertaken several audits related to Defence acquisition, and had foreshadowed an investigation of DMO's management of major projects to commence in late 2003.

As a consequence, the Committee decided to 'take a snapshot' of the progress of the DMO's reform agenda and assess that progress against both the spirit and the implementation schedule of the reforms. The Committee also decided that it would try to determine a series of benchmarks against which future progress could be measured. These benchmarks would provide the pegs upon which the Committee could hang its ongoing scrutiny of the DMO's performance. In the event, these benchmarks emerged out of the evidence provided by DMO officials at public hearings, and from the various manuals and guides that document the procedures for the development and procurement of a weapons system and its logistical support. The Committee specifies, at various points throughout this Report, the particular events and timeframes that it will be monitoring to ensure that the DMO actually achieves the goals that its officials have declared to the Committee. The Committee will also be scrutinising closely DMO's compliance with its own documented procedures, especially for managing the capability systems life cycle. These benchmarks are summarised in an appendix to this Report.

³ *Committee Hansard*, 21 February 2001, p. 93 (Major General Peter Dunn, Head, Change Management Materiel Division)

⁴ Major General Peter Dunn, Head Change Management Materiel Division, *Briefing on Defence Materiel Organisation*, 25 October 2001

In seeking to obtain a comprehensive view of the DMO reforms, the Committee received preliminary briefings from Defence officials, undertook a number of visits and inspections to System Program Offices and industrial sites, received submissions and took evidence in hearings—both public and *in camera*—and examined an array of key documents related to strategic defence industry policy and Defence’s management of capability across its life cycle.

Findings

- The Committee is satisfied that the reform agenda set out in the 1998 *Team Australia* Defence and Industry Strategic Policy Statement, the 2000 Defence *White Paper*, and in numerous official statements thereafter constitutes an appropriate and workable mechanism for overcoming a legacy of failed or delayed major projects and for achieving capability for the Australian Defence Force.
- The Committee is broadly confident that the organisational, structural and process reforms being implemented by the DMO are providing the disciplined basis necessary to deliver project outcomes on time and within budget. In order to decide whether that confidence is truly justified, the Committee will monitor closely the operations of the DMO, and the progress of acquisition projects that are currently under way or scheduled to commence between now and 2005.
- The Committee recognises that cultural change is fundamental to the translation of new policies and procedures into effective day-to-day project management and to the nurturing of mutually rewarding partnerships with industry. The blue skies of optimism remain somewhat clouded by a lack of trust and a degree of cynicism on the part of both Defence and industry. This will continue to impede progress unless issues of cultural change are tackled head on. There is a serious obligation upon the leadership of both Defence and industry to attend closely to the ways in which their people engage with each other, and to the building of shared values, goals and expectations.
- The Committee remains concerned that some of the people reforms being sought by the DMO are proving difficult to implement. These include overcoming skill shortages in project management, contracting and software engineering; the difficulty of arranging industry exchanges and experience for DMO personnel; and ensuring appropriate levels of accountability, judgement and expertise at the middle management level. The retention of highly-skilled specialists in a remuneration environment which lacks congruence with the corresponding private employment market will remain a vexing issue.
- The dispersed System Program Offices seem to be proving effective in achieving efficiencies and better communications between the DMO and its customers. There is also an improvement in the stability of key personnel, thereby partially addressing one of industry’s frequent complaints about staff turnover in Defence. Some questions remain in the Committee’s mind about the location of some of the SPOs in terms of convenient interfaces between

relevant industry partners. Broadly speaking, however, the establishment of the SPOs and the increased personal accountability of SPO Directors for the projects managed by their Office has already started producing productivity and morale dividends. The Committee will continue to monitor the success of the SPO reforms.

- The *Capability Systems Life Cycle Management Manual 2002* constitutes a comprehensive guide to all phases of capability definition, acquisition and implementation. The Committee will use the *Manual* as a key reference document in its ongoing scrutiny of the implementation of DMO's reforms, and in particular its examination of the extent to which its processes are realised in practice. There remains some doubt in the Committee's mind about the sustained rigour of the implementation of prescribed processes, and the depth of commitment within and across the DMO to the day-to-day implementation of strategic defence industry policy.

The Committee is satisfied that the current structural arrangements applying to capability development and acquisition are appropriate. However, a greater effort must be applied to ensuring that staff in both divisions understand the critical nature of the relationship between the capability definition and acquisition phases, and of their fundamental role in interpreting to each other the requirements and opportunities of each phase of the capability life cycle.

- Notwithstanding some strong representations to the effect that a corporatised DMO would enhance its capacity to work with Australia's defence industries, the Committee finds that such a proposal is not in the best interests of key relationships between the DMO, the three Services and other relevant sections of the Defence organisation. In the Committee's view, Australia's strategic capability interests can be met, and Australian industry properly integrated into these, as long as the present reform agenda is diligently implemented.
- The Committee was impressed with the intellectual and technological capacity of many of the Defence industry's Small to Medium Enterprises (SMEs). It is important that SMEs have the opportunity to participate in all acquisition and logistics projects. For major projects, such participation rests largely in the hands of the prime contractors. The Committee exhorts Tier 1 companies to engage Australian SMEs wherever possible consistent with their capacity and competitiveness. The Committee remains concerned that the research and development activity of Australian SMEs remains largely under-developed.
- The Committee regards the 'scorecard' approach to assessing relationships between the DMO and industry as an effective feedback mechanism. The system has not yet reached anywhere near its full potential, but the Committee is confident that it will enhance the transparency of projects at the boardroom level in companies, and will promote frank and mature dialogue between project partners concerning problems which may arise.

- The Committee was concerned by the intensity of criticism of the DMO voiced by some industry witnesses—and also occasionally from within Defence itself—and the frequent reluctance of industry to place its views on the public record. In part, the criticism went to the gaps between the rhetoric and the reality associated with the reform agenda. It also went to the manner in which the DMO dealt with criticism and complaints levelled at it. While the Committee makes no findings in respect of specific complaints or criticisms brought to its attention, it is important that the DMO establishes a comprehensive, consistent and transparent mechanism for handling complaints—and one which does not unduly interfere with the progress of tenders. The Committee regards a case management approach as the most likely to produce satisfactory outcomes all round.
- The Committee considers the question of Unsolicited Proposals from industry to be one requiring particular attention from Defence. There appears to be a gap between policy and practice that is denying Defence the benefit of the innovation and ferment that is characteristic of many Australian firms operating at the ‘knowledge edge’. To sustain that ferment and innovation, companies require early feedback on proposals that they submit to Defence. Time is not only money, but also affects competitive advantage. The Committee believes that the efficient handling of Unsolicited Proposals would not only deliver a significant boost to ADF capability, but would encourage firms to even greater heights of innovation, and would assist these firms to consolidate their place in the global defence supply chain.
- The Committee is satisfied that the DMO has made substantial efforts to enhance project management and to develop a sound project reporting system. The risk of failure of new major capital acquisition projects is therefore correspondingly reduced, but for the so-called ‘legacy projects’ such risk may remain relatively high. The Committee remains concerned that while the internal reporting of projects, including to cabinet level, may have been enhanced, projects still remain largely invisible to the parliament and the public. Significant improvements are required in both the quantity and quality of information made publicly available.
- The Committee is encouraged by DMO’s progress in making tender processes more efficient—in particular through the use of contract templates. A reasonable balance seems to be being achieved between the degree of functionality that needs to be specified by Defence, and the flexibility available to industry to offer innovative solutions to the procurement of capability. Some work still needs to be done to ensure that all DMO staff incorporate the revised practices and values into their negotiating behaviour. As well, the Committee sees room for greater transparency in the contract process, including the publication of as much detail as possible about winning bids.
- Systematic test and evaluation is an area that requires greater attention and resources in order to provide the level and sophistication of feedback necessary

to ensure the integrity, functionality and safety of the materiel entering into service. The Committee notes the review of test and evaluation policy being undertaken by Defence, and will be looking for an outcome that embeds test and evaluation firmly into all phases of the capability development cycle, while ensuring that T&E is carried out with the requisite independence and rigour. Test and evaluation policy and procedures should be a key responsibility of the VCDF, and its implementation should be closely monitored by the Service chiefs.

The Committee has made a number of recommendations consistent with the findings summarised above. The Committee will persist with a high degree of scrutiny of the DMO's operations and of the acquisition projects for which DMO is responsible. Some recommendations are geared explicitly to the direct enhancement of the Committee's capacity to carry out such a task.

The forthcoming audit of major projects by the ANAO will also assist the Committee in this work. The Committee will seek a formal reference from the Senate to examine and report upon the effectiveness of the DMO over the period to the end of 2005. In the meantime, the Committee may meet with relevant parties to explore particular aspects of the matters addressed in this Report. Should this activity produce material that the Committee regards as relevant to Defence acquisition reform, the Committee will table a supplementary report to that effect.

The Committee is grateful for the cooperation of Defence officials and senior members of the Defence Materiel Organisation in providing a range of important background documents for the Committee's examination, and in assisting the Committee to undertake visits and inspections of Defence and industry facilities in most states of Australia. The Committee also thanks the many people from industry who gave freely of their time and knowledge to help the Committee gain insights into the contribution of some remarkable companies to the defence capability of Australia.



Senator the Hon Peter Cook

Chair