

# Chapter 1

## The DMO's reform program

I think the amalgamation of Acquisition and Logistics functions, which is at the very heart of the reform process they have under way at the moment, is unlikely to be a solution in itself to the problems... but it is potentially, if well managed, a good foundation, a good starting point for reform process. Obviously the creation of SPOs, the system program offices, looked like a good way to go about reaping the potential benefits that ought to be derivable from an amalgamation of Acquisition and Logistics, but it will be—and it already is—a very complex and disruptive process. There is a question as to how well that process is being implemented and what it will deliver in the long run, but it is not a bad model to start with.<sup>1</sup>

1.1 These remarks were offered to the Committee early in its inquiry by Hugh White, the Director of the Australian Strategic Policy Institute. They convey the essential tenor of the overall advice placed before the Committee by a range of well-informed witnesses from outside the Defence organisation.

1.2 The Defence organization itself consistently presented a much stronger view of the efficacy of the reforms, both current and potential. This is hardly surprising. The Committee tested the claims of Defence both in public hearings and in discussions with industry and Defence personnel during numerous site visits and inspections. The Committee's assessment draws on the full range of its exposure to the issues.

1.3 The structural and procedural reforms of the DMO have, in the Committee's view, the potential to improve considerably the acquisition and management of Defence materiel. These reforms constitute necessary, but not sufficient, conditions for the achievement of best practice in materiel matters and the successful implementation of defence industry policy.

1.4 Beyond organizational and process factors lie the somewhat less tangible issues of cultural change—both within Defence, the DMO and industry. These 'softer' factors will have a significant bearing on the extent and efficacy of reform activity. The Committee has heard some rather depressing claims about the cultures on both sides of the DMO—industry divide. It has also heard that such pessimistic views are not warranted. And there are surveys and scorecards which offer mixed messages.

1.5 The Committee's considerations of DMO cultural change later in this Report are framed in terms of questions like: Will the DMO become an organization "skilled at creating, acquiring and transferring knowledge, and at modifying its behaviour to

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1 *Committee Hansard*, p. 57 (Mr Hugh White)

reflect new knowledge and insights”<sup>2</sup> Will it become “a type of organization we would truly like to work within.”<sup>3</sup>

1.6 Before exploring these matters further, it is important to reflect briefly on the DMO reforms in the context of a longer history of reform activity within Defence as a whole.

### **The establishment of the DMO**

The net result was that, by late 1999, Defence had dug itself into a hole. Our operational skills and courage were matchless, but our organisational and project management skills undermined our capability.

*Defence Annual Report 2000–02*

1.7 On 22 June 2000, the Minister for Defence approved the establishment of the Defence Materiel Organisation (DMO) to equip and sustain the Australian Defence Force (ADF). It is responsible for acquisition and through-life support of equipment and systems used by the ADF.

1.8 The DMO brought together the Defence Acquisition Organisation, Support Command Australia and part of National Support Division. The goal was to improve delivery of ADF materiel by integrating acquisition and through-life support activities into a whole-of-life capability management system. This integrated organisation came into being on 1 July 2000 and structural changes to the organisation were completed by December 2000.

1.9 The formation of DMO was not the first initiative to improve materiel support—a point that was reiterated to the Committee by several witnesses.

We keep using the word ‘reform’ as if it is something novel and recent. My own observation is that it is more a case of continuous reform. DMO is pretty much an overnight sensation which took years, if not decades, to come about. Over a period of 20 or 30 years... there has been a gradual process of evolutionary change and continuous reform... focused on aligning ourselves better with capability and its development, management and implementation.<sup>4</sup>

I think we have to set the context for these remarks. The Defence organisation has gone through an incredible amount of change over the last three or four years—in fact, over the last 10 years. My own service [Air Force] has gone from a force of 23,000, to just over 13,000... There has been a lot of organisational change, there has been a lot of operational

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2 A definition of a ‘learning organisation’ offered by David Garvin in the August 1993 Harvard Business Review.

3 Kofman, F & Senge, P ‘Communities of Commitment: The heart of the learning organisation’ in Cawla & Renesch (ed) *Learning Organizations: Developing Cultures for Tomorrow’s Workplace* (Productivity Press, Oregon, 1995), p. 31

4 *Committee Hansard*, p. 82 (Mr John Pluck)

change and there has been a lot of cultural change. The effect of all that change is that we now have more capability than we had 13 years ago. A lot of our support functions have, obviously, been outsourced. Some of the things that are mentioned in that article are a consequence of the reform program. In Air Force we talk about gaining a soft landing from the effects of the reform program.<sup>5</sup>

1.10 In the early 1990s, a Force Structure review led to a joint approach to capability development and the Defence Logistics Redevelopment Project rationalised Defence warehouses. About the same time, the Air Force introduced Electronic Purchasing by Units for local procurements, while Army trialed its Direct Unit Purchasing model.

1.11 On 1 July 1997 Support Command Australia was established to integrate and rationalise the three former Navy, Army and Air Force materiel support systems. In this combined Support Command, and under the impetus of the Defence Reform Program, numerous non-core activities were market tested to achieve better value for the Government’s money.

1.12 During the mid-term review of Support Command’s progressive development, consultants KPMG were asked to consider the amalgamation of Support Command and the Defence Acquisition Organisation. KPMG noted that a change of this size would bring financial costs and tensions between people, but added:

The risks ... are considerable, but the risks of doing nothing are even greater, for no other reason than that the latter diminishes the ability of the Government to acquire total capability. The benefits associated with such a merger are very significant and the Review believes that, while there will also be regrets that will be of short-term and longer-term impact, the likely rewards to be gained will outweigh the regrets.<sup>6</sup>

1.13 The Committee acknowledges that the establishment of the DMO was the culmination of many years of ongoing reform, and agrees with the judgment that ‘it will take five years to bed [the DMO] down’.<sup>7</sup>

1.14 Already, the implementation of aspects of the reform process has demonstrated to the Committee’s satisfaction that there is cause for optimism. There is much that has impressed the Committee—for example in the operation of System Program Offices, and the articulation of very clear processes for the management of capability systems life cycle.

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5 *Committee Hansard*, p. 214 (Air Marshal Angus Houston)

6 KPMG report 2000, p. 3, cited in *Submission 10* (Department of Defence)

7 *Committee Hansard*, p. 215 (Air Marshal Angus Houston)

1.15 There are 'about 110-odd individual new processes'<sup>8</sup> that the DMO has introduced to the way it does business. The Committee has listened carefully to the accounts of those processes, and examined the documentation associated with many of them. It all looks very promising. However, as the Committee has stated clearly in the Introduction to this Report, it is determined to sustain a high level of scrutiny of the DMO over the period to 2005. The purpose of this close monitoring is to enable the Committee to satisfy itself and the parliament concerning the implementation and efficacy of the DMO reform agenda.

### **The nature of DMO's reforms**

1.16 In its submission to the Committee, DMO stated that it has three fundamental types of reform under way: organisational reforms, process reforms, and people reforms.

The organisational reforms, which are well advanced, include the integration of the acquisition and support elements of Defence and locating them with their customers or supplier to provide greater focus on effective outcomes.

The process reforms include identifying and adopting best acquisition and asset management practice (including commercial practices where these are appropriate to Defence) and developing strategic relationships with industry.

The people reforms are aimed at creating a climate where the personnel responsible for Defence materiel are suitably trained, valued and motivated to do their best in a complex work environment that requires an innovative work ethic.<sup>9</sup>

1.17 According to the Defence Portfolio Budget Statements 2002-03, the Defence Materiel Organisation's reform program:

... encompasses a comprehensive range of measures to:

- integrate the acquisition and support elements of the Defence Materiel Organisation's business and locate them appropriately with customers;
- reform its processes based on commercial approaches and best practice;
- adopt a more strategic approach to its relationship with industry;
- improve its relationship with stakeholders and customers; and
- create the climate where people are valued and can do their best.<sup>10</sup>

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8 *Committee Hansard*, p. 143 (Mr Michael Roche)

9 *Submission 10*, p. 4 (Department of Defence)

10 2002-03 Budget Related Papers No. 1, Portfolio Budget Statements (Defence), p. 98

## Organisational structure reforms

1.18 At the corporate level, DMO is organised into divisions according to the operating environment for their systems. The main System Divisions are Aerospace, Maritime, Land, Electronic, and Airborne Surveillance and Control. These divisions are supported by the Finance and Management Information divisions. A separate Industry Division is dedicated to industry programs and initiatives, while Joint Logistics Command directly supports the three Services with warehousing, transport, and commonly used commodities.<sup>11</sup>

1.19 A series of integrated System Program Offices (SPOs) have replaced the previously separate acquisition project offices and support units. In most cases, a single commander or director (at Colonel level or equivalent) is responsible for the acquisition projects affecting a weapon system, as well as the support and ultimate disposal of these assets.

1.20 To reinforce this through-life responsibility, most of the SPOs have been relocated to work alongside the Force Element Groups and industry, in capital cities and regional centres outside Canberra.<sup>12</sup>

## Process reforms

1.21 The whole process of materiel acquisition and management has its roots in the definition of a future capability. It had become clear to Defence that inadequate definition of capability requirements prior to the acquisition phase, and the subsequent adjustments to capability requirements, was a major cause of changes in the scope of projects. This led invariably to cost overruns and delayed delivery of product. Defining capability without reference to cost and risk drivers had also significantly increased the risk of cost and schedule overruns.

1.22 To address these problems, the then VCDF Lieut. General Mueller issued (in December 2001) a *Capability Systems Life Cycle Management* Guide which emphasized the front end of the life cycle, especially the management of Major Capital Investment projects. This was modified and re-issued as a *Manual* in November 2002.

1.23 The Committee is impressed with the comprehensiveness of the *Manual* and regards it as providing a most suitable benchmark against which the future performance of the DMO and Defence's capability development process can be measured. The *Manual* also serves as an important reference document for the issues discussed by the Committee in this Report, and will be used systematically by the Committee in its ongoing detailed scrutiny of the materiel acquisition and management processes.

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11 *Submission* 10, p. 5 (Department of Defence)

12 *Submission* 10, p. 5 (Department of Defence)

1.24 The DMO’s submission to the Committee listed a series of specific process reforms to overcome the identified shortcomings that had plagued the capability and acquisition domain. The reforms are intended to operate across the capability-acquisition life cycle. Some of the more significant are outlined briefly hereunder.

- Capability requirements will now be accompanied by a set of documents to specify the details of those requirements and guide the acquisition process. These are:
  - an Operational Concept Document that clearly articulates how the equipment will be used and supported, and will provide a reference for determining ‘fitness for purpose’.
  - Function and Performance Specification documents will specify system requirements and provide the basis for the design and qualification testing of the system.
  - Test Concept Documents will specify the warfighter’s intended test approach and the strategy for acceptance between the DMO and the customer. The TCD will also be used to prepare a Test and Evaluation Master Plan.
- A Defence Business Model will guide in-service support after the project phase. The mature model includes a cascading set of agreements:
  - Organisational Performance Agreements between CDF/Secretary and each Defence Group head,
  - Customer Supplier Agreements between Output Executives and Enabling Executives, and
  - Service Level Agreements between the DMO SPOs and the Force Element Groups.
- A two-pass approval process has been introduced for the acquisition of new ADF equipment. In the first pass, Defence will identify the gap in capability and will provide the Government with a range of options. Defence will identify approximate costs, risks and timing issues. At the second pass, Defence will provide the necessary level of detail to make an informed decision on acquisition and through-life support.
- Tender documents are to be less technically prescriptive and more functional. Tender processes will be shorter and companies will be progressively stood aside as they become uncompetitive. A new tendering and contracting template has been developed for use in high risk, software intensive projects. Templates for lower risk acquisitions and in-service support are currently being developed in consultation with industry.
- DMO has introduced a reform program aimed at developing policy, guidelines, training programs and technical expertise for software-intensive

projects. The Standard Acquisition Management System (SAMS) and a systems engineering improvement program are part of a revised approach.

- DMO has introduced a commercial-in-confidence company scorecard system. The company scorecard enables DMO to collect, assess and monitor contractor performance using an objective set of measures. DMO is piloting the 360 degree view scorecard, intended to measure DMO's performance from an industry perspective.
- Project governance boards have been established to review the technical, financial, contractual, risk, and schedule performance of projects. The boards provide independent advice to delegated decision makers, to relevant Division Heads and to the Under Secretary Defence Materiel. The aim is to assure accountability, transparency, disclosure and independence.
- DMO reports monthly to the Defence Committee and to the Minister on the status of its largest projects, other projects of concern and any critical issues, including through-life support.

1.25 Accounts of these reforms were provided in considerable detail by DMO witnesses at the Committee's public hearings. Interested readers should consult the Committee Hansard transcripts of proceedings. These may be downloaded from the internet at <http://www.aph.gov.au/hansard/senate/commtee/s-fadt.htm>.

1.26 There is also an excellent overview of Defence Materiel Reform initiatives in the *Defence Annual Report 2001–02*. The Committee commends the Department for providing such a convenient and comprehensive overview of its reforms in its key reporting and accountability document.

1.27 The Committee regards the process reforms outlined earlier as fundamental to achieving robust capability definition and efficient acquisition of materiel. It seems, however, that some aspects of these reforms have already been present in previous incarnations of Defence's capability development and acquisition policy, and should thus have already been implemented. On this account, some of the reforms are not 'new', and the Committee is assuming that their restatement in the recent *Guides and Manual* constitutes both a re-affirmation of the importance of certain procedures and a re-commitment to their rigorous implementation. The Committee will be closely monitoring the congruence between theory and practice.

## **People reforms**

1.28 The DMO has advised the Committee that a holistic approach to people reforms has been adopted and deals with six separate but complementary initiatives:

- workforce planning,
- career streaming,
- training and development,

- performance management,
- developing a remunerations policy, and
- work value analysis.

1.29 Workforce planning will help DMO predict its future workforce requirements in terms of personnel numbers, distribution and skills. To date initial pilot studies have been conducted on the critical job disciplines of project management, contracting and software engineering.

1.30 The work undertaken has indicated substantial shortages in each of these areas. To address these shortages, Defence has begun a series of recruiting initiatives, but a critical factor in recruiting and retaining people with these skills is their general shortage in Australia.

1.31 A succession planning tool is being developed, which will reduce the cost of vacancies to the organisation.

1.32 A career management framework will assist employees make choices within the DMO. It will identify the skills and qualifications required for a particular job discipline, such as project management. A training and development framework, to identify the appropriate training needed by DMO personnel, will link to the career management framework.

1.33 A review of remuneration and conditions to attract and retain employees has been completed and the outcomes were incorporated into the Defence Employees Certified Agreement. A work value analysis has also been completed for some positions at Executive Levels 1 and 2, to determine if there are any anomalies in the DMO structures in terms of accountability, judgement and expertise. This work will be extended to other positions.

1.34 The Materiel Graduate Scheme is a DMO recruitment strategy to attract and develop university graduates from specific disciplines. The scheme also recognises the distributed nature of DMO by encouraging Materiel Graduates to spend at least one of their six-month work rotations in a regional area.

1.35 Among DMO's training initiatives for middle managers are its Leadership Program and Project Managers Development Program. The DMO Project Managers Development Program provides advanced qualifications (Master of Engineering Studies, with a Project Management major) and experience to become project managers. In its fourth year, 41 people have completed the program and 39 are still in the organisation.

### ***Turnover, retention and the loss of expertise***

1.36 A common theme in many hearings, and in conversation with industry representatives, was the difficulty associated with uniformed Defence personnel



moving on every few years, thereby disrupting the continuity of contact between an industry supplier and the Defence customer.

That is a very big issue. A typical Defence project—anything from five years through to 15 or 20 years—is quite a reasonable, normal project. With a defence posting cycle of every two years and most project managers being Defence personnel, while sometimes they do not always turnover on those two-year frequencies, that can mean you have seven or eight project managers throughout the life of a project. If the documentation is not 100 per cent up to scratch when that new project manager hits the deck, you can be looking at three to six months to really get that person up to speed, and that can create major issues.<sup>13</sup>

1.37 The Committee notes that senior Defence officials are alert to the problems associated with posting cycles, and have already taken steps to ensure longer appointments for key people involved in significant projects.

One of the great criticisms in the past has been churn of key staff. The head of the AEW&C project has been put in place for five years. He is an air vice marshal and he is there for five years. The project manager for Air 87 is a brigadier and he is in place until the first aircraft is delivered. The project manager for JSF is also from Air Force and he will be in position for, I think, the next five years, so he will be there until one of the next major milestones. We are starting to get that right.<sup>14</sup>

1.38 The department is also attempting to manage the ‘churn’ problem by adopting a more systematic approach to appointments while retaining opportunities for career development and advancement.

We have recognised, not just in project management but in areas such as personnel, that this rapid turnover ... is not good for our business. So ...we are looking at streaming people into project management, such that, if you were to follow the project management stream, you might go through staff college and your first appointment post ... might be in the DMO at the acquisition end of the cycle. Following that, you could come back into capability systems to work on the requirements end. In the ideal world, you would go back to perhaps the systems program office. That sort of career structure is being worked on ... We are trying to build career streaming such that we can overcome that problem.<sup>15</sup>

1.39 Industry witnesses, and others who place a high value on technical and engineering expertise in particular, were frequently critical of the erosion or absence of what they called ‘domain expertise’.

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13 *Committee Hansard*, p. 46 (Mr Raymond Ahern)

14 *Committee Hansard*, p. 147 (Mr Michael Roche)

15 *Committee Hansard*, p. 212 (Vice Admiral Russ Shalders)

The loss of in-house expertise over the last five years has exacerbated the already significant problem of mismatch of experience and expertise between Defence and industry. This mismatch causes difficulty in contract formation and management and is at the core of many problems of project risk and cost.<sup>16</sup>

The fashionable management theory cant that places the inexpert, inexperienced and even unsympathetic, over the expert, experienced and personally involved end-user cannot be further justified by the results. There have been too many disastrous choices of equipment, which have acted against the best interests of the military users.<sup>17</sup>

1.40 The issue of domain expertise is taken up in discussions elsewhere in this Report that deal with proposals for corporatisation of the DMO.

1.41 The Committee has outlined earlier in this section the variety of ways in which the DMO is tackling issues of expertise among its own staff—with training and development linked to career development, special graduate courses (including programs with the United States), and industry placement schemes. In the Committee’s opinion it will be some years before these initiatives really start to bear fruit.

1.42 The DMO does not have the capacity under its current certified agreement ‘to be that flexible in the way we remunerate our civilian staff’.

I believe that the philosophy has often been that we know that remuneration is a key factor but not the only factor. A lot of the information that comes back into the Defence level about why both civilian and military staff choose to stay or choose not to stay is about other factors such as job satisfaction and the quality of the leadership they experience in the work place. Those are also important factors. It has been the philosophy of the Secretary and the CDF to date that we perhaps need to put greater emphasis on those sorts of issues rather than see remuneration as the only way to retain our people.<sup>18</sup>

1.43 The Committee appreciates the difficulties associated with establishing fair remuneration schemes that are flexible enough to attract and retain people with high, specialist expertise in skill areas where there is considerable national or global demand. But the Committee also has sympathy with the view expressed in a submission by an experienced engineer lamenting the departure of fully qualified personnel from key positions.

A consequence of this has been much loss of engineering appreciation and corporate knowledge—the appreciation/knowledge of how things work, of

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16 *Submission 11*, p. 3 (SAAB Systems Pty Ltd)

17 *Submission 7*, p. 2 (Mr John Elliott)

18 *Committee Hansard*, p. 264 (Ms Kim Isaacs)

why they are done or done in a particular way, of what is sensible, of what is risky; the instinct for the scope of the project/problem etc. which might permit corrective action before the problem manifests itself seriously etc. etc. In short all those things which cannot sensibly be committed to paper or floppy disk but are passed down, discussed and/or experienced which enable a senior person in any field to exercise professional judgement. What remains of both is incomplete by an amount that we do not know and fragmented between various closed shop offices, both within and without DMO. The ability to *anticipate* problems inevitable in the procurement of complex systems is reduced and worse, is still reducing<sup>19</sup>

1.44 The Committee acknowledges the DMO's efforts to enhance the skills, knowledge and efficiency of its staff. There are several discrete staff management, professional development and operational matters that the Committee addresses in more detail under various headings in this Report. The Committee also gives further consideration to 'people reforms' when it turns its attention to issues of cultural change.

### **Overall impact of reforms thus far**

1.45 The Committee received a range of evidence concerning the overall impact of the DMO reforms thus far on Defence customers and industry contractors. The impact of the structural reforms involving System Program Offices received substantial attention by witnesses, and is dealt with separately by the Committee in a later section of this Report. The impact of process reforms is also dealt with separately as part of the Committee's consideration of tender processes and project management. People reforms are considered more thoroughly under the heading 'cultural change'.

1.46 The Defence Science and Technology Organisation (DSTO) is one group that has discerned considerable beneficial impact arising from the DMO reforms.

[T]he first message that I would like to leave with you today is that the new materiel acquisition and through-life support system has allowed DSTO to take a major initiative of greater engagement and support to DMO and DMO has responded positively and effectively to this engagement. The practical result of this engagement is the improved direct support to high-priority projects such as the SEA4000 future destroyer, the Collins improvement project ... and the AEW&C ... A further result has been the coordinated DMO-DSTO approach to research and development into finding better ways of reducing operating costs for defence capability when it is in service.<sup>20</sup>

1.47 Positive reactions to the DMO reform agenda were also forthcoming from representatives of companies—although almost all insisted that there was still more to be achieved.

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19 *Submission 5* (Mr David Truelove)

20 *Committee Hansard*, p. 164 (Dr Timothy McKenna)

ABL’s [Australian Business Limited’s] Defence Industry Committee is of the view that recent DMO acquisition reforms are delivering positive outcomes. These include: benefits from the formation of the DMO; more refined and informed approaches to tendering... and the decentralisation of the System Program Offices.<sup>21</sup>

In comparison to equivalents in other countries, [the DMO] holds its own well, and I acknowledge that there have been a number of significant improvements recently, most importantly I think the combination of acquisition and logistics into the single organisation.<sup>22</sup>

The Australian Industry Group Defence Council has been working with the Defence Materiel Organisation to develop a ‘360 degree ScoreCard’ process. It is envisaged this would provide companies involved in major capital acquisitions (at this stage) the opportunity to provide their view of the Defence Materiel Organisation’s performance. This is a very positive development and needs to be seen as indicative of a mature relationship.<sup>23</sup>

The previous Defence acquisition organisation tended to say, ‘Here it is.’ The DMO has been more consultative... I think [the reformed DMO] creates a more productive working environment. It creates one where problems are likely to be highlighted earlier and fixed, rather than ‘Let’s keep it secret’ until it becomes a major problem and a complete fiasco. So I think it is an important development.<sup>24</sup>

1.48 The Committee discerns from its encounters with both industry representatives and Defence personnel a generally favourable disposition towards the DMO’s reform agenda, and guarded optimism about its continued success. The Committee is sufficiently encouraged by these views to proceed on the assumption that the DMO has established an adequate basis—structurally and procedurally—from which to secure capability for the ADF that is fit for its purpose and that represents value for money.

1.49 However, the uneven history of Defence procurement, and the persistence of strongly critical, and often cynical, voices among long-time observers of these matters cannot easily be ignored by the Committee. The Committee will therefore persist with its close scrutiny of the performance of the DMO, moderately confident of the diligence with which the reforms will be pursued, but by no means certain that, by themselves, they will produce the thoroughgoing changes that are so desperately required.

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21 *Submission 23*, p. 2 (Australian Business Limited)

22 *Committee Hansard*, p. 181 (Mr Nicholas Hammond)

23 *Submission 20*, p. 7 (Australian Industry Group Defence Council)

24 *Committee Hansard*, p. 189 (Mr Nicholas Hammond)

## Creation of the System Program Offices

1.50 A major organizational reform has been the decentralisation of key functions of the DMO through the establishment of System Program Offices (SPOs) at various locations around the country.

...System Program Offices (SPOs) have replaced the previously separate acquisition project offices and support units... To reinforce [their] through-life responsibility, most of the SPOs have been relocated to work alongside the Force Element Groups and industry, in capital cities and regional centres outside Canberra. Soon, less than 20 percent of DMO staff are expected to be located in Canberra. Currently there are almost 50 SPOs, employing about 3,500 people.<sup>25</sup>

1.51 The concept of a dispersed series of SPOs was endorsed during the Committee's inquiry on several occasions, including by Mr Hugh White, the Director of the Australian Strategic Policy Institute:

For people involved in the delivery of capability, and particularly on the latter stages of acquisition and into the support and through life support sides, getting out there close to where people are trying to make these things work and turning them into real life capability is a pretty good idea. My instinct is that it is conceptually a good proposal.<sup>26</sup>

1.52 The Under Secretary Defence Materiel (Mr Roche) summarised his assessment of the decentralisation exercise in the following terms:

It is still very much early days. The move out of Canberra has gone fairly well. There has been a certain amount of personal disruption, which is inevitable and which we have been doing our best to mitigate. Most of the system program officers are now in operation and we are getting very good feedback from the customer. I think the committee has talked to a number of customers. The relationship is working well.<sup>27</sup>

1.53 The Committee concurs broadly with the USDM's view. There were indications from some that the transition was not conducted in an optimal fashion, and that it may be some time before the difficulties caused by the process have worked themselves through. It has been asserted, for example, that:

The exercise was conducted without a business case or cost benefit analysis. The cost of the exercise was unfunded and therefore was inevitably carried out at the expense of project deliverables. At the end of the day:

- project activities and deliverables were confounded and delayed during the period of disorganisation, discontent and uncertainty;

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25 *Submission 10*, p. 5 (Department of Defence)

26 *Committee Hansard*, p. 76 (Mr Hugh White)

27 *Committee Hansard*, p. 150 (Mr Michael Roche)

- few expert staff relocated, their places being often taken by those with little relevant experience but eager to relocate for personal reasons and glad of the windfall offered by the relocation packages;<sup>28</sup>

1.54 Given that the issue of 'domain expertise' arose frequently during the course of the Committee's inquiry, the Committee has sought to assess the extent to which the above criticism applies. The DMO advised the Committee that:

Work is now under way to replace specialist expertise in the new SPO locations. In the past, DMO and its predecessors have experienced difficulties in attracting a highly trained workforce to Canberra from other capital cities. DMO now has access to a larger workforce based outside Canberra, particularly for acquisition. In addition, regional staff have enhanced career options by being able to apply their knowledge of a particular weapon system in different roles. DMO SPO staff will have the opportunity to work across the life cycle of their weapon systems, rotating from acquisition roles, to in-service logistics support, to working directly with end-users and industry, and ultimately disposals. There is also greater opportunity for movement of experienced people from industry to Defence.<sup>29</sup>

1.55 The Committee intends to monitor the issue of domain expertise in the DMO generally, and the capacity of the SPOs in particular to maintain adequate levels of such expertise among the staff assigned to the projects for which each SPO is responsible.

1.56 On several occasions the Committee invited comment from various sources concerning the opportunity for people to flow from industry to Defence. Such a flow appears not even to constitute a trickle. Indeed the Committee was hard pressed to discern any such movement—a matter which is taken up in more detail elsewhere in this Report.

1.57 Industry witnesses were invariably favourably disposed towards the establishment of SPOs and were complimentary about the enhanced service and support delivered by SPO personnel. For example, the National President of the Australian Industry and Defence Network (Mr Michael Turner) reported that:

[T]he DMO has explicitly opened the doors to SMEs by providing avenues of contact and then acting upon the questions asked by SMEs and expeditiously returning with answers. That previously was not available... In talking to SMEs, they find them [SPOs] to be a major advantage. ... We think it is a good idea.<sup>30</sup>

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28 *Submission* 13, p. 2 (Confidential)

29 *Submission* 10, p. 6 (Department of Defence)

30 *Committee Hansard*, p. 230 (Mr Michael Turner)

1.58 An important consideration for industry generally is the continuity of the Defence personnel with whom they have to deal.

I am speaking from experience here in dealing with [a Victorian SPO] whereby the director, Bev Lyttle, one of their officers, Malcolm Best, and the other guys there have been there for a number of years. Therefore, the rapport that they build up with industry is fantastic. They can pick up the telephone and call me by my first name, and I them. That is very important in giving industry the feeling that they have a direct route resource... There is continuity. That is sound commercial practice. In commerce, a person gets into a project, and they are there for the term of the project. That is of vital importance to the success and expedition of the project. The difficulty arises—especially with Defence, as I have said before—when these guys get moved on in three years.<sup>31</sup>

1.59 Some questions have been raised by industry about the locations of certain SPOs given the distance of those SPOs from the head offices of key partners.

The approach of locating most Army SPOs in Melbourne adjacent to their support organisations is certainly sound. In a number of cases, however, the location of the System Program Offices does not appear to have been thought through and the more complex interfaces with other organisations have been made more difficult by relocation. As an example, the ANZAC Ship SPO is located at Rockingham WA. While close to those WA-based ships that happen to be in their home port at the time, the office is six or more hours travelling time from the organisations in Melbourne, Adelaide and Canberra with which its most numerous, closest and most complex interfaces exist.<sup>32</sup>

1.60 The Committee is encouraged by the general consensus between Defence and industry on the merits and effectiveness of the System Program Offices. For example, the company Nautronix has already had 12 years experience with the Sonar and Ranges Program Office, and reports that:

[T]his office has performed to a very high standard throughout the twelve years of Nautronix experience with the group. The team is well led and focuses tightly on good outcomes for defence and for industry. This group has established some significant capabilities not only in Nautronix but also in other Australian companies and the recent changes to decentralise the SPO appear to have enhanced this already capable organisation.<sup>33</sup>

1.61 Defence personnel working under the new arrangements in SPOs were uniformly enthusiastic about the opportunities and responsibilities that these arrangements provided. The Committee was struck by the passion with which SPO personnel spoke about the enhanced personal and professional satisfaction that came

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31 *Committee Hansard*, p. 231 (Mr Michael Turner)

32 *Submission 11*, p. 7 (SAAB Systems Pty Ltd)

33 *Submission 9*, p. 3 (Nautronix Ltd)

with their new roles, and also with the conviction that they were delivering a quality service to their customers.

The situation has brought the old Support Command and the Acquisition Organisation together so we can cradle to grave. Many of us have, over the years, said that this would be a good move and we should do it. Now we have done it. We are getting a lot out of it... The key difference is that we own the whole process. ... Because we are now in the same location and the same team goes to all the meetings and is part of the whole process, we very clearly understand what we have to do.<sup>34</sup>

1.62 The capacity of SPO personnel to be closely involved with their customers, and to be associated with both the acquisition and through-life support of systems and equipment is seen by the Committee as a key benefit of the dispersed SPO arrangement. It has clear advantages for the Defence customer and industry, and appears to have re-energised, and secured 'shop floor' commitment from, those responsible for managing the process and achieving the outcomes.

**Group Capt. Sheedy**—I have had over 25 years in the Air Force, during which time I have worked in support command, operational command areas and also in the previous acquisition areas. What we have here within DMO is the greatest opportunity to get things right, from my perspective as a SPO director... As the director of my particular SPO, I am ultimately responsible for all aspects associated with the projects that I run and the through life support aspects. I think the synergy of that is absolutely fantastic. It adds responsibility to the task but it makes eminent sense to me and it actually provides a clear direction...

**CHAIR**—You are saying that, in your 25 years, this is the best deal that has come along.

**Group Capt. Sheedy**—That is correct.

**CHAIR**—That's a fairly big wrap. Give us your view about what are the most notable changes for you, at your level, that cause you to make that statement.

**Group Capt. Sheedy**—From my perspective, basically it is the fact that I have to take full account of the long-term aspects of any consideration I make, from a project point of view, to ensure that it serves as a full life type consideration, so that a decision I make early on, from a project point of view, ensures that I have the best value for money for the longer term future of the running system. That would be the key feature I see.<sup>35</sup>

1.63 The Committee is pleased to report that such positive views expressed by SPO personnel are shared by those who are the recipients of SPO services. The Chief of Air

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34 *Committee Hansard*, p. 81 (Colonel Peter Acutt)

35 *Committee Hansard*, p. 193 (Group Captain Stephen Sheedy)



Force, for example, who must rely on the effectiveness of SPOs if he is to ensure the delivery of the capability for which he is responsible, reported to the Committee as follows:

My force element groups are getting fantastic support from the System Program Officers. It is not perfect but, as I think as you saw when you were at Edinburgh the other day, it works wonderfully well and I am sure you found a very happy customer in Air Commodore Phil Byrne. So I would support what you say, Chair, in terms of perhaps allowing the DMO time to bed down because, sure, there is still a lot of work to be done, particularly in the systems area and the logistics process areas at the higher level, but we are well on the way. Give us the time and I am sure that, at the end of five years, you will see a model organisation which is world's best practice.<sup>36</sup>

1.64 Additional endorsement of the SPO concept was also forthcoming from an industry consultant who has worked closely with Defence over several years in matters of project management. From the perspective of the company Tanner James:

...the creation of SPO's has been a strong positive for project management systems. The dispersed nature of the SPO's makes support more difficult. However, the SPO's appear to be very focused on delivery of quality equipment within specified time and cost. Smaller co-located groups appear more able to focus on whole-of-capability solutions and much more attention seems to be given to support requirements and costs. The chain of command appears to be much clearer in these organisations and Tanner James finds that, when it is engaged to assist projects, the projects are themselves committed and enthusiastic about 'doing it right'. The smaller structures seem to mean that there is less time spent editing documents and more time spent thinking about the project direction.<sup>37</sup>

1.65 While acknowledging and applauding the good work being undertaken in many of the SPOs, the Committee is cognisant of the risks associated with very close relationships between two parties. One such risk relates to a potential lack of transparency.

Given that ... managers will work in daily contact with contractor staffs, and that both are committed to the production/construction of the contracted equipment, it is not surprising that a cooperative relationship based on monitoring and control can on occasion degenerate into a collaborative one based on a mutual desire to protect "the project" from unwelcome scrutiny or criticism.<sup>38</sup>

1.66 Another risk relates to rigorous management of a contract when the two parties have, in certain quite significant ways, different and important needs and obligations which transcend those that apply to their immediate joint enterprise. What

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36 *Committee Hansard*, pp. 216–217 (Air Marshal Angus Houston)

37 *Submission 8*, p. 14 (Tanner James Management Consultants)

38 *Submission 12*, p. 9 (Mr Gary Brown)

happens when ‘crunch time’ arrives at, say, a milestone point in a project? Drawing on his own experience of relationships between a SPO and its industry customers, the Director of the SPO concerned responded:

We do not have a cuddly relationship; we have a professional relationship but not a cuddly one. They have to produce at certain times. If they do not produce then, we inform them of what is required. So, while we have constant communication between the two parties, it is certainly not like a love relationship. This is a key professional relationship that we would see develop between any two commercial companies<sup>39</sup>

1.67 The Committee accepts the validity of the Director’s statement with respect to his own bailiwick. However, the emergence of project difficulties in other areas and on other occasions, suggests to the Committee that failure to differentiate the interests and responsibilities of Defence (representing the Commonwealth) from the interests and responsibilities of the industry contractor, and/or the failure to manage such differentiation, may have been a significant contributing factor in project losses.

1.68 This problem was brought home strongly in the following submission that made reference to the management of the Collins submarine project, but which has more general resonance.

[O]ne of the most disturbing things I have ever read was the following observation (made in 1992) by the Audit Office on the relationship it perceived between the Navy’s Submarine Project Office and the contractor, the Australian Submarine Corporation:

Despite the Contractor’s often strong tactics the Project Office continues to view the Contractor as almost an extension of itself... *At times it has appeared to the ANAO that the Project Office has a perspective that its role is to act as an agent of the Contractor in its dealings with the Commonwealth rather than as an arm of the Commonwealth monitoring and controlling the Contractor.*

It is essential that an appropriate distance be maintained between agents of the Commonwealth, tasked with project management and contract compliance monitoring, and those of the contractor, whose ultimate objective, as in any commercial operation, is to make a profit. If this does not happen on a given project, the seeds of serious trouble are already there.<sup>40</sup>

1.69 The Committee’s interim assessment of the decentralized SPO concept is that it seems to be delivering benefits across the parties—the Defence acquisitions and logistics personnel themselves, the warfighters in their Force Element Groups who are the SPOs’ customers, and the firms and contractors with whom Defence is involved.

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39 *Committee Hansard*, p. 98 (Colonel Peter Acutt)

40 *Submission 12*, p. 5 (Mr Gary Brown)

1.70 The Committee will continue to monitor the effectiveness of the System Program Offices.

**Recommendation**

**1.71 The Committee recommends that in the years 2004 and 2006 the Defence Materiel Organisation seeks advice on the perceived effectiveness of System Program Offices from the Defence Industry Advisory Council, the Australian Industry Group Defence Council and the Australian Industry and Defence Network. That advice should be compiled into a short report, to include a response by the Under Secretary Defence Materiel, and submitted prior to the 2004 and 2006 Budget Estimates to the Senate Foreign Affairs, Defence and Trade References and Legislation Committees, and to the Defence Subcommittee of the Joint Committee on Foreign Affairs, Defence and Trade.**

