

Chapter 4

Strategic analysis and needs

4.1 This chapter and the chapters to follow discuss the respective Defence reviews namely the Kinnaird Review, Mortimer Review and Pappas Report. All chapters consider the extent to which the recommendations of the reviews have been implemented by Defence and its agencies whilst noting where the evidence suggests issues remain or challenges have emerged. Concerns raised in evidence in relation to aspects of the capability development process and areas which require further clarification and discussion are also noted for future committee consideration.

4.2 This and the following chapter detail the main findings of the reviews and their recommendations in relation to the first phase of the capability life cycle concerning strategy, and needs analysis and requirements.

Overview of the strategic analysis and needs stage

4.3 The needs and requirements phase in the capability development life cycle is recognised by most reviews as critical to the lifecycle of a project. This is because the phase entails the articulation and translation of strategic priorities and the identification of current and future capability gaps. During this phase, costs, capability and risks need to be considered and balanced as capability options are translated into costed, defined solutions.

4.4 The *Defence Capability Development Handbook* (DCDH) describes the outcome of the needs stage as the:

...identification of high level capability and cost requirements for individual projects, and a Government approved DCP outlining planned capability acquisition over the next 10 years.¹

4.5 Key issues identified in relation to strategy and needs by the respective Defence reviews include improving communication between Defence and government on capability and strategy, accurate costing and schedule estimates of projects including whole-of-life costs on entry to the DCP and early engagement with industry.

4.6 The Kinnaird Review (2003) established that poor project definition, analysis and planning before tenders had been sought from industry contributed to failures such as cost over-runs, schedule delays, and reduced capability of the delivered platforms and systems.² The Mortimer Review (2009) highlighted that as capability systems remain in service for 20 or 30 years, it is critical that new systems or upgrades

1 Department of Defence, *Defence Capability Development Handbook*, August 2011, p. 25.

2 Malcolm Kinnaird, *Defence Procurement Review 2003*, pp. 9–10.

are 'initiated on the basis of a long-term defence strategy' which demands 'high quality strategic and capability advice to Government'.³

Relating strategy to capability

Process

4.7 In considering the priorities for the development of the ADF and its resources, the government must relate its strategic priorities for the defence and security of the country with the development of Defence capability.

4.8 Both Kinnaird and Mortimer made a number of recommendations to Defence directed at strengthening the information provided to government to enable it to 'assess the consequences of strategic decisions in terms of required defence capability within the context of its overall budget'.⁴ A classified Defence Planning Guidance was introduced in response to these recommendations to provide government-endorsed direction on strategy, force structure and investment priorities on an annual basis.

Priority setting

4.9 The key cyclical planning documents that provide the foundation for Defence capabilities and serve as overarching guidance on capability include:

1. Force Structure Review (FSR)

4.10 This classified document considers defence capabilities broadly across Defence as well as specifically in areas such as submarine capability over a five-year period.⁵ Its findings inform the Defence White Paper and in turn, the Defence Capability Plan.

2. Defence White Paper (DWP)

4.11 The Defence White Paper is a key strategic document that presents the government's long-term strategic forecast and commitments for Defence including for its future capability. Mr Neil Orme, acting Deputy Secretary, Strategy described it as

3 David Mortimer, *Going to the next level: the report of the Defence Procurement and Sustainment Review*, September 2008, p. 2.

4 Malcolm Kinnaird, *Defence Procurement Review 2003*, p. 4; David Mortimer, *Going to the next level: the report of the Defence Procurement and Sustainment Review*, September 2008, p. 3.

5 In June 2011, the Minister for Defence announced a new Force Posture Review would be undertaken which would inform the security and strategic considerations for the 2014 Defence White Paper. Minister for Defence, 'Announcement of the Force Posture Review', Press Conference, 22 June 2011, <http://www.minister.defence.gov.au/2011/06/22/minister-for-defence-press-conference-announcement-of-the-force-posture-review/> (accessed 15 November 2011).

'the capstone guidance paper' for Defence.⁶ This important public policy document also 'apportions Defence funding and workforce resources to achieve strategic interests and goals in accordance with priorities'.⁷ According to Defence, together with other guidance provided by government, the White Paper informs:

...the development of more detailed planning, capability, workforce, preparedness and financial guidance. This guidance, alongside classified documentation, sets the parameters for the Annual Defence budget.⁸

4.12 Defence argues that White Papers provide 'public transparency and accountability for Defence policy and plans'.⁹ The 2009 DWP outlines the strategic priorities to 2030 including deterring and defeating armed attacks on Australia, contributing to stability in the South Pacific and East Timor and contributing to military contingencies in the Asia-Pacific region and the rest of the world.¹⁰ The DWP provides a 'broad picture' of what major capability investment is required for the development of Force 2030 over a five-year cycle.¹¹ The capability investments laid out in the DWP are then translated into a Defence Capability Plan of solutions to meet requirements in the DWP.

3. Defence Planning Guidance (DPG)

4.13 The Defence Planning Guidance provides an opportunity for Defence to deal with threats and opportunities as they arise within the DWP five-year cycle.¹² This classified document is Defence's lead strategy document as it articulates the strategic priorities that guide Defence to produce the military outcomes sought by government.¹³

4. Defence Capability Plan (DCP)

4.14 The DCP is a costed, rolling ten-year program of unapproved major capital equipment projects identified to meet the requirements of the DWP.

4.15 In consultation with other Defence Services and Groups, CDG prepare the DCP which is then approved by the NSC. The DCDH states that the Defence

6 Neil Orme, Department of Defence, *Committee Hansard*, 5 October 2011, p. 13.

7 Department of Defence, *The Strategy Framework 2010*, p. 20, <http://www.defence.gov.au/publications/TheStrategyFramework2010.pdf> (accessed 6 September 2011).

8 Department of Defence, *The Strategy Framework 2010*, p. 20.

9 Department of Defence, *The Strategy Framework 2010*, p. 20.

10 Department of Defence, *The Strategy Framework 2010*, p. 23.

11 Department of Defence, *Defending Australia in the Asia Pacific Century: Force 2030*, Defence White Paper 2009, p. 15.

12 Neil Orme, Department of Defence, *Committee Hansard*, 5 October 2011, p. 38.

13 Department of Defence, *Strategic Planning Framework Handbook 2006*, p. 13.

Investment Committee endorses capability proposals and recommends any changes to the DCP before it is provided to government. It makes clear:

Defence capability committees may endorse proposed changes to the DCP, but they are not given effect until they are approved by the government.¹⁴

4.16 Once approved by government, a project in the DCP will be developed as part of the first and second pass government approval process in the requirements phase.

Structure

4.17 Kinnaird and Mortimer made recommendations regarding the provision of information to enable government to match strategic priorities with defence capability. In response to these recommendations, the Strategic Policy Division within Defence's Strategic Executive was made responsible for leading the strategic process with the support of CDG and other Defence elements.¹⁵

4.18 The Strategic Executive is responsible for developing and articulating the strategic guidance and military priorities that form the starting point of the needs analysis.¹⁶ The five-yearly FSR and five-yearly DWP are key elements to this guidance.¹⁷ The Strategy Executive will then translate the broad guidance of the DWP into an annual Defence Planning Guidance to provide a more refined assessment of needs and Quarterly Strategic Review.¹⁸ In addition, the Strategic Executive is responsible for ensuring that the development, acquisition and evaluation of capabilities align with Defence's strategic priorities as articulated in the CDF's planning directives, Australian capability context scenarios, ad hoc strategic papers and the future joint operating concept.¹⁹

4.19 The strategic guidance developed by the Strategic Executive will inform the development of Force Structure Options which are then fed into the development of the DCP which 'articulates projects that give effect to delivering those capability outcomes'.²⁰

4.20 In terms of establishing whether capabilities for later inclusion in the DWP are feasible, the Strategy Executive will commission environmental scans and

14 Department of Defence, *Defence Capability Development Handbook*, August, 2011, p. 10.

15 Department of Defence, *The Response to the Report of the Defence Procurement and Sustainment Review*, 2009, p. 17, http://www.defence.gov.au/publications/Mortimer_Review_Response.pdf (accessed 6 July 2011).

16 Neil Orme, Department of Defence, *Committee Hansard*, 5 October 2011, p. 10.

17 Neil Orme, Department of Defence, *Committee Hansard*, 5 October 2011, p. 10.

18 Neil Orme, Department of Defence, *Committee Hansard*, 5 October 2011, p. 10.

19 Neil Orme, Department of Defence, *Committee Hansard*, 5 October 2011, pp. 10–11.

20 Neil Orme, Department of Defence, *Committee Hansard*, 5 October 2011, p. 14.

analysis. At the same time, intelligence assessments inform the development of policy guidance which in turn, help to shape more detailed plans to meet the government's security objectives which will then be developed into formal government guidance as a DWP.²¹

4.21 Once capability needs are identified in the DWP and Defence Planning Guidance, CDG will then take over and lead the development of the DCP which outlines a ten-year program for new major capital equipment investment. Thereafter, as CDG has representation on the internal Defence committees responsible for reviewing proposals prior to first and second pass, the Strategy Executive will consider each project that comes through the Defence committee system in terms of strategic guidance.²²

People

4.22 The Strategy Executive is headed by the Deputy Secretary Strategy. The Strategy Policy Division, responsible for the strategic guidance, comprises approximately 80 people of whom 'a couple of dozen or so would be involved in the strategic planning business' including the Force Structure Development Cell.²³

4.23 In terms of the skills and expertise of the Strategy Executive, the committee was not able to establish the level of expertise in this group and its ability to draw on and process information to inform strategic guidance. Moreover, the extent to which the Strategy Executive draws on and utilises personnel from CDG, DMO and the Services to inform its work was not clear.

Unanswered questions

4.24 The committee held two days of hearings with Defence agencies to discuss and clarify each stage of the capability development and acquisition process, the responsibilities of those involved in the process and the division of responsibility and accountability between them. However, the questions that remain for the committee go to heart of the capability identification process from inception.

4.25 There is a strong claim made by Defence and government that there is a clear linkage between strategic guidance and capability, otherwise defined as the ability to 'achieve an operational effect'. In fact, witnesses highlighted that Defence drives much of the White Paper development which it then in turn quotes as the strategic guidance that gives it leave to develop and propose a capability case to government. Witnesses also discussed the propensity of government to delay funding for projects in the DCP and the impact this is having on industry. However, there is now a disconnect emerging between government expectations of Defence (stemming from NSC

21 Neil Orme, Department of Defence, *Committee Hansard*, 5 October 2011, pp. 10 & 13.

22 Neil Orme, Department of Defence, *Committee Hansard*, 5 October 2011, p. 14.

23 Neil Orme, Department of Defence, *Committee Hansard*, 5 October 2011, p. 13.

guidance as to the desired ability to achieve 'an operational effect' and the capability Defence actually operates. That is, capability in the procurement cycle, capability held captive in an unfunded DCP, and capability cases drawn from the White Paper that have yet achieved first or second pass approval from government.

4.26 Reviews of defence and procurement in the United States and United Kingdom have highlighted the importance of a transparent audit trail between government expectations and Defence capability management. Despite the claims, the committee is interested to establish how robust this linkage is in the Australian context. The committee intends to investigate the degree of alignment between the NSC guidance as to the ability it expects Defence to have in order to 'achieve an operational effect'. These matters will be raised in light of the budget which is eventually allocated in any given planning period and the agreed measures (if in fact any exist) by which both Defence and government can evaluate performance.

4.27 The committee understands that the Deputy Secretary Strategy drafts the DWP whilst the Strategy Executive is also responsible for informing the DWP. What is not clear to the committee, however, is the extent to which industry and other stakeholders are consulted as part of the DWP development process. A key example in point pursued by the committee is that of SEA 1180, the multirole vessels described in the DWP as an 'offshore combatant vessel', otherwise referred to as the patrol boat, mine-hunter, coastal and hydrographic ship replacement project.²⁴ SEA 1180 entered the DCP in 2009. Whilst the committee was informed by Defence that industry was engaged in the project through the Rapid Prototyping Development and Evaluation Team, other submitters questioned the timing of industry engagement and argued that the project's inclusion in the DWP demonstrates 'the risk of planning in an information vacuum'.²⁵

Funding in the White Paper

4.28 The 2009 White Paper contained a financial plan with the following central features:

- 3 per cent real growth in the Defence budget to 2017–18;
- 2.2 per cent real growth in the Defence budget from 2018–19 to 2030;
- 2.5 per cent fixed indexation in the Defence budget from 2009–10 to 2030.²⁶

4.29 A former Chief of the Defence Force, Admiral Chris Barrie, stated that the White Paper could be seriously criticised because of its lack of detail on funding. In this regard he noted that the White Paper only deals with funding in 1½ pages 'in

24 Department of Defence, *Defending Australia in the Asia Pacific Century: Force 2030*, Defence White Paper 2009, p. 73.

25 Mark Davies and Andrew Thomson, *Submission 8*, p. [2].

26 Department of Defence, *Defending Australia in the Asia Pacific Century: Force 2030*, Defence White Paper 2009, paragraph 18.4, p. 137.

broad brush statements of average percentage growth to the budget, and imperatives about savings (or cost reductions) intended to balance the books'.²⁷

4.30 Dr Thomson noted that the 'analysis of the underlying trend in the cost of delivering military capability shows that real funding growth of around 2.7% per year is needed to maintain a modern defence force. Consistent with this, the trend in Australian defence funding over the past sixty years has been 2.7% real growth'. In his assessment, 2.2 per cent real growth post 2018–19 'will force a contraction of either the scale and range (or both) of capabilities in the defence force.' Furthermore, he was concerned about the 2.5 per cent fixed indexation. He argued that the adoption of a fixed index subverts the goal of maintaining the buying power of defence budget against changing circumstances. In his view it would make 'more sense to index the budget to the consumer price index, that way defence funding would be protected against an extended period of higher than average inflation'.²⁸

Procurement targets

4.31 A number of submissions were also concerned about achieving the procurement targets set in the White Paper. They cited the Defence Incoming Government Brief 'Red Book' released by the government on 28 October 2010, which revealed that the two-pass process had stalled.²⁹ It was clear to Dr Andrew Davies and Dr Thomson that projects were falling behind schedule as early as May 2010. Since then, the situation has deteriorated further. They identified several contributing factors:

- The government has deferred substantial defence funding to beyond 2012–13, presumably to hasten a return to surplus for the Commonwealth.
- Some projects have been displaced by the bringing forward of projects to ensure force protection for Australian troops in Afghanistan.
- Bureaucratic delays in Defence have caused the approval of projects to proceed much more slowly than anticipated, especially in the case of first-pass approvals.
- Industry has failed to deliver capability to the contracted schedule across a large number of projects.³⁰

4.32 In their view:

27 Chris Barrie, 'The Defence White Paper 2009 and Australia's Maritime Capabilities', *Security Challenges*, Vol. 5, No. 1 (Winter 2009), p. 58.

28 Mark Thomson, 'Defence Funding and Planning: Promises and Secrets', *Security Challenges*, Vol. 5, No. 2 (Winter 2009), p. 91.

29 Australian Industry Group Defence Council, *Submissions 10*; BAE Systems Australia, *Submission 12*.

30 Andrew Davies and Mark Thomson, *Submission 8*, p. [3].

Given the mounting delays, it looks increasingly unlikely that the program of modernisation can be achieved on schedule. To make matters worse, the deferral of funds to beyond 2012-13 has created a five year period where spending will need to grow in real terms by 6% a year to regain the promised '3% real growth over the decade'. On past experience, this is unlikely to be feasible especially in light of capacity limitations at almost every step of the process, from initial approval to industry delivery.

Moreover, the level of funding promised (5.5% nominal growth to 2017-18 and 4.7% nominal growth thereafter) is unlikely to adequately maintain let alone expand the force as planned.³¹

4.33 More recently in his Defence Budget Brief, Dr Thomson stated that Defence 'can change the goalposts all they want, but the fact remains that implementation of *Force 2030* has fallen steadily behind schedule over the past two years'. He noted that over the past 24 months, only ten projects had been approved, 'whereas more than three times that number was planned. And it is set to get worse'.³² He suggested that 'the unambiguous lesson of the past decade was that while planning for new capability is easy, delivering it can be very difficult'.³³ Dr Thomson informed the committee that his statistical analysis showed:

...the plans that existed in May this year [2011] for approving projects first pass and second pass were clearly and manifestly unrealistic. They were beyond credibility. The rate at which projects have been approved since the introduction of the two-pass process has been very much smaller than what is an enormous bow wave of future approvals that are planned.³⁴

4.34 Air Marshal Harvey acknowledged that Defence faces challenges regarding delays in procurement activities post project approval but was addressing them 'on a case-by-case basis at an organisational level'.³⁵ He was of the view that:

...when we report at the end of this financial year you will see a number well above the average over the last few years. So far this year we have had nine approvals, one first pass and seven second passes, in the three-month period, which is already a good positive trend.³⁶

31 Andrew Davies and Mark Thomson, *Submission 8*, p. [3].

32 Mark Thomson, 'the Cost of Defence ASPI Defence Budget Brief 2011-2012, Seventy-two million, seven hundred & sixty-six thousand, six hundred & nineteen dollars & eighteen cents per day', Australian Strategic Policy Institute, 2011, p. vii.

33 Mark Thomson, 'the Cost of Defence ASPI Defence Budget Brief 2011-2012, Seventy-two million, seven hundred & sixty-six thousand, six hundred & nineteen dollars & eighteen cents per day', Australian Strategic Policy Institute, 2011, p. 103.

34 Mark Thomson, private capacity, *Committee Hansard*, 12 August 2011, p. 10.

35 Air Marshal J Harvey, Department of Defence, *Committee Hansard*, 7 October 2011, p. 2

36 Air Marshal J Harvey, Department of Defence, *Committee Hansard*, 7 October 2011, p. 42

4.35 When questioned about funding and the slow down in approvals, Air Marshal Harvey indicated that 'quite a ramp-up of funds' would be 'available in the not-too-distant future, so we are making sure we get the project approval rate up to match that funding'.³⁷

4.36 The committee is yet to be convinced about Defence's assurances regarding the approval rate and funding.

4.37 Furthermore, the committee had a series of questions pertaining to contestability and scrutiny of the DWP and FSR which remain largely unanswered. The committee would like, therefore, to establish:

- how particular capabilities enter the DWP and of those responsible for such decisions;
- how proposals for entry into the DWP are contested and by whom;
- the extent to which assumptions underpinning capability priorities identified in the DWP and FSR are subjected to independent and rigorous scrutiny and analysis;
- whether risk assessments are undertaken by the Strategy Executive in relation to particular capabilities before they are identified in the DWP;
- the extent to which the Strategy Executive engages with industry if at all during this early stage;
- the level of expertise within the Strategy Executive and its ability to digest information from across Defence and beyond into strategic guidance; and
- the weight that should be given to the funding arrangements and extent to which they shape or even bind future allocations to projects and how robust this process is.

Defence Capability Plan

Process

4.38 Identification of capability needs leads to the development of the DCP which outlines a 10-year program of new major capital equipment investment. In this regard, a revised DCP completes a five-yearly Force Structure Review and Defence White Paper package.

4.39 Projects for entry to the DCP are prepared by CDG on behalf of Defence for approval by the NSC.³⁸ The government will endorse the need to address the

37 Air Marshal J Harvey, Department of Defence, *Committee Hansard*, 7 October 2011, p. 43.

38 Department of Defence, *Defence Capability Development Handbook*, August 2011, p. 10.

identified gap as a capability project by including the project and an indicative budget provision in the DCP.³⁹

4.40 In order to develop the projects for inclusion in the DCP and provide the rigour and discipline which Kinnaird and Mortimer identified as lacking, the following documents are developed:⁴⁰

1. Initial Capability Definition Statement (ICDS) which summarises the scope, key assumptions, risks, costs and performance criteria for the individual project and potential impact on all elements of the Fundamental Inputs to Capability;⁴¹
2. Preliminary Operational Concept Document (POCD) developed out of the ICDS which is a key document in the Capability Definition Document (CDD) suite which is progressed through various internal Defence committees before submission to government at first pass;
3. Capability Definition Document (CDD) which comprises three documents including the POCD detailed above and:
 - a. Test Concept Document which is developed by the Defence Science and Technology Organisation (DSTO);⁴² and
 - b. Function and Performance Specifications developed by CDG.

Understanding risks and estimating costs

4.41 The Kinnaird Review found that there had been an inadequate understanding of technology risks and whole-of-life costs and too great a focus on presenting specific platform solutions to government 'in advance of a more complex understanding of a joint approach to overcoming the identified capability gap'.⁴³ In response to Kinnaird's findings, the Chief Defence Scientist who heads the DSTO was given the responsibility for providing independent advice on technical risk.

39 Department of Defence, *Submission 21*, p. 30.

40 Kinnaird found that poor project definition, analysis and planning before tenders were sought from industry contributed to failures including cost over-runs, schedule delays, and reduced capability to deliver platforms and systems. The Kinnaird Review concluded that the underlying reason was that the current process of capability definition and assessment 'generally lacked rigour and discipline'. Malcolm Kinnaird, *Defence Procurement Review 2003*, pp. 9–10.

41 Department of Defence, *Defence Capability Development Handbook*, August 2011, p. 27.

42 DSTO is responsible to consult with the Australian Test and Evaluation Office to ensure that appropriate risk treatments are included in the TCD (Defence Science and Technology Organisation, *Technical Risk Assessment Handbook*, Version 1.1, 2010, p. 30).

43 Malcolm Kinnaird, *Defence Procurement Review 2003*, pp. 9–10.

4.42 The Mortimer Review established that cost and schedule estimates in the DCP had shown a 'persistent trend to significantly underestimate the cost and time needed to deliver capability'. Mortimer emphasised the importance of applying greater analysis to projects before entry into the DCP. He also highlighted the need to define more clearly what a project is to 'deliver, providing an initial judgement of the risk inherent in the project, and more accurately estimating its cost and schedule on the basis of evidence'.⁴⁴ Similarly, Pappas raised a number of concerns regarding cost estimates and individual accountabilities in relation to the development of cost estimates.⁴⁵ As part of efforts to strengthen the process, the Department of Finance and Deregulation (Finance) was mandated to 'provide external evaluation and verification of project proposals'.⁴⁶

4.43 The committee acknowledges the Kinnaird Review's emphasis on the importance of funding for analysis and project development prior to inclusion in the DCP. Within this context, Kinnaird recommended the expenditure of up to 15 per cent of project funds prior to approval to cover independent investigation and analysis and industry studies.⁴⁷ Mortimer also underlined the crucial role of early analysis and project definition while recommending that CDG be adequately resourced to develop capability proposals and incorporate specialist advice.⁴⁸

4.44 The DCDH refers to the importance of early engagement with industry as a means of providing, amongst other things, an indication of whole-of-life costs, any innovative options that might be available to address the capability gap and insight into the marketplace to inform an acquisition strategy.⁴⁹ The issue of early industry engagement, however, attracted considerable comment during the inquiry. Indeed, the committee recognises that the recently invigorated environmental working groups which serve as a means to facilitate early informal engagement within industry are utilised in the requirements stage prior to first-pass rather than during the needs stage. The committee intends, therefore, to pursue the issue of early industry engagement in relation to the drafting of the DWP and the needs stage of the capability development process.

44 David Mortimer, *Going to the next level: the report of the Defence Procurement and Sustainment Review*, September 2008, p. 5.

45 George Pappas, *2008 Audit of the Defence Budget*, Department of Defence, 3 April 2009, pp. 60–68.

46 Department of Defence, *Submission 21*, p. 8.

47 Malcolm Kinnaird, *Defence Procurement Review 2003*, pp. 13–16.

48 David Mortimer, *Going to the next level: the report of the Defence Procurement and Sustainment Review*, September 2008, p. 26.

49 Department of Defence, *Defence Capability Development Handbook*, August 2011, p. 48.

Over-programming in the DCP

4.45 The Pappas Report raised the practice of over-programming whereby extra projects are included in the DCP, the total expected value of which exceeds the total amount of funding available. Pappas recommended that only those projects that Defence intends to deliver be included in the DCP (both pre- and post-first pass). In addition to over-programming, Pappas suggested that Defence should be trying to reduce the level of overplanning—'planning more expenditure than budget in the expectation it will be offset by slippage'— in the DCP.⁵⁰

4.46 While he noted the tendency to overprogram and overplan, Pappas was also concerned that the lack of prioritisation in the DCP compounded these problems. As a result:

...Projects can be rescheduled without reference to strategic requirements or rigorous debate about the consequences. It also means projects that should fill the most important capability gaps could have their scope changed, de-prioritised or not delivered at all.⁵¹

4.47 Pappas called for 'much greater transparency on which projects are priorities, and when they are expected to be delivered.' Overall, he concluded that 'the DCP should be an accurate statement of the capability Defence intends to acquire'.⁵²

4.48 The DWP and the DCP are foundation documents. They not only inform parliament, industry and the public more generally but also reflect the consideration, planning, analysis and decision-making around the procurement of major capital assets. Both documents should be reliable and informative and provide the transparency required for scrutiny.

4.49 Earlier, the committee considered the ambitious acquisition program outlined in the DWP and raised concerns about both the funding and schedule targets. It has now noted criticism of the DCP—over-programming, over-planning and failure to indicate priorities. These two key documents are critically important to industry and government should ensure that they provide accurate and reliable signals that would encourage and enable companies to plan ahead with confidence.

4.50 In August 2011, the minister stated that Defence would implement improved planning to reduce over-programming in the DCP 'by better aligning capability with resources and strengthening management focus'.⁵³ He noted that while over-

50 George Pappas, *2008 Audit of the Defence Budget*, Department of Defence, 3 April 2009, p. 84.

51 George Pappas, *2008 Audit of the Defence Budget*, Department of Defence, 3 April 2009, p. 84.

52 George Pappas, *2008 Audit of the Defence Budget*, Department of Defence, 3 April 2009, p. 84.

53 Minister for Defence and Minister for Defence Materiel, 'Release of the 2011 On Line Public Defence Capability Plan', 18 August 2011, <http://www.minister.defence.gov.au/2011/08/18/minister-for-defence-and-minister-for-defence-materiel-release-of-the-2011-on-line-public-defence-capability-plan/> (accessed 7 November 2011).

programming provides flexibility and serves as an 'aid in ensuring that best use is made of available funding in the event of delays to the development of individual projects', reducing over-programming would improve the quality of information provided. The committee sought clarification as to what level Defence would reduce over-programming in the DCP. Air Marshal John Harvey informed the committee that whereas the current level of over-programming was around five per cent, the minister would like a reduction to zero.⁵⁴

4.51 The committee recognises a disconnection in the information provided by Defence regarding a reduction in over-programming. It understands that the minister would like to see a reduction in rather than no over-programming and intends to consider over-programming and its impact on the public DCP in a latter report.

Structure

Capability Development Group

4.52 The development of the DCP is defined as a 'whole of defence' activity led by CDG but with 'input across the portfolio with all interested parties' to ensure there is alignment between strategy, priorities and resources.⁵⁵

4.53 CDG was formed in accordance with Kinnaird's recommendation for a single point of accountability to manage the capability definition and assessment process.⁵⁶ In terms of overall responsibility, therefore, CDG is responsible and accountable for the development of the DCP. Indeed, the role of CDG is to prioritise all Defence's major procurements in line with strategic guidance and ensure that project proposals put to government for inclusion in the DCP have reliable capability, cost, risk and schedule estimates.⁵⁷

4.54 Principally, CDG makes recommendations to government on the appropriate capability that would meet government priorities with agreed workforce and funding guidance. According to the DCDH, CDG manages four key transition points in the capability life cycle:

- developing the capability strategy aspects of the Defence Planning Guidance (DPG) which articulates strategic options, and capability priorities and themes, for DCP development;
- transforming future force capability needs into capability system needs for DCP entry;
- obtaining government approval of the DCP and associated projects; and

54 Air Marshal J Harvey, Department of Defence, *Committee Hansard*, 7 October 2011, p. 34.

55 Neil Orme, Department of Defence, *Committee Hansard*, 5 October 2011, p. 11.

56 Malcolm Kinnaird, *Defence Procurement Review 2003*, pp. 9–10.

57 Department of Defence, *Submission 21*, p. 8.

- transitioning approved projects to the Capability Manager and acquisition agency (usually DMO), following government approval.⁵⁸

Capability Investment Resources Division of CDG

4.55 The Capability Investment Resources Division (CIR Div) is one of three divisions within CDG and is responsible for providing independent analysis and to review capability proposals and their related costs. The CIR Div is divided into two branches, the Investment Analysis Branch and the Cost Analysis Branch.

4.56 In line with the Pappas recommendations regarding independent analysis, CDG's CIR Div provides such analysis and reviews capability proposals and related costs, including the overall balance of investment in current and future capabilities, major investment proposals and priorities. The division is responsible for:

- a) ensuring that the DCP is appropriately programmed;
- b) independently reviewing capital and operating costs for all projects going to the Defence committees; and
- c) management of Net Personnel and Operating Costs (NPOC) estimates for all DCP projects and those approved projects (ie post-second pass) for which NPOC has not been triggered.⁵⁹

4.57 The Cost Analysis Branch (CAB) in the CIR Div is responsible for developing independent cost estimates as required whilst managing the DCP and associated NPOC.⁶⁰ The CAB will approve a cost model (which is a standardised spreadsheet) used to present whole-of-life cost information and capture assumptions on which the costs are developed.⁶¹ The DCDH notes that the cost estimates presented at first pass for government consideration should be based on the cost model and articulate the basis and cost drivers for the estimates whilst determining amongst other things the 'overall affordability of each option in terms of acquisition and NPOC'.⁶² Thereafter, at second pass, each option presented to government requires an Acquisition Business Case which includes a cost template detailing estimates and risks for total acquisition and whole-of-life costs including amongst other things, Personnel and Operating Costs (POC) and NPOC.⁶³

58 Department of Defence, *Defence Capability Development Handbook*, August 2011, p. 15.

59 Department of Defence, *Defence Capability Development Handbook*, August 2011, p. 16.

60 Department of Defence, *Defence Capability Development Handbook*, August 2011, p. 16.

61 Department of Defence, *Defence Capability Development Handbook*, August 2011, p. 57.

62 Department of Defence, *Defence Capability Development Handbook*, August 2011, p. 57.

63 Department of Defence, *Defence Capability Development Handbook*, August 2011, p. 77.

Defence Materiel Organisation

4.58 The Defence Materiel Organisation (DMO) is responsible for assisting CDG to develop the CDD suite which defines the capability system baseline, provides cost and schedule estimates, and incorporates the results of risk reduction studies. It provides advice on industry's capacity to support new capabilities across the DCP whilst meeting current commitments to extant capabilities being either acquired or supported in-service.⁶⁴

Defence Science and Technology Organisation (DSTO)

4.59 Science and Technology (S&T) advice informs government on capability development decisions. The DSTO is a principal source of that advice and provides a range of services through the capability development stages. The DSTO will produce a preliminary Test Concept Document for each project entering the DCP for further development.

Capability Managers

4.60 Capability Managers will develop some of the documents that make up the capability proposals which define the requirements of each of the Fundamental Inputs to Capability (FIC) elements of the capability system. They identify the requirements to generate capability including personnel and workforce requirements, organisation, collective training, major systems, supplies, facilities and training areas, support, and command and management. They are also responsible for detailing the risks for each option.⁶⁵

Engaging with and informing industry

4.61 The need for early engagement with and the provision of adequate information to industry in the early stages of the capability development process was emphasised by many submitters to the inquiry as essential to both inform the development of the DCP and enable industry to plan for the future.

4.62 In response to Mortimer's recommendations regarding the public DCP, the *Defence Capability Development Handbook* (DCDH) states that the public DCP contains details of project descriptions and scope information including the interrelationship with other approved or unapproved projects or project phases as well as industry opportunities for acquisition and through-life support.⁶⁶

4.63 However, evidence before the committee suggests that the clarity of the public DCP, which is a primary information tool for industry, has declined making

64 Defence Materiel Organisation, *DMO Acquisition and Sustainment Manuel*, 2007, p. 48.

65 Department of Defence, *Defence Capability Development Handbook*, August 2011, p. 111.

66 Department of Defence, *Defence Capability Development Handbook*, August 2011, p. 29.

measuring progress in the initial stage of a project and ability to align workforce capabilities with project demands extremely difficult.⁶⁷ The committee intends to consider evidence regarding the public DCP and extent to which it is sufficiently accurate in terms of time projections and estimated project value to meet industry expectations and enable industry to plan according. Conversely, the question for the committee is to what extent industry is led to rely upon the public DCP, as well as the DWP and other published information from Defence when making investment decisions.

4.64 Other issues for consideration include the impact of industry policy and implementation on long term industry capacity and how this implicates procurement decisions. In this context, key questions emerge in relation to the *Defence Industry Policy Statement 2010*. Whilst this policy has committed \$445.7 million in industry support over ten years, it is not clear how much of those funds have already been distributed. Furthermore, the committee is interested to establish whether the policy framework is adequate and how well it has been implemented to date. Acknowledging that the strength of the Defence industry base has a real impact on its capacity to engage with the procurement process at the early stages and throughout the lifecycle, the committee intends to pursue these matters.

4.65 Many submitters also raised concerns about the state of Australia's defence industry and its future more broadly including the consequences of delays in capital procurement outcomes on the viability of local industry and expertise.⁶⁸ Others emphasised the point that maintenance of a viable defence industry is critical to Australia's (maritime) defence.⁶⁹ Some submitters held that Australian design, development and construction of new equipment for the ADF should be recognised as a first order policy priority for government.⁷⁰ These are matters for the committee's main report.

People

4.66 CDG is responsible for both the DCP and the preparation of documentation for submission to government at first and second pass. In the context of considering the requirements phase in the next chapter, the committee will consider CDG and other players responsible across the needs and requirements phase.

67 Submarine Institute of Australia, *Submission 9*, p. 2.

68 Australian Industry Defence Network Inc, *Submission 19*, p. 1; Northern Territory Government, *Submission 4*, p. 1.

69 Australian Association for Maritime Affairs, *Submission 17*; Royal Institution of Naval Architects (Australia Division), *Submission 18*.

70 Australian Industry Group Defence Council, *Submission 10*, p. [4].

Unanswered questions

4.67 The committee appreciates that the process by which the DCP is developed has been strengthened in response to the Kinnaird, Mortimer and Pappas findings and recommendations. However, the committee questions the extent to which the process provides for contestability and independent verification. One of the key areas where this should take place is in relation to industry and early engagement with industry.

4.68 The majority of submitters to the inquiry held the view that whilst early engagement with industry is fundamental, there are few opportunities for two-way exchange of information and knowledge with industry in the needs stage of the capability development process.⁷¹ However, the committee was unable to establish exactly how and when industry is involved at the needs stage. Questions remains therefore as to:

- when and how industry is involved in the needs stage;
- the role and importance of the public DCP in informing industry planning, and in relation more broadly to the question of contestability;
- the process by which projects entered into the DCP are subject to rigorous and independent verification and analysis.

4.69 Whilst the committee appreciates that DSTO has a role in the needs stage, the committee is interested to establish whether:

- the Capability Managers, CDG and DMO have the science and technology expertise to fully appreciate the risk assessments undertaken by DSTO; and
- whether the DSTO Test Concept Document is given adequate weight in consideration of feasibility and technical risk.

Committee view

4.70 The committee recognises a number of challenges in relation to the strategic analysis and needs stage including the strength and clarity of the linkages between strategic guidance and capability development as identified in the DWP. Furthermore, the committee acknowledges the concerns raised in relation to the DWP funding and procurement targets and the key questions of whether the DWP program will be achieved. Such matters raise concerns for the committee regarding the reliability of the DWP and DCP as central planning documents. The committee intends to pursue these questions and consider the inefficiencies in the process from the earliest analysis and how they impact along the process including in terms of changes to scope and delays. These questions also go to the issue of risk management and the capacity of Defence to identify and mitigate risk from the beginning of the capability process, the

71 Australian Business Defence Industry Unit, *Submission 6*, p. 5; BAE Systems Australia, *Submission 12*, p. 3; Andrew Davies and Mark Thomson, *Submission 8*, p.[2]; Australian Industry Defence Network, *Submission 19*, p. 3; Australian Industry Group Defence Council, *Submission 10*, p. [4]; Defence Teaming Centre Inc, *Submission 16*, p. 4.

veracity of the process as well as to the management feedback loops recognised as fundamental for providing transparency in relation to a project's status.