

Joint Committee of Public Accounts and Audit

Answers to Questions on Notice

Department/Agency: Australian National Audit Office

Topic: Inquiry into the 2018-19 Defence Major Projects Report and the Future Submarine Program—Transition to Design (Auditor-General's Reports 19 and 22 (2019-20))

Date of Hearing: 20 May 2020

Committee Member: Senator Rex Patrick

Type of question: Written

Date set by the committee for the return of answer: 8 May 2020

Number of pages: 8

Question 1:

On Page 20 under para 1.20 It states "The Department of Defence's estimates for its \$89 billion Naval Construction Programs [including the Offshore Patrol Vessel, Future Frigate and Future Submarine programs] remain unchanged as at the most recent Integrated Investment Program Bi-Annual review informing the Defence Portfolio Budget Statements 2019-20", then at para 1.22 it states "At a reported cost in the order of \$80 billion, the design and construction of the Future Submarine represents the largest Defence procurement in Australia's history".

1. Based on these numbers there would be \$9B for the OPV and Frigate programs, in circumstances where the 2016 Defence Integrated Investment Plan (see Table 6) suggests the OPV program is projected to cost \$3 - \$4 billion out-turned and the Future Frigate Program is projected to cost >\$30B out-turned. How does the Auditor reconcile the cost differences?

Answer to question 1:

The ANAO did not seek to reconcile the cost estimates presented by Defence.

Auditor-General Report No.22 2019-20 *Future Submarine Program—Transition to Design* cited the documented Department of Defence (Defence) estimates available at the time of the audit. The Defence estimates were: \$89 billion for the Offshore Patrol Vessel, Future Frigate and Future Submarine programs (this estimate was provided by Defence to the Joint Committee of Public Accounts and Audit and was dated 13 August 2019); and in the order of \$80 billion for the Future Submarine Program (this estimate was provided by Defence to the Senate Foreign Affairs, Defence and Trade Legislation Committee on 29 November 2019). Defence's estimates are reported in paragraphs 2, 1.20, 3.28 and 3.29 of the audit report.

The audit objective was to examine the effectiveness of Defence's administration of the future submarine program to date, with a focus on program activities relating to design. The audit was not focused on the shipbuilding enterprise as a whole, and the ANAO did not seek to reconcile the available Defence estimates. However, at paragraph 1.18 of the audit report, the ANAO referenced earlier audit findings and a recommendation regarding the affordability of Defence's naval construction programs made in Auditor-General Report No.39 2017-18 *Naval Construction Programs—Mobilisation*, which did focus on the shipbuilding enterprise as a whole.

In paragraphs 4.37 to 4.40 of that earlier report, the ANAO observed that Defence had not revisited the 2016 White Paper cost assumptions, and that there would be benefit in doing so, in light of the Australian Government's decision to construct all ships and submarines in Australia and the bringing forward of expenditure for those programs to meet the compressed build schedule for surface ships. The Auditor-General recommended that 'Defence, in line with a 2015 undertaking to the Government, determine the affordability of its 2017 *Naval Shipbuilding Plan* and related programs and advise the

Government of the additional funding required to deliver these programs, or the Australian Defence Force capability trade-offs that may need to be considered.' Defence did not agree to the recommendation.

Questions 2 and 3:

On para 2.2. The Commonwealth's objectives for the Future Submarine Program are listed, with - Dot Point 3 "to deliver an affordable Future Submarine capability within a realistic timeframe and with the knowledge and skills to understand and control sustainment cost drivers for the life of the class."

2. What examination did the Auditor-General do in respect of Defence's assessment of "affordable".
3. Does the Auditor-General consider that the capability meets the 'affordable' test? Please provide details that ground the auditor's assessment.

Answers to questions 2 and 3:

The questions relate to paragraph 2.2 of Auditor-General Report No.22 2019-20 *Future Submarine Program—Transition to Design*. Paragraph 2.2 reports factually, in dot point form, on the Australian Government's documented objectives for the Future Submarine Program.

As discussed in the response to question 1 above, the audit focused on program activities related to design and did not examine the Australian Government's assessment of what constitutes an affordable capability. The response to question 1 also details the ANAO's previous observations on affordability and the recommendation made to Defence to determine the affordability of its shipbuilding programs, including the Future Submarine Program.

Questions 4 to 7:

Dot Point 4 "to maximise Australian industry involvement through all phases of the Future Submarine Program without unduly compromising capability, cost and schedule."

4. What does the Auditor-General understand the metrics that is/will be used by Defence to track performance against this object are?
5. Is the Auditor-General satisfied that Defence has put an appropriate framework in place to achieve these metrics?
6. Is Defence meeting this objective?
7. How does the Auditor-General make this assessment?

Answers to questions 4 to 7:

The questions relate to paragraph 2.2 of Auditor-General Report No.22 2019-20 *Future Submarine Program—Transition to Design*. Paragraph 2.2 reports factually, in dot point form, on the Australian Government's documented objectives for the Future Submarine Program.

The ANAO reviewed the Strategic Partnering Agreement (SPA) signed in February 2019, including the terms and conditions relating to Australian Industry Content. There were no contracted metrics set out in the terms and conditions reviewed by the ANAO. The ANAO notes that subsequent to the audit, Defence advised the Senate Foreign Affairs, Defence and Trade Legislation Committee on 4 March 2020 that the SPA did not contain a minimum Australian industry involvement requirement.

Table 2.1 of the audit report outlines the 12 contractual framework goals that the SPA aims to achieve. Goal 10 relates to Australian industry objectives. In respect to goal 10, the ANAO reported that under the SPA Naval Group is required, among other things, to deliver an Australian Industry Program and to prepare an Australian Industry Capability strategy and Australian industry capability plans for each stage of the Future Submarine Program detailing plans, procedures, responsibilities and timeframes for the development of Australian industry. These documents were being developed in the course of the audit.

The audit objective was to examine the effectiveness of Defence's administration of the future submarine program to date, with a focus on program activities relating to design. As noted in paragraph 1.25 of the report, the audit did not examine in any detail non-design program activities and expenditures to date, such as the achievement of Australian industry objectives.

Question 8:

On para 2.25. As a deliverable of the Design and Mobilisation Contract, there was an objective to sign the Strategic Partnering Agreement by 17 October 2017. The Strategic Partnering Agreement was signed on 11 February 2019, nearly 16 months later than the objective.

8. What is the Auditor-General's assessment of the effect of this delay on the overall schedule?

Answer to question 8:

Auditor-General Report No.22 2019-20 *Future Submarine Program—Transition to Design* reported on the following delays experienced by the Future Submarine Program:

- There was a delay in commencing negotiations and the Strategic Partnering Agreement was signed 16 months later than the objective (see paragraph 2.25 of the audit report).
- The design schedule was extended by nine months against Defence's pre-design contract estimates, to help retire design risk (see paragraphs 3.5 to 3.7 and paragraphs 3.45 to 3.46 of the audit report).
- The concept studies review commenced two months later than scheduled, and there were incomplete work items at completion (see paragraphs 3.13 to 3.21 of the audit report).
- The systems requirements review commenced five weeks later than scheduled (see paragraphs 3.24 and 3.25 of the audit report).

The ANAO sought representations from Defence regarding the impact of these delays on the overall schedule for the Future Submarine Program. Defence's advice to the ANAO is reported at paragraphs 2.27 and 3.7 of the audit report. Defence's response to the audit, reproduced at paragraph 20 and Appendix 1 of the report, was that 'the commencement of construction activities in Australia, and the delivery of the Future Submarines has not been delayed.'

The audit conclusion, at paragraph 9 of the report, is that 'Defence has established the formal arrangements necessary for the effective administration of the Future Submarine Program, through the *Strategic Partnering Agreement*. However, the two key mandated design milestones were extended. Program success is dependent on the timely and cost-effective delivery of major design milestones.'

Questions 9 to 10:

On Table 2.1 Goal Statement 1: The contractual framework reflects the undertakings and commitments of Naval Group during the Competitive Evaluation Process (CEP), which were the basis of Naval Group's selection. ANAO Analysis Goal 1 - Defence advised the Government in February 2019 that: The undertaking and commitments of Naval Group in the CEP Final Deliverables and Commitment Deeds have been incorporated into the SPA Conditions of Agreement (COA), Conditions of Contract (CoC) and the Approved Subcontractor Deeds.

9. What analysis did the Auditor-General staff do to validate this?

10. Did the Auditor-General staff examine the proposals in the AIC Plan delivered through the CEP and reconcile the proposals against what is occurring under contract?

- a. If so, what was the assessment?
- b. If not, why not?

Answers to questions 9 and 10:

The ANAO did not validate or provide assurance on Defence's advice to the Australian Government regarding contract goal 1.

Part of the audit conclusion, at paragraph 10 of the report, is that the Strategic Partnering Agreement (SPA) includes provisions which address 11 of the 12 documented contract goals outlined in Table 2.1. These were goals 2 to 12. In respect to goal 1, the audit conclusion is that Defence has assured the Government that the remaining contract goal has been addressed. Table 2.1 factually references Defence's February 2019 advice to the Australian Government on this matter, and paragraph 2.31 of the audit reports that in respect to goal 1, 'Defence has asserted to government that the undertakings and commitments of Naval Group during the competitive evaluation process have been incorporated into the *Strategic Partnering Agreement*'.

Defence did not prepare, in support of its assertion relating to goal 1, a reconciliation of the Competitive Evaluation Process Final Deliverables and Commitment Deeds, and the SPA Conditions of Agreement. Accordingly, there was no basis for the ANAO to apply audit procedures to assess the reasonableness of Defence's advice to government, and the ANAO considered it to be beyond the scope of this audit to undertake such a detailed technical reconciliation process itself.

Questions 11 and 12:

Goal Statement 5 "The contractual framework includes appropriate obligations and rights concerning intellectual property, Australian industry capability, transfer of technology, access to technical data and cost transparency." ANAO analysis 5 "The Commonwealth has obtained intellectual property rights that aim to meet the Commonwealth's sovereignty requirements. The Agreement requires Naval Group Australia to develop and implement a Transfer of Technology program in line with the requirements of the program contracts to ensure that sufficient technology, know-how and know-why is transferred to the Commonwealth and to Australian industry."

11. What was the Audit team's understanding or expectation in regards to obligations and rights concerning Australian Industry Capability?

12. How was this assessed/analysed?

Answers to questions 11 and 12:

The ANAO conducted its audit review against the 12 contract goals established by the Australian Government and Defence's reporting to government on how it achieved those goals. As the auditor, the ANAO did not set its own expectations.

In its review of the goal statements in Table 2.1 of the audit report, the ANAO's approach was to verify whether there were provisions in the Strategic Partnering Agreement (SPA) that address the Australian Government's objectives for the Future Submarine Program and the 12 documented contract goals, and provide a basis for establishing a successful strategic partnership and delivering shared program objectives. SPA provisions were reviewed for relevance and completeness. This approach was adopted to address the high-level audit criterion documented in paragraph 7 of the report: has Defence established a fit-for-purpose strategic partnership in accordance with government requirements?

Question 13:

Goal Statement 6 "The contractual framework promotes the establishment of a capable and competent NGA [Naval Group Australia] as the builder of the Attack class fleet and as the enduring Design Authority for sustainment that operates under sound governance and management arrangements underpinned by appropriate means for the Commonwealth to protect its interests including through asset securities." ANAO analysis 6 "Naval Group Australia has been established as a single purpose subsidiary in Australia for the purpose of the Future Submarine Program. Naval Group

Australia is a party to the Agreement which establishes roles and responsibilities for Naval Group Australia. The Commonwealth has appropriate controls in place for the delivery of the Future Submarine Program's objectives."

13. What provides the ANAO the confidence that there are appropriate controls in place for the delivery of the Future Submarine Program's objectives in the context of this goal?

Answer to question 13:

As discussed in the response to questions 11 and 12, the ANAO conducted its audit review against the 12 contract goals established by government and Defence's reporting to government on how it achieved those goals. The relevant Strategic Partnering Agreement provisions were reviewed against the goal statements. The ANAO also reviewed Naval Group Australia's company constitution.

The ANAO's analysis was informed by lessons learned from the previous performance audit of Defence's administration of the Air Warfare Destroyer program—Auditor-General Report No.22 2013–14 *Air Warfare Destroyer Program*—which examined the governance of that program.

Questions 14 to 18:

Goal Statement 10 "The contractual framework promotes the establishment of a sustainable industry base in Australia with maximum opportunities for involvement in the delivery and sustainment of the Attack class fleet without unduly compromising cost, capability or schedule." ANAO analysis 10 "Naval Group is required to: • Deliver an Australian Industry Program and to prepare an Australian Industry Capability strategy and Australian industry capability plans for each stage of the Future Submarine Program detailing plans, procedures, responsibilities and timeframes for the development of Australian industry. • Utilise Australian industry, and develop an Australian industry base; and establish and maintain a sustainable supply chain."

14. What was the Auditor-General's understanding or expectation in regards to obligations and rights concerning Australian Industry Capability?

15. How was this assessed/analysed?

16. Did the Auditor-General's staff sight any of the "detailed plans procedures, responsibilities and timeframes for the development of Australian industry"?

17. Did Auditor-General's staff draw a view from them?

18. Were these compared against previous AIC documents delivered by Naval Group?

Answers to questions 14 to 18:

As discussed in the response to questions 11 and 12, the ANAO conducted its audit review against the 12 contract goals established by government and Defence's reporting to government on how it achieved those goals. As the auditor, the ANAO did not set its own expectations.

In its review of the goal statements in Table 2.1 of the audit report, the ANAO's approach was to verify whether there were provisions in the Strategic Partnering Agreement (SPA) that address the Australian Government's objectives for the Future Submarine Program and the 12 documented contract goals, and provide a basis for establishing a successful strategic partnership and delivering shared program objectives. SPA provisions were reviewed for relevance and completeness.

As discussed in the response to questions 4 to 7, the documents required in respect to goal 10 were being developed in the course of the audit. For example, the ANAO saw evidence of a draft Australian Industry Content Plan under development in accordance with the SPA.

As further discussed in the response to questions 4 to 7, the audit objective was to examine the effectiveness of Defence's administration of the future submarine program to date, with a focus on program activities relating to design. As noted in paragraph 1.25 of the audit report, the ANAO did not

examine in any detail non-design program activities and expenditures to date, such as the achievement of Australian industry objectives. Accordingly, the audit procedures did not include the review of previous documents relating to Australian industry content.

Question 19:

On para 2.32 The ANAO report states "it is too early to assess the success of the Strategic Partnering Agreement or the partnership between Defence and Naval Group."

19. In the ANAO's view when should the project be subject to additional reviews to assess the "success of the Strategic Partnering Agreement or the partnership between Defence and Naval Group"?

Answer to question 19:

Part of the audit conclusion, at paragraph 12 of the report, is that this key relationship is at a relatively early stage and the parties' active management of both specific issues and the partnership is essential for effective risk management and program success. Accordingly, the relationship and program governance will be an ongoing focus of future ANAO audits of the Future Submarine Program. It is anticipated that the next performance audit in this series will align with the Critical Design Review. Table 3.1 of the audit report identifies that this review is currently scheduled for June 2022.

Questions 20 to 23:

On Table 3.1 and para 3.52 The Milestone "Information Communication Technology/Transfer of Technology Way Forward Review" was contracted to occur in Sep 2019, then in Sep Defence advised the ANAO that the Way Forward Review had been delayed.

20. Did ANAO staff sight the 'Transfer of Technology Forward Options Report' that was to be delivered in July 2019?

21. What advice did Defence give to the ANAO about when this would be conducted?

22. Did Defence provide any explanation on why this was delayed?

23. Does the ANAO deem this to be another missed milestone?

Answers to questions 20 to 23:

The ANAO sighted the Transfer of Technology Way Forward Report in September 2019. As discussed in paragraph 3.52 of the audit report, Defence advised the ANAO in September 2019 that the Way Forward Review originally scheduled for September 2019 had been delayed. Defence did not provide a revised date to the ANAO. The ANAO sought clarification on the status of the review and was advised by Defence in December 2019 that the delay was due to the Transfer of Technology Way Forward Report not being approved by the Commonwealth.

A high-level audit criterion, documented in paragraph 7 of the audit report, was: is Defence meeting the planned design milestones for the Future Submarine Program? As discussed in paragraph 3.8 of the audit report, the ANAO examined whether the two key contracted design milestones that were scheduled to be met by 31 October 2019 had been achieved. The milestones were: the Concept Studies Review under the Design and Mobilisation Contract; and the Systems Requirements Review under the Submarine Design Contract. In contrast to these reviews, the Transfer of Technology Way Forward Review does not relate to the design of the platform system and is not a 'gateway' to other design processes. It relates to the transfer of detailed design activities to Australia and is in the nature of a risk mitigation activity. Accordingly, the ANAO did not consider a delay in this activity to be a missed design milestone, comparable to the delayed Concept Studies Review and Systems Requirements Review. Part of the audit conclusion and findings, at paragraphs 9 and 17 of the report, was that these two key mandated design milestones were extended.

Question 24:

On Table 3.1

24. Is the Auditor-General satisfied that the shift in Preliminary Design Review from March 2020 to January 2021 has not introduced a schedule delay to the completion date of the first submarine?

Answer to question 24:

See the response to question 8 above.

Question 25:

On para 3.22 and Appendix 1

25. Noting the successive contract changes (as listed at para 3.22 dot points) which overall included an increase in contract value, and the residual deliverables that were outstanding. Does the ANAO agree that the program work is progressing to the required level of maturity within the allocated resources?

Answer to question 25:

Paragraph 3.22 of the audit report summarises the Director-General Future Submarine Program's assessment of key deliverables against milestones. The ANAO did not review the effectiveness of the Director-General's decision-making in approving the specific contract changes. Defence's summary response to the audit, reproduced at paragraph 20 and Appendix 1 of the report, states that 'Design work has continued to progress to the required level of maturity under the Submarine Design Contract within allocated resources as demonstrated by entry to the second major milestone, Systems Requirements Review on 5 December 2019.' The ANAO did not assess the maturity of the design work.

Questions 26 to 28:

On para 3.24 and 3.25 "Under the amended design schedule, this Review was scheduled for completion by 31 October 2019."

"In December 2019, Defence advised the ANAO that the Systems Requirements Review commenced on 5 December 2019, five weeks later than scheduled."

The Systems Requirements Review (SRR) was scheduled to be completed by 31 Oct 2019, yet in December Defence advised the ANAO that the review commenced on 5 December, five weeks late.

26. On what date was the review supposed to commence?

27. Did the ANAO seek advice from Defence as to when the SRR was completed?

28. Is it the ANAO's assessment that the program is only five weeks behind schedule?

Answers to questions 26 to 28:

The Systems Requirements Review (SRR) did not have a required commencement date. The required completion date was 31 October 2019. The audit report reflects Defence documentation on this matter. The SRR was ongoing when the audit was finalised in December 2019.

For question 28, see the response to question 8 above.

Questions 29 to 31:

On Figure 1.2, para 3.56, para 3.57, para 3.58 "... a key strategy to address the 'high' risk of the Future Submarine Program was ongoing review of the program by the Naval Shipbuilding Advisory Board and the Submarine Advisory Committee."

"... independent critical peer review of the current and projected submarine capability to validate existing plans and actions as well as to enable early identification of areas of weakness."

"Defence advised the ANAO that it provides submissions to the Submarine Advisory Committee if and when needed. Defence provided submissions to this Committee during 2017 and up until July 2018."

29. Noting the Submarine Advisory Committee is part of the Governance arrangements and part of the key strategy to address the risk, did the ANAO query why no submissions had been put to them since July 2018?
30. What information did the ANAO obtain from Defence on the frequency of meetings of the Submarine Advisory Committee?
31. How did the ANAO assess the suitability and/or effectiveness of the Submarine Advisory Committee?

Answers to questions 29 to 31:

The ANAO asked Defence why no submissions had been put to the Submarine Advisory Committee since July 2018. As reported at paragraph 3.58 of the audit report, Defence advised the ANAO that it provides submissions to the Committee if and when needed. The ANAO was further advised that the Submarine Advisory Committee meets on an 'as required' basis.

The ANAO reported on the Submarine Advisory Committee as one of the risk mitigation strategies for the Future Submarine Program. Part of the audit conclusion and findings, at paragraphs 12 and 18 of the report, were that Defence has adopted relevant risk mitigation strategies. The ANAO did not review the suitability or effectiveness of the Committee or its members, but did report in paragraph 3.57 and footnote 56 of the audit report that the Committee consists of three former senior naval officers from the United States Navy and the Royal Australian Navy.