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Attn: Committee Secretary
Joint Committee of Public Accounts and Audit

Ref: Inquiry into Defence Major Projects Reports and Procurement of Hunter Class Frigates - Invitation to make a submission - dated 18 May 2023.

Dear Committee,

BAE Systems Australia welcomes the opportunity to input to the Joint Committee of Public Accounts and Audits (JCPAA) call for submissions into the Inquiry into the Defence Major Projects Report 2021-21 and 2021-22 and Procurement of Hunter Class Frigates. As the Prime contractor for the Hunter class frigates, BAE Systems Australia also welcomes this opportunity to update on current program performance in response to the Australia National Audit Office (ANAO) Report No.21 – The Department of Defence’s Procurement of the Hunter Class Frigate. This submission will provide insight into the progress made on the project since contract signature in December 2018 as Prime contractor.

The terms of reference for the JCPAA inquiry has primary focus on the tender evaluation process, including Departmental record keeping, decision making and evaluation criteria. These sections, and the lessons arising for future capability acquisitions, are matters for the Defence and Finance Departments respectfully, and it would not be appropriate for BAE Systems Australia or industry to comment on procurement processes of the Government. However, as Prime contractor from contract signature, BAE Systems Australia can respond to the terms of reference section 3(c) Contract management, monitoring and reporting, and current progress delivery, and welcome the opportunity provide the committee with an up to date confidence and transparency of progress on the project and current and future milestones.

1. Hunter Class Frigate Program progress

- 1.1. The Head Contract for the Hunter program was signed in December 2018, and the Batch 1 proposal will be delivered on schedule at the end of June 2023. As outlined in the obligations within in the Head Contract, BAE Systems Australia is responsible for the development and implementation of a sovereign capability as part of Australia’s continuous naval shipbuilding plan. The obligations that BAE Systems Australia accepted as part of the Sovereign Capability Option Deed (SCOD) are measured over six capabilities; Design and Engineering, Combat Systems Engineering, Project Management, Shipbuilding and Production, Supply Chain management and Sustainment. Recent audits conducted can confirm that we are meeting and/or exceeding the required capability levels as part of the Design and Productionisation contract. Over the life of the program, over 5000 jobs will be created and sustained at BAE Systems Australia and the wider Australian defence supply chain.

- 1.2. In order to enable delivery of the Hunter program, the Osborne South Shipyard required significant infrastructure upgrades by Australian Naval Infrastructure (ANI) and was due to be completed and handed over to BAE Systems Australia in April 2020.
- 1.3. This was delayed by nine months primarily due to COVID-19 preventing European-based suppliers unable to travel to complete work activities. Despite this delay to handover and the volume of work required to be undertaken by BAE Systems Australia to commission the new buildings, the prototyping phase began in December 2020 with the commencement of construction on the first prototype block.
- 1.4. Since then, all prototyping milestones have been achieved to schedule with shipbuilding capability (infrastructure, resource capability, systems and processes) developed and demonstrated through the construction of five representative ship blocks to Type 26 design with increasing levels of complexity and Hunter class changes.
- 1.5. The prototyping blocks are currently in various stages of production completion through the shipyard, with the first structurally complete with hot work outfit installed and fully blast and painted. The very high quality and dimensional tolerance of the blocks being achieved has been widely recognised as best practice by national and international shipbuilding subject matter experts that have visited the shipyard.
- 1.6. A readiness review was held in February 2023, jointly chaired by BAE Systems Australia and the Commonwealth, where shipbuilding capability and readiness was reviewed across 20 work streams including engineering, production, planning, project management and quality assurance, measuring the effectiveness of the prototyping phase of the program. The review concluded with a 'pass' endorsing the shipyard as capable of producing fully compliant Hunter class product in accordance with the design intent and the requirements of Lloyd's Register of Shipping.
- 1.7. Following the readiness review 'pass', construction began on 1 May 2023 on the first block to be built to the Hunter class design that is expected to be used in the construction of the first of class Hunter frigate, signalling a shift from prototyping to production.
- 1.8. Running concurrently to prototyping, in April 2022, BAE Systems Australia successfully completed System Definition Review (SDR), whereby the Mission System Specification (MSS) and the Functional Baseline (FBL) were agreed as meeting the 23 required performance criteria for the design of the ship.
- 1.9. In July 2023, BAE Systems Australia will hold the Preliminary Design Review (PDR) event, which is the technical assessment that ensures the design is operationally effective, and detailed design can commence. The PDR is scheduled to be completed in October 2023.
- 1.10. In June 2021, the Australian Government announced that construction of the first Hunter class frigate would be delayed from end of 2022 until mid-2024. This was a risk mitigation decision based on the impact of COVID-19, supply chain delays and the desire to ensure greater certainty around delivery milestones. This decision to delay the build also provided more time to mature the Hunter frigate design prior to manufacture – specifically the Australian-specific changes to the reference ship design and Combat Systems architecture. The delay would create greater build efficiency, restoring the program to optimal build strategy, and reduce the risk of rework as the program progressed.

- 1.11. In August 2022, BAE Systems Australia confirmed that through the prototyping process, the workforce has been able to demonstrate new, more efficient ship-build methods and innovations into the process. The high-level quality and productivity being achieved at the Osborne Naval Shipyard has resulted in construction of the first Hunter-designed ship block, effectively recovering 13 months of previously announced schedule delay, while maintaining a steady rate of production.
- 1.12. BAE Systems Australia has grown its workforce, and latest figures show the Hunter program employs nearly 1,500 people. Over 80 per cent of those employees are Australian, in line with the criteria agreed in the SCOD.
- 1.13. This also includes employees in our Early Careers program which currently employs 27 apprentices, with an additional 24 apprentice placements planned for later this year and early 2024. Thirty-five graduates are currently rotating through the program, and a further ten interns are working within the business.
- 1.14. BAE Systems Australia is currently exceeding the commitment of 58 per cent Australian Contract Expenditure over the life of the program. To date, the company has awarded \$127m in contracts to 45 local Australian suppliers, delivering over and above our contracted commitments.
- 1.15. Over the last 12 months the program has met all of the key Performance milestones including recovering key aspects of weight and margin management.

2. Allowable costs

- 2.1. In addressing the topic of allowable/ disallowable costs, the Head Contract sets out an allowable costs framework aligned with contracting under Department of Defence principles.
- 2.2. BAE Systems Australia has established systems and implemented processes that monitor that all costs that are invoiced to the Commonwealth under the program meet this criteria, are reasonable and comply with the terms of the agreement.
- 2.3. These systems and processes are subject to periodic internal and external audit reviews to ensure they are functioning appropriately and processes are being followed. All personnel employed by BAE Systems Australia acknowledge their obligations under the company's Code of Conduct annually, of which, correctly coding time and expenses to projects is an employee obligation.
- 2.4. BAE Systems Australia provides full transparency to the Commonwealth of Australia on a monthly basis of all costs incurred and invoiced, and have an open and engaged process of review and validation through formal bi-annual allowable cost reviews with the Commonwealth. Through this joint process any clarifications are sought and adjustments are made if any items are agreed as not being aligned with the contract framework.
- 2.5. The costs reported on in the ANAO Report were charged in error and were quickly identified through the agreed financial auditing process. This is an example of self-regulation being thoroughly applied and reported in a transparent manner rather than an attempt to mislead. In this case, the process and systems worked in identifying the costs that did not meet this criteria or were incorrectly or mistakenly charged in error and were immediately rectified.

Concluding remarks

The Hunter Class Frigate Program is making strong and tangible progress. On 1 May 2023, BAE Systems Australia began construction of the first Hunter-designed ship block that is expected to be used in the first Hunter class frigate. Again on schedule, BAE Systems will provide the Commonwealth, in particular the Capability Acquisition and Sustainment Group (CASG), the cleared proposal for the Batch 1 (first three ships) for consideration. BAE Systems Australia remains committed to building nine anti-submarine warfare Frigates for the Royal Australian Navy as approved by the 2017 Defence Strategy and contracted through the Hunter Head Contract, signed in Dec 2018.

We have established a significant workforce in support of the Hunter program that is achieving a very high quality of product in modern shipbuilding that is being used as a benchmark for other BAE Systems ship build operations around the globe. We continue to build an extensive supply chain here in Australia and with each contract, assessing Australian industry content. The design has been stable since the System Definition Review and is making good progress in recovering weight and margin issues, predominately related to the incorporation of Australian-led design change

BAE Systems Australia will continue to contribute to a program that is the cornerstone to delivering continuous naval shipbuilding in Australia and developing a competitive and cost-effective naval shipbuilding and sustainment industry over the coming decades.

Yours Sincerely,



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