



29 August 2014

Dr Andrew Southcott MP
Chairman
Joint Committee of Public Accounts and Audit
Suite R1.108
Parliament House
CANBERRA ACT 2600

Dear Dr Southcott

JCPAA Report 442 – Recommendations and Proposed 2014–15 Major Projects Report Guidelines

I am writing to provide you with our response to the recommendations from JCPAA Report 442 and to provide advice in relation to the Major Projects Report (MPR) Guidelines.

The Committee's recent report considering the 2012–13 Defence Materiel Organisation (DMO) MPR made 10 recommendations, six of which concern the Australian National Audit Office (ANAO).

My staff have consulted with the DMO prior to formulating our response, which is outlined below:

Recommendation 1 (paragraph 3.72)

“The Committee recommends that starting from the 2013–14 Major Projects Report, the DMO and the ANAO publish expanded information on each Major Project's budget estimates and actual expenditure during the financial year. Additional details for each Major Project could include:

- Comparison of variation citing specific dollar amounts;
- Percentage of variance; and
- Overall totals and averages, where calculable.

Additionally, ANAO should analyse DMO's reasons and explanations for projects' in-year budget variance.”

I agree to this Recommendation and the DMO has advised that it has no objections to this approach. For the 2013–14 MPR, the DMO has agreed to compile this information and include it within their section of the report.

Recommendation 2 (paragraph 3.73)

“The Committee recommends that the ANAO and DMO consult as necessary and amend Section 2.2 of the Project Data Summary Sheets (PDSSs), in time for submission of the draft 2014–15 MPR Guidelines to the JCPAA, to ensure that the following are reported:

- (a) each Major Project’s 1 July budget estimates, as published in the Portfolio Budget Statements;
- (b) mid-year estimates, as published in the Portfolio Additional Estimates Statements;
- (c) if necessary, any more subsequent estimates since the mid-year estimates; and
- (d) 30 June actual expenditure; along with
- (d) explanations of variance between each of the above.”

I agree to this Recommendation and the DMO has advised that it has no objections to this approach.

The draft 2014–15 MPR Guidelines have been updated accordingly.

Recommendation 5 (paragraph 3.82)

“That starting from the 2013–14 Major Projects Report, ANAO publish a similar version of Figure 8 (on page 64 of the 2012–13 MPR), relating to Major Project total slippage post Second Pass Approval and acquisition type by approval date.”

I agree to this Recommendation and the DMO has advised that it has no objections to this approach.

We will continue to update this graph as per the Committee’s request.

Recommendation 6 (paragraph 3.113)

“That the ANAO and DMO consult as necessary to ensure that statements or graphs relating to capability in the PDSSs, particularly Section 1.2 and 5.1, be appropriately qualified in the 2013–14 Major Projects Report, by noting that:

- The graphs in Section 5.1 do not necessarily represent capability achieved; and
- The capability assessments and forecasts in the PDSSs are not subject to ANAO’s assurance audit.”

I agree to this Recommendation and the DMO has advised that it has no objections to this approach.

We will update the PDSS template in this year’s MPR with a footnote reflecting the criteria included in the recommendation.

Recommendation 7 (paragraph 3.114)

“To improve the robustness of capability performance information, that the ANAO and DMO consult as necessary and propose amendments to Section 5.1 and 1.2 in the 2014–15 MPR Guidelines, to:

- Apply a more objective method to assessing capability performance; and
- Distinguish capability achieved from capability yet to be achieved, capability unlikely to be achieved, and capability exceeded.

ANAO and DMO should provide a specific proposal to the Committee preferably by the end of August 2014 in line with submission of the 2014–15 MPR Guidelines.”

As highlighted in the March 2014 hearing, there is no system that universally tracks the inputs to capability by the DMO and hence no easily auditable representation of information. However, the DMO has suggested including the key deliverables which constitute Initial Materiel Release and Final Materiel Release as stipulated in the Materiel Acquisition Agreements for each project, which we consider is appropriate at this time, noting that there can be sensitivities in regard to disclosing information about elements of capability.

The draft 2014–15 MPR Guidelines have been updated accordingly, with a new table (Section 4.2).

Recommendation 10 (paragraph 4.27)

“The ANAO and DMO consult as necessary to propose amendments to the 2014–15 MPR Guidelines to make provision for information on exited Major Projects.”

The DMO has agreed to include this information in their section of the 2013–14 MPR, because essentially the Guidelines refer to projects to be reported in the PDSSs.

Proposed 2014–15 Major Projects Report Guidelines

The updates primarily reflect project selection (refer Attachment A), the new reporting period, minor readability improvements, clarification of requirements resulting from our experience during site visits, and recommendations arising from the JCPAA Report 442 *Review of the 2012–13 Defence Materiel Organisation Major Projects Report* as outlined above. The more important suggested changes include:

2014–15 Project Selection

- Updates to project naming convention: to project number; agreed project name; and, agreed project abbreviation; to align to the Defence Capability Plan (JCPAA Recommendation 3).

Changes to the PDSS

- *Section 1.4 Linked Projects*
Suggest removal as this is not achieving the intended benefit and is substantially covered by Section 1.3 Project Context (Other Current Sub-Projects).
- *Section 2.2 In-year Budget/Expenditure Variance*
The Guidelines propose disclosing the initial (PBS), mid-year (PAES) and final budget estimates along with explanations of any variances between these and the 30 June actual expenditure (JCPAA Recommendation 2).
- *Section 4 – Project Cost and Schedule Status*
Suggest removal. This section arose from Recommendation 9 of the JCPAA Report 422 *Review of the 2009–10 Defence Materiel Organisation Major Projects Report* requesting “that the DMO in conjunction with the ANAO develop a standardised graphical representation of each project’s cost and schedule variance” to compensate for the lack of available Earned Value Management Systems data. However, the information in this section is already covered in Section 2.1 and Section 3.3 and as such, does not assist in providing additional information.
- *Section 4.2 (new) – Materiel Capability Delivery Performance*
The Guidelines propose disclosing the key deliverables which constitute Initial Materiel Release and Final Materiel Release as stipulated in the Materiel Acquisition Agreements for each project to support the interpretation of graphical representation (JCPAA Recommendation 7).

Attachment B contains a copy of the draft 2014–15 MPR Guidelines which are highlighted in grey to indicate the changes explained above.

We thank the Committee for its interest in, and consideration of the Major Projects Report.

We would be pleased to discuss any matters arising from this response to Report 442 with the Committee.

Yours sincerely



Ian McPhee
Auditor-General

Attachments

- A. Proposed project changes for the 2014–15 Major Project Report
- B. Draft 2014–15 Major Projects Report Guidelines

Proposed project changes for the 2014–15 Major Projects Report

The draft 2014–15 Major Projects Report (MPR) Guidelines propose the removal of four projects and the addition of two projects, resulting in a total of 28 projects. In addition, the Chief Executive Officer (CEO) DMO has proposed the early exit of an additional three projects. This document sets out the reasons for these proposals.

Removal

In accordance with the draft Guidelines, AIR 5418 Phase 1 Follow On Stand Off Weapon achieved Final Operational Capability (FOC) in January 2014 and is recommended for removal.

In addition, following a satisfactory post-Final Materiel Release (FMR) risk assessment of the timely achievement of FOC in accordance with paragraph 1.9 of the draft Guidelines, the projects below are recommended for removal:

- AIR 5376 Phase 2 F/A-18 Hornet Upgrade which achieved FMR in September 2012 (as approved by the Chief of Air Force);
- JP 2008 Phase 4 Next Generation SATCOM Capability which achieved FMR in June 2014 (as approved by the Chief Information Officer); and
- LAND 17 Phase 1A Artillery Replacement which achieved FMR in September 2013 (as approved by the Chief of Army).

The removal of the above projects has been reflected in the draft Guidelines.

Further, the CEO DMO has advised that he wishes to seek the early exit of an additional three projects, namely SEA 1390 Phase 2.1 Guided Missile Frigate Upgrade Implementation, SEA 1390 Phase 4B SM-1 Missile Replacement and JP 2043 Phase 3A High Frequency Modernisation, due to their low remaining budgets, low levels of materiel delivery remaining and low risk to timely achievement of FOC, as agreed by the Chief of Navy. As these projects have not met FMR, they do not strictly meet the criteria in the draft Guidelines for exiting the MPR. However the draft Guidelines also allow for exit of projects subject to the Committee's discretion.

Inclusion

Based on an assessment of projects against the JCPAA endorsed project selection criteria in the draft Guidelines, two new projects are recommended for inclusion. A brief rationale for the inclusion of these projects is summarised below.

AIR 7000 Phase 2 Maritime Patrol and Response Aircraft System

This project seeks to acquire a fleet of eight Poseidon P-8A Increment 2 aircraft for the Royal Australian Air Force (RAAF) to replace the current fleet of AP-3C aircraft through a Cooperative Program with the US Navy.¹ In addition, this project will acquire support for the aircraft and facilities at RAAF bases Edinburgh, Townsville, Pearce and Darwin. The Cooperative Agreement also allows Australia to participate in the development of the Increment 3 upgrade for the aircraft. The project achieved Second Pass Approval in February 2014² and has a total budget of approximately \$3.5 billion.³

¹ Source: < <http://www.defence.gov.au/dmo/EquippingDefence/AIR700PH2-MaritimePatrolAndResponse> > [accessed 27 August 2014].

² Prime Minister of Australia, The Hon. Tony Abbott MP, *P-8A Poseidon Aircraft To Boost Australia's Maritime Surveillance Capabilities*, 21 February 2014.

³ This figure is based on advice received from the DMO 8 July 2014.

SEA 1442 Phase 4 Maritime Communications Modernisation

This project seeks to acquire and support modernised communication systems for the Royal Australian Navy's eight ANZAC Class frigates. The design of the modernised system is similar to that used by the US, Canadian and the Royal Navies. As a result, it will deliver a significant improvement to the communications capability through an integrated system, including new radio and switching systems, secure voice and tactical communications system, and a communications management system.⁴ The project achieved Second Pass Approval in July 2013 and has a total budget of approximately \$426 million.⁵

The inclusion of the above projects has been reflected in the draft Guidelines.

Recommendation

As explained above, we recommend:

- a) The Committee agree to the removal of the following projects:
 - AIR 5418 Phase 1 Follow On Stand Off Weapon,
 - AIR 5376 Phase 2 F/A-18 Hornet Upgrade,
 - JP 2008 Phase 4 Next Generation SATCOM Capability, and
 - LAND 17 Phase 1A Artillery Replacement.
- b) The Committee agree to the addition of the following projects:
 - AIR 7000 Phase 2 Maritime Patrol and Response Aircraft System, and
 - SEA 1442 Phase 4 Maritime Communications Modernisation.
- c) The Committee decide whether to use its discretion to remove the further projects nominated by the CEO DMO:
 - SEA 1390 Phase 2.1 Guided Missile Frigate Upgrade Implementation,
 - SEA 1390 Phase 4B SM-1 Missile Replacement, and
 - JP 2043 Phase 3A High Frequency Modernisation.

⁴ Minister for Defence, Senator the Hon. David Johnston, *ANZAC Class frigate communications upgrade*, 2 December 2013.

⁵ This figure is based on advice received from the DMO 8 July 2014.