

Joint Committee of Public Accounts and Audit
Parliament House
Canberra ACT 2600

30 December 2016

Re: Inquiry into the 2015-16 Defence Major Projects Report

Dear Committee

Although this report is not now intended to be tabled until January 2017, I felt I had enough on hand to be able to do a prequel to this inquiry.

On researching for source material for another Senate Committee's inquiry, I happened upon a response to a Senator's QoN in the Supplementary Estimates 2010-11, October 2010. [W26](#) page 43 of 46.

Both the question and the answer added four topics of interest to my work and this inquiry in particular,

- a. FMS – Foreign Military Sales
 - (i) Exemption from ANAO inspection.
 - (ii) Exemption from FOI
- b. FOREX – Foreign Exchange
- c. 'No-Win No-Loss'

The above would be mute but for my belief that the ['Letter of Transmittal'](#) that has been signed by the Secretary and the CDF and presented to the Minister and the Parliament since 2002 is tokenism at its best and deception at its worst.

a. Foreign Military Sales / Defence Major Projects are a major proportion

From the Foreword to the 2014-15 Major Projects Report (refer to Closing Thoughts reference to Appendix A Defence Annual Report 2015-16)

Following the delisting of the Defence Materiel Organisation (DMO) from 1 July 2015, and consistent with the recommendations of the Government's *First Principles Review: Creating One Defence*, the functions of the DMO were merged back into Defence under the new Capability Acquisition and Sustainment Group. The ongoing reporting of the status of Major Projects under the new Capability Acquisition and Sustainment Group is the subject of this, the eighth Major Projects Report.

The former DMO oversaw the introduction of a Military-Off-The-Shelf focused acquisition strategy for Major Projects, following the *Defence Procurement Review 2003* (Kinnaird Review). This has resulted in an improvement in schedule performance over time, with current analysis showing that 73 per cent of the total schedule slippage across the Major Projects relates to projects approved prior to DMO's demerger from Defence in 2005. It is important that Defence continue to pursue these improvements in project delivery.

For the first time, the 2014–15 Major Projects Report's scope includes the project financial assurance statement, which provides readers with an articulation of each project's financial position in relation to delivering project capability. The independent conclusion now provides assurance over these statements within each Project Data Summary Sheet.

b. FOREX – Foreign Exchange

[Australian Government Foreign Exchange Risk Management](#)

Chapter 4 – Budget Adjustments

This document was published in September 2006 and had as its basis the Financial Management and Accountability Act 1997.

Has there been any requirement to amend the Australian Government Foreign Exchange Risk Management Policy to conform/comply with the new Public Governance, Performance and Accountability Act 2013?

c. 'No-Win No-Loss'

1.18 In addition, in 2013–14, a number of project offices added additional disclosures to their PDSSs, and in particular, AWD Ships, LHD Ships and ANZAC ASMD Phase 2B, recognised that available funding for price indexation was a key concern. Prior to 1 July 2010, projects were periodically supplemented for price indexation, whereas the allocation for price indexation is now provided for on an out-turned basis at Second Pass Approval.⁴⁹ This change in supplementation policy has meant that price Indexation has emerged as a risk for some projects, which is required to be managed individually, by each project office.

1.19 In effect, projects which slip past original delivery dates must now access contingency funding where pre-calculated indexation is insufficient. Previously, the separation of yearly indexation funding from other budget components allowed for greater transparency in reporting and fewer risks for project offices to manage.⁵⁰

2.22 Exchange rate variations in project budgets are a result of projects' exposure to foreign currencies and movement in foreign exchange rates against the Australian dollar.⁸⁸ The exposure of specific projects to currency exchange variations is established through the initial government procurement decision and contractual agreement. The US dollar and the Euro are the main influences, although other currencies also have an impact. This year the Australian dollar generally weakened against the US dollar, while against the Euro, similar to last year, it varied significantly across the year but had stabilised to a similar level to where it began by the end of the financial year.

2.23 The large in-year exchange variation of \$2.8 billion is due to adjustments in December 2014, February 2015 and May 2015 totalling \$0.2 billion, \$2.1 billion and \$0.5 billion respectively.

Given the current FOREX investigations going on in the private sector, when was the last Quality Review and Quality Assurance done in the Foreign Exchange area of Defence.

I can ask this question now, for when a similar question was asked of the then Inspector General Defence in the Supplementary Budget Estimates of 20 November 2013, Q47 on PDF Page 60 of 251, it appears that "The Inspector General of Defence is satisfied with the AFP oversight through the QAR process."

I should not be thinking of 'we're good' memes when I read this statement.

Closing thoughts.

Given the fact that in the last say twenty (20) years the Department of Defence has been appropriated in excess of \$340bn (billion) and that in the same period only reported something like \$25m (million), yes \$million in detected fraud, then yes I feel a little sceptical about the efficiency of the then Inspector General Defence's office (now the Assistant Secretary Fraud Control).

The public portal to FCIB is <http://www.defence.gov.au/afc/> with the Fraud Control and Investigations Branch at <http://www.defence.gov.au/afc/FraudControllInvestigations.asp>

Why is it that in the last twenty years that I have had an interest in the reporting of, and handling of notifiable interests in the Department of Defence, I have never seen accountability for any fraud in Major Projects to the Parliament?

Maybe because if you refer to the Defence Annual Report for 2015-16 [Appendix A: Consultancies and contracts](#)

During 2015-16 Defence had 48 contracts that were exempt from the requirement to provide access to the Auditor-General (Table A.3)
Total ANAO exempt for the Capability Acquisition and Sustainment Group:
\$3,334,447,408

Defence uses the United States Department of Defense's Foreign Military Sales program, which facilitates sales of US arms, defence equipment, defence services and military training to foreign governments. The standard terms and conditions of Foreign Military Sales contracts do not contain ANAO access provisions.

Result: More than 10% of the 2015-16 Defence Budget is exempt from access to Audit.

Yet the ANAO publishes its Major Projects Audit with apparent gaps in its credibility.

As an example to this, I refer the Committee to the current issue of the [US Army's journal 'Military Review'](#) where the article 'Against Bureaucracy' by Richard Adams, PhD is printed on pages 8-14.

This article uses the Seasprite as an example when considered in a [post-event ANAO report](#).

“ The Seasprite report reveals a bureaucracy riddled with habits of avoidance. Despite evident waste and obvious failure – since no Seasprite capability exist, or ever existed – the Australian National Audit Office report manages to avoid moral language and ideas. The word “wrong” for example, occurs three times in the report. On pages 260 and 319, the word “wrong” appears in the phrase, “wrong side of the aircraft”. On page 334, we read of a “wrong impression”. Despite the nonevent that was the Seasprite helicopter, no person is seen to have been wrong. No person is seen to have made a mistake.”

Further to the above, in the recent [Supplementary Estimates 2016-17 of October 2016](#), a Senator asked about access to a list of Defence's Contracts and Consultancies, (Q65-68) and was 'politely' referred to the AusTender site managed by the Department of Finance.

Now on reading the same [Appendix A](#), I was also to find 'Exempt contracts' from FOI.

'In 2015–16, Defence reported a total of 265 contracts, standing offers or variations, with a total value of \$565,688,434.63, which were subject to an exemption under the *Freedom of Information Act 1982*. These exemptions were generally applied under the national security provisions of the Act.'

Has Defence obfuscated a Senator and more importantly multiple Senators in the Estimates process, given Senate Standing Order 25(20)?

Another Senator in the same Estimates Q114 asked whether there had been any official site inspections for any of Defence's contractors or subcontractors, to which Defence had replied,

'2(c) None of the internal audits completed by Audit and Fraud Control Division since July 2015 have included an official site inspection.'

This reply to the Senator coincided with my FOI 156/16/17 to Defence on the matter, and in part:

1. AUDIT REPORTS AND MANAGEMENT DIRECTED TASKS: FY 2015-16	
Audit Reports	17
Controls Testing - Round 1 - 2015-16	
Controls Testing - Round 3 - 2014-15	
Defence International Engagement Activities	
Disposal Management in Defence	
Establishment of the Fuel Services Branch	
Fleet Marine Services Contract	
Infrastructure Projects	
Joint Health Command: Administrative Operation of Garrison Health Services	
Management of Intellectual Property across Defence	
Management of Military Support Items	
Management of Post Separation Employment and Conflict of Interest Declarations	
Pacific Patrol Maritime Security Program	
Performance of contract management across Defence	
Performance of SeMPRO	
PGPA Act Framework Implementation and Compliance	
Progress on the Implementation of the Wraith Review	
Review of the Defence Logistics Transformation Program - ICT Aspects	
Management Directed Tasks	13
Assistance to IG - Regimental Trust Fund and Public Money	
Audit of the Directorate of Defence Counsel Services	
Contract and Project Management of Sentinel	
End User Computing Gate 3 Readiness Review	
Financial Audit of Training Ship (TS) Canberra - Australian Navy Cadets	
Project SENTINEL Phase 2	
Review of Mandatory SES Training	
Review of Procurement Compliance at RAAF Security and Fire School	
Review of Procurement Management Processes	
Review of the Garrison and Estate Management System Project	
Technical Risk Assessment (TRA) on the Next Generation Desktop (NGD) Project	
Contracted Services Arrangements in Capability Acquisition and Sustainment Group System Program Offices	
Potential Conflict of Interest	

The Committee may find some of the above of interest in this inquiry.

It may also want to reflect on Defence's recent ['Re-thinking Systems of Inquiry, Investigation, Review and Audit'](#)

I would refer you here to the Phase 2: Audit (See Attached) [RSR audit – First report Page 19](#)

In the Supplementary Budget Estimates of 21 October 2015 Q51 regarding this document, Defence was asked:

'Can Defence give a succinct Departmental understanding of the categories highlighting the 'Common Themes Emerging from Audit Reviews of Major Capital Acquisition Projects.'?
If not, why not?'

And their reply to the Senator was:

(2) (a) to (j) Defence is unable to provide all the requested information as disclosure of Defence internal audit activity would significantly reduce the effectiveness of the audits and consequently, could reasonably be expected to have a substantial and adverse impact on the proper and efficient conduct of the operations of Defence.

This was a Governance 101 question, and definitely not related to Investigative processes. Just another example of obfuscation to the Estimates process.

(Please refer to '[Requirements for Annual Reports document](#)' Budget Estimates 2014 PM&C Q170)

Please see the full question attached to see how warped the accountability of Defence Major Projects has become, when read in conjunction with the article 'Against Bureaucracy' referenced earlier.

I hope to do a subsequent submission to this Inquiry into the 2015-16 Defence Major Projects Report once it has been tabled.

Yours respectfully

Michael Wunderlich

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

Attached:

Supplementary Budget Estimates – 21 October 2015

Gaps/delays in briefing senior decision-makers and Ministers	✓	✓	✓	✓	✓	✓	✓	✓
Leadership failure at a senior level	✓	-	✓	-	✓	✓	✓	✓
Failure to appreciate complex interdependencies	✓	✓	✓	✓	✓	-	✓	✓
Underestimated project complexity and cost	✓	✓	✓	-	✓	✓	✓	✓
Changes to project scope and objectives	✓	✓	✓	✓	✓	-	✓	✓
Project management deficiencies	✓	✓	✓	-	✓	-	✓	✓
Insufficient skilled personnel	✓	-	✓	-	✓	-	-	✓
Project record-keeping deficiencies	✓	✓	✓	-	-	-	✓	✓
Controls not effective	✓	-	✓	✓	✓	-	-	✓
Failure in project accounting	✓	✓	✓	-	-	-	✓	✓

Figure 3 – Common Themes Emerging From Audit Reviews of Major Capital Acquisition Projects

Topic: Fraud – ‘Re-thinking Systems of Inquiry, Investigation, Review and Audit’ Report

Question reference number: 51

Senator: Xenophon

Question:

In 2015, Defence has released the 'Re-Thinking Systems of Inquiry, Investigation, Review and Audit'.

(1) Can Defence provide the “Heading of Figure 3, Page 19 of Report on Stage B (possible models for an optimal system of audit) 10 May 2013 > RSR audit - First report.”

(2) Can Defence give a succinct Departmental understanding of the categories highlighting the 'Common Themes Emerging From Audit Reviews of Major Capital Acquisition Projects.'? If not, why not?

- (a) Gaps / delays in briefing senior decision-makers and Ministers
- (b) Leadership failure at a senior level
- (c) Failure to appreciate complex interdependencies
- (d) Underestimated project complexity and cost
- (e) Changes to project scope and objectives
- (f) Project management deficiencies
- (g) Insufficient skilled personnel
- (h) Project record-keeping deficiencies
- (i) Controls not effective
- (j) Failure in project accounting

(3) Can Defence provide the final overall budget for each of the projects mentioned (redacted) in this Figure? If not, why not?

Answer:

(1) Defence is able to provide a redacted version at Attachment A.

(2) (a) to (j) Defence is unable to provide all the requested information as disclosure of Defence internal audit activity would significantly reduce the effectiveness of the audits and consequently, could reasonably be expected to have a substantial and adverse impact on the proper and efficient conduct of the operations of Defence. The audit reports of the three Australian National Audit Office (ANAO) audits can be accessed on the ANAO website.

(3) Defence is able to provide the final overall budgets for the three ANAO audits outlined in Attachment A.

M-113 Armoured Personnel Carrier Upgrade (LAND 106):
\$791 million, final spend at project closure as at January 2015.

Lightweight Torpedo (JP 2070 Ph 2&3): \$645 million, as at October 2015.

Seasprite Helicopter (SEA 1411 Ph 1): \$990 million, as at October 2015.