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Australian Government
Department of Defence

HUNTER CLASS FRIGATE PROCUREMENT

INTERNAL REVIEW FINDINGS AND NEXT STEPS

Findings by Auditor-General

Auditor-General Report No. 21 2022-23 – Department of Defence’s Procurement of Hunter Class Frigates – concluded, *inter alia*, that the Department of Defence (Defence) did not conduct an effective limited tender process for the ship design and that Defence’s advice to government at second pass was not complete. These conclusions were underpinned by a number of findings outlined in the report.

Defence accepted the report into the procurement. Defence also agreed to the two recommendations by the Auditor-General as well as the three areas for improvement.

The first recommendation concerned proper record keeping – Defence acknowledges and understands that it must maintain appropriate records and employs a sophisticated and regulatory compliant record management system. Defence will endeavour to improve its compliance with all current policy.

The second recommendation concerned ensuring procurement advice to government documents the basis for proposed selection decisions and includes information on whole-of-life cost estimates and value for money assessments. Defence agrees that this is sound practice.

Review undertaken by Defence

Following from the Auditor-General’s report, Defence undertook a review to examine Defence’s conduct of the Hunter class frigate procurement up to and including the second pass advice provided to government. Enclosed to this submission is a copy of the Terms of Reference for the review. The report was delivered in late September 2023.

The review was undertaken to provide Defence with a clearer understanding of the manner in which the procurement process for the Hunter class frigates was managed, decisions regarding the procurement proposal were made, and advice to government was formulated.

The review focussed on the findings made by the Auditor-General in connection with the Hunter Class Frigates procurement process including in relation to achieving value for money as it applies to the procurement of this Defence capability, and to formulate recommendations strengthening the development of capability procurement proposals.

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The review team had authority to examine all Defence records related to the procurement of the Hunter class frigates, and to interview relevant former and current Defence officials who were involved in the process as the procurement progressed.

Observations

I have now considered the review report and better understand the perspectives of former Defence officials involved in the process across the four-year process from 2014 to second pass in 2018.

A number of those officials reported that successive government ministers were closely involved as the process developed and iterative advice was provided to government. This is as I would expect given the scale and importance of the proposed program. Additionally officials were conscious that a key program objective from the outset was to ensure that the program could materially contribute to the implementation of the then-government's policy to achieve continuous naval shipbuilding in Australia.

These senior Defence officials considered across this period that there was sufficient advice provided to government to allow it to make a value for money assessment.

The need for a frigate that delivers a high-end anti-submarine warfare capability modified to meet Australian requirements remains a key objective for the program. The Hunter class frigate has been designed to meet this key requirement.

Findings of the review

The relevant findings of the review are summarised below:

Procurement planning and the tender process

Time

1. The tender process planned and implemented by Defence was sound and capable of supporting the recommendation of a tenderer that best met the program objectives on a value for money basis.
2. The tender process was conducted within an accelerated timeframe. If it had been afforded more time, the process would have been able to generate for all tendered options suitably acceptable whole-of-life cost models, a more detailed assessment of schedule and a clearer understanding of the design issues that impacted each option.

Incompatibility of program objectives and procurement method

1. Following initial pass in June 2014, the review found that there was a growing incompatibility between project objectives including continuous naval shipbuilding and the intended procurement method as described throughout the tender process.
2. After initial pass and up until first pass, there was no consistent expression of the goals and purpose of the procurement. Planning for the procurement fell into a process of

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disjointed advice to government that did not include deliberate steps to maintain clear coherent goals and a procurement method commensurate with the scale, scope and risk of the procurement.

3. Defence did not appear to recognise how the incompatibility between the project objectives including considerations relating to price and continuous naval shipbuilding and the procurement method as described in the tender documents would impact on Defence's ability to achieve value for money.

Shortlisting and down-select processes

1. Across the planning, shortlisting and down-select stages of the procurement, deficiencies in the process complicated the ability of Defence to achieve value for money during the course of the procurement and compliance with legislated requirements and Defence procurement policy.
2. Defence did not adequately recognise that the shortlisting of alternatives and the decision to shortlist was part of the procurement process and therefore subject to the legislated requirements and Defence procurement policy.
3. The shortlisting process was designed to be logical and demonstrate rigour. During the shortlisting process and to take into account the evolving project objectives including continuous naval shipbuilding and an accelerated schedule. Defence departed from the agreed process and this departure led to shortfalls in terms of the extent of reasonable enquiries made to facilitate accountable and transparent decision making; the level of diligence, fairness and consistency applied during shortlisting considerations; and the overall effectiveness of this stage of the procurement.
4. The absence of formal documentation means that there is no evidence to demonstrate that the shortlisting activities and decision were commensurate with the scale, scope and risk of the decision.
5. Defence did not use all information available out of the tender process to undertake a comparative assessment in a manner consistent with Defence procurement policy. In failing to do this, Defence did not fulfil the requirements of the Commonwealth Procurement Rules in relation to achieving value for money.
6. The focus on achieving capability requirements displaced sufficient attention to the risks as well as the consideration of the tenders against other criteria which information was assessed and documented as part of the process.

Advice to government

1. Advice to the then-government at second pass in connection with the conduct of a value for money assessment was poorly executed by Defence.
2. The process was appropriately planned and conducted but for completing a comparative evaluation and ranking of the tenderers in a manner consistent with Defence procurement policy. The tender process was structured around achieving project objectives advised to tenderers but the advice to government was not complete

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with respect to the material outcomes of the process, affordability or compliance and risk assessments with respect to project objectives.

3. The process shortfalls identified as well as the inadequate record keeping, resulted in recommendations to government that could not be adequately traced to:
 - a. the evaluation of tenders conducted by the formally designated tender evaluation organisation in accordance with promulgated tender documentation; and
 - b. a comparative assessment and ranking of tenders to determine which one best supported the achievement of the project objectives (as advised to tenderers) on a value for money basis.
4. These shortfalls mean that advice to government did not include other information that could have been considered in the circumstances where government makes the assessment of value for money.

Other Findings

Record keeping

1. Mandatory record keeping obligations commensurate with the scale, scope and risk of the procurement were not complied with. This was inconsistent with the mandatory requirements of rule 7.2 of the Commonwealth Procurement Rules. The absence of documentation means that there is insufficient evidence to demonstrate how decisions were taken.

Transition to One Defence

1. As a result of the First Principles Review of Defence in 2016 and through the transition to the One Defence there was a substantial change in leadership and management of capability proposals and related procurements.
2. Under the One Defence structure, Capability Managers assumed a prominent role in leading the development of capability proposals and associated advice to government. The former delineation that existed between roles and functions led by separate senior departmental officials, ceased to exist.
3. There appeared to be no process during the transition to One Defence to assure the transition of procurement policy, processes and procedures and relevant delegations before the transition was effectively transferred to suitably qualified and resourced senior officers with defined responsibilities for procurement. The absence of a process undermined Defence's ability to ensure compliance with the legislated requirements and Defence procurement policy in this procurement.

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Overarching observations of Defence

Now having considered the review report, these matters in combination could have ultimately led ANAO to form their view in connection to Defence not fulfilling the requirements of the Commonwealth Procurement Rules in relation to achieving value for money.

I have noted that former Defence officials interviewed considered that there was sufficient advice provided to government to allow it to make a value for money assessment.

Lessons learned and implementation

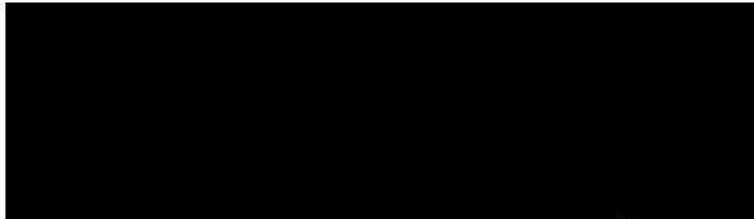
1. Defence intends to implement a number of changes to existing governance and assurance policies, processes and structures to strengthen the manner in which Defence develops value for money capability proposals.
2. These changes are intended to strengthen not just procurement processes but the wider capability life cycle.
3. These changes include:
 - a. **Planning** - Changes to the earliest stages of procurement planning to ensure that strategy, force structure and the needs are aligned to be able to develop and deliver executable programs that deliver meaningful capability.
 - b. **Responsibilities, accountabilities and authorities** - Re-communication of responsibilities, accountabilities and authorities relevant to the development of capability proposals.
 - c. **Contestability** - Enhancement of the internal contestability functions throughout all stages of the development of capability proposals.
 - d. **Record keeping** - Enhancement of record keeping and retention compliance across the Defence enterprise and consistency of approach to retention of formal records of process, evaluation, decisions and recommendations in compliance with legislative obligations and Defence policy.
 - e. **Defence committee structures** - Consideration of changes to senior Defence committee governance and assurance functions and oversight over each phase of the capability life cycle including proposals brought to committees.
 - f. **Governance** - Implementation of governance regimes to assure:
 - i. Consistency of proposals with strategic guidance particularly during early stages of the capability life cycle;
 - ii. Compliance with processes established to ensure conformance with legislated and other obligations;
 - iii. Due diligence with respect to any matter in the proposal of concern to committee members; and

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- iv. Executability within the resources approved and allocated for that purpose.
4. Defence has commenced the implementation of a program to embed these recommendations into Defence policy and governance structures.
5. Defence is committed to continuing transparency and accountability in connection with these reforms.



Greg Moriarty

Secretary

10 November 2023

Enclosure:

1. Hunter Class Frigate Procurement Review – Terms of Reference

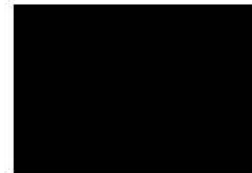
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Enclosure 1: Hunter Class Frigate Procurement Review – Terms of Reference

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HUNTER CLASS FRIGATE PROCUREMENT REVIEW

TERMS OF REFERENCE

Background

Auditor General Report No. 21 2022-23 – Department of Defence’s Procurement of Hunter Class Frigates –concluded, *inter alia*, that the Department of Defence (Defence) did not conduct an effective limited tender process for the ship design and that Defence’s advice to Government at second pass was not complete. These conclusions were underpinned by a number of findings outlined in the report.

Defence is undertaking a review to examine Defence’s conduct of the Hunter class frigate procurement up to and including the second pass advice provided to Government.

Purpose of Review

The review is being undertaken to provide Defence with a clearer understanding of the manner in which the procurement process for the Hunter class frigates was managed, decisions regarding the procurement proposal were made, and advice to Government was formulated.

The review shall focus on the findings made by the Auditor-General in connection with the Hunter Class Frigates procurement process including in relation to achieving value-for-money as it applies to the procurement of this Defence capability, and formulate recommendations to strengthen the development of capability procurement proposals.

Tasks

The review team is to:

- Identify decisions that shaped the Hunter class frigate procurement path and influenced timeframes.
- Review the processes Defence documented and/or put in place to progress the procurement, and assess the conformance of those processes with mandatory requirements and rules for procurements of the scale of the Hunter class frigate capability.
- Review the conduct of the procurement against documented processes and mandatory requirements and rules for the procurement.
- Examine second pass advice to Government against material outcomes of the procurement process, identifying shortcomings.
- Consider other factors that may have contributed to any identified procurement shortfalls.
- Propose recommendations to strengthen the manner in which Defence develops value-for-money capability procurement proposals.

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Conduct

The review team has authority to examine all Defence records related to the procurement of the Hunter Class Frigates, and to interview former and current Defence officials who were involved in the process as the procurement proposal was developed for Government consideration.

The review team will also maintain an open dialogue with the Associate Secretary to ensure that the team has adequate support and access to personnel and records.

The review team is to prepare a report of its findings and recommendations for Secretary of Defence by mid July 2023.



Greg Moriarty

Secretary

26 May 2023

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