



Australian Government

Department of Defence

EXECUTIVE MINUTE

on

JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

REPORT No. 442

**REVIEW OF THE 2012-13 DEFENCE MATERIEL ORGANISATION MAJOR
PROJECTS REPORT**

Response to the recommendations

Recommendation No. 1 paragraph 3.72

The Committee recommends that starting from the 2013-14 Major Projects Report, the Defence Materiel Organisation and the Australian National Audit Office 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 the DMO's reason and explanations for projects' in-year budget variance.

Response: Agree

The table below, which satisfies the requirements of Recommendation 1, will be published in Part 2 Chapter 2 of the MPR. Corresponding explanation of the variation is also provided in Part 2, Chapter 2 of the MPR.

| Project Name | Portfolio Budget Statements (\$m) | Portfolio Additional Estimate Statements (\$m) | Final Plan (\$m) A | Actual (\$m) B | Variation (\$m) B-A | Variation (%) |
|--------------------------|-----------------------------------|--|--------------------|----------------|---------------------|---------------|
| Joint Strike Fighter | 231.5 | 213.8 | 218.6 | 223.3 | 4.7 | 2.1% |
| AWD Ships | 625.1 | 622.9 | 662.7 | 659.3 | -3.4 | -0.5% |
| Wedgetail | 87.3 | 59.1 | 60.2 | 61.3 | 1.0 | 1.7% |
| MRH90 Helicopters | 204.2 | 244.4 | 250.9 | 250.5 | -0.3 | -0.1% |
| Overlander Vehicles (3B) | 44.9 | 45.4 | 33.3 | 33.4 | 0.1 | 0.4% |
| MH-60R Helicopters | 411.8 | 425.3 | 460.0 | 454.9 | -5.1 | -1.1% |
| LHD Ships | 202.9 | 227.3 | 247.3 | 247.5 | 0.2 | 0.1% |
| EA-18G Growler | 89.7 | 290.8 | 376.2 | 370.3 | -5.9 | -1.6% |
| ARH Tiger Helicopters | 4.4 | 6.5 | 6.6 | 6.6 | 0.0 | -0.7% |
| Homet Upgrade | 16.7 | 10.7 | 10.9 | 10.4 | -0.5 | -4.2% |
| Air to Air Refuel | 61.2 | 29.4 | 29.8 | 31.3 | 1.5 | 4.9% |
| FFG Upgrade | 6.5 | 18.0 | 18.4 | 13.5 | -4.9 | -26.5% |
| Battlefield Airlift | 162.3 | 164.0 | 146.1 | 146.6 | 0.5 | 0.3% |
| Bushmaster Vehicles | 62.2 | 59.5 | 59.4 | 59.4 | 0.0 | 0.0% |
| Overlander Vehicles (3A) | 234.6 | 204.2 | 220.2 | 222.4 | 2.2 | 1.0% |
| Next Gen Satellite | 37.7 | 38.6 | 39.5 | 22.6 | -16.9 | -42.7% |
| Anzac ASMD 2B | 72.7 | 62.5 | 71.6 | 70.8 | -0.8 | -1.1% |
| Additional Chinook | 12.8 | 144.4 | 147.9 | 145.6 | -2.3 | -1.5% |
| HF Modernisation | 21.7 | 11.1 | 6.0 | 6.6 | 0.6 | 10.3% |
| Battle Comm. Sys. (Land) | 151.9 | 114.5 | 119.0 | 122.1 | 3.1 | 2.6% |
| Collins RCS | 2.7 | 2.6 | 2.4 | 2.0 | -0.4 | -15.6% |
| UHF SATCOM | 18.1 | 8.4 | 8.5 | 8.1 | -0.3 | -4.1% |
| Hw Torpedo | 6.8 | 3.5 | 3.6 | 2.7 | -0.9 | -26.0% |
| Collins R&S | 13.9 | 11.8 | 10.8 | 9.1 | -1.7 | -15.9% |
| SM-2 Missile | 23.6 | 6.6 | 6.7 | 5.2 | -1.6 | -23.6% |
| Anzac ASMD 2A | 23.4 | 16.6 | 22.9 | 22.8 | -0.1 | -0.6% |
| 155mm Howitzer | 28.4 | 22.0 | 22.4 | 23.4 | 1.0 | 4.5% |
| Stand Off Weapon | 9.8 | 0.2 | 0.2 | 0.1 | 0.0 | -11.6% |
| Battle Comm. Sys. | 30.1 | 28.7 | 29.1 | 18.9 | -10.2 | -35.0% |
| Amphibious Watercraft | 36.7 | 39.2 | 46.7 | 44.5 | -2.2 | -4.6% |
| Total | 2935.6 | 3131.8 | 3337.9 | 3295.4 | -42.5 | -1.3% |

Recommendation No. 2 paragraph 3.73

The Committee recommends that the Australian National Audit Office and Defence Materiel Organisation consult as necessary and amend Section 2.2 of the 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*
- e) Explanations of variance between each of the above.*

Response: Agree

Following consultation with the ANAO, the table provided below is provided for JCPAA endorsement and for subsequent inclusion in Part 3, Section 2.2 of the MPR. It is expected that provision of this table will improve alignment with the PBS, PAES and Annual Report.

The two tables show budget variance between PBS, PAES (table 2.2A) with an explanation and then another table showing Final Plan and Actuals (table 2.2B) with variance explanation.

Further, to align seamlessly with the Defence Statutory Reports, it is recommended that the MPR publish for Section 2.2 a rounded figure to the closest million.

2.2A In-year Budget Estimate Variance

| Estimate PBS \$m | Estimate PAES \$m | Estimate Final Plan \$m | DMO's Explanation of Material Movements (PBS to Final Plan) |
|---------------------|----------------------|----------------------------|--|
| 90 | 291 | 376 | The variation from PBS is due to revised project scope from converting existing Super Hornet aircraft to acquisition of new-build Growler aircraft. The variation includes Forex (+27m) The variation from PAES is due to [insert reason] |
| Variance \$m | 201 | 85 | Total Variance (m): 286 |
| Variance % | | | Total Variance (%): 318 |

2.2B In-year Budget/Expenditure Variance

| Estimate Final Plan \$m | Actual \$m | Variance \$m | Variance Factor | Explanation (Final Plan to Actual Expenditure) |
|----------------------------|------------|--------------|---------------------------------------|---|
| | | | FMS | |
| | | | Overseas Industry | |
| | | (10) | Local Industry | |
| | | | Brought Forward | |
| | | | Cost Savings | |
| | | | FOREX Variation | |
| | | | Commonwealth Delays | |
| | | | Additional Government Approvals | |
| 376 | 370 | (6) | Total Variance | |
| | | 2 | % Variance | |

Recommendation No. 3 paragraph 3.74

The Committee recommends that Defence and Defence Materiel Organisation take the necessary actions to ensure there is improved line of sight between the Major Projects Report and the Portfolio Budget Statements and Portfolio Budget Estimates Statements. For example, by improving the consistency of project names and groupings between the documents.

Response: Agree

The ANAO and the DMO will add the project and phase number as a first column in all tables in the MPR as this is the unique identifier assigned to each project (and its phases) when added to the Defence Capability Plan (DCP). These details are also used in all reporting to Government by both Defence and the DMO. Using the project and phase numbers will also alleviate the confusion over multi-phased projects having the same name. Further, from the start of the next Portfolio Budget Statements cycle the DMO will transition to a naming convention that is consistent.

However, the sample of projects reported in the MPR will differ from the top 30 projects reported in the Portfolio Budget Statements, Portfolio Additional Estimates and Annual Report as these are based on annual forecast expenditure, whereas projects identified for reporting in the Major Projects Report are based on total budget.

Recommendation No. 4 paragraph 3.75

The Committee recommends that the Defence Materiel Organisation prepares a suitable and separate methodology for reporting sustainment activity and expenditure, and that this methodology be reported to the Committee within six months of the tabling of this report.

Response: Disagree

The Vice Chief of Defence Force advises in relation to this recommendation that Defence's position is that the current arrangements of Portfolio Budget Statements (PBS) and Defence Annual Report (DAR) reporting to Parliament, and Preparedness reporting to Government, balance effectively the obligation to allow Parliamentary scrutiny of the expenditure of Commonwealth funds on sustainment efforts, while protecting the classified information on capability readiness and availability which is associated with those sustainment efforts and which is separately provided to Government.

Assessments around the readiness and availability of major Defence capabilities are by necessity classified. In addition to the DMO reporting, the manager's of major Defence capabilities (Service Chiefs and certain Group Heads) also provide broad capability targets in the PBS and their achievement against these targets in the DAR. However the level of information in the PBS and DAR is constrained to that which is publicly releasable. This publicly releasable reporting to Parliament complements the classified assessment and reporting which is provided to Government.

Each quarter a Defence Preparedness Assessment (DPAS) is undertaken, the report from which is considered by the Chief of Defence Force and the Secretary at their Strategic Command Group. This assessment considers any constraints or risks associated with the concurrent demands of undertaking current operations and being prepared to meet future operations or commitments as required by Government. Issues of sustainment are key inputs in the assessment process. The DPAS has a two year outlook and is informed by a Quarterly Strategic Review which considers likely developments in Australia's security situation and possible military responses that might be directed by Government. The outcomes and key judgements from this assessment process are provided to the Minister as the classified Preparedness and Concurrency

Ministerial Submission. This process has been refined considerably over the last four years, and provides a high level of assurance to Government as to the capability of Defence to meet current commitments and conduct future operations.

Recommendation No. 5 paragraph 3.82

That starting for 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.

Response: ANAO have agreed to respond to this recommendation.

Recommendation No. 6 paragraph 3.113

That the Australian National Audit Office and Defence Materiel Organisation 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.*

Response: Agree

A footnote will be inserted against Sections 1.2 and 5.1 to reflect the above criteria.

Recommendation No. 7 paragraph 3.114

To improve the robustness of capability performance information, that the Australian National Audit Office and Defence Materiel Organisation consults as necessary and propose amendments to Section 5.1 and 1.2 in the 2014-15 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.

Response: Disagree

The DMO can provide information on capability milestones achieved to date through achievement of the 'cardinal' milestones; Contract Signature, IMR, IOC and FMR, FOC. The IMR-FMR construct is designed to clearly define the points at which the DMO is to meet its responsibilities for the acquisition of materiel supplies – the materiel element of the capability. The materiel element of capability is but one element of a number of Fundamental Inputs to Capability (FIC). The Capability Manager (CM) is

responsible for integrating the FICs to achieve a capability state that can be operationally deployed by the CM. The FIC elements that are managed by various Defence Agencies include:

- Major Systems
- Supplies
- Facilities
- Support
- Command and Management
- Personnel
- Organisation
- Collective Training

Achievement of all FICs would then provide the fully operational capability state. The definition and responsibility for the FIC elements is included in the table below.

Expressing capability achieved in quantitative terms is problematic, especially before Materiel Release milestones are achieved. Even after a project is concluded, capability delivery can be difficult to express quantitatively. As part of the Bernard Gray's 2009 *Review of Acquisition* for the Secretary of State for UK *Defence*, a team from L.E.K. Consulting, a global strategic consulting business, performed a deep dive into the Ministry of Defence's project performance data. The team constructed a detailed picture of project cost and schedule performance, which is explored in the opening chapters of the report. However, capability delivery was summed up in the following sentence on page 16 of the report:

"...it has not been possible to establish definitively in this study how much of the military capability originally sought was delivered, because that is not easily expressed in quantitative terms, nor is it reliably captured within the MoD's own management information systems..."

However, the DMO proposes including the Initial Materiel Release and Final Materiel Release constitution (as stipulated in the Materiel Acquisition Agreement) for each project under Section 5.1 of the PDSS.

Example text: SEA 4000 PH 3 AWD

IMR Constitutes: One Hobart Class Ship System with up to category 5 trials, testing and certification completed; initial sustainment arrangements in place to support IOC; and training of the Hobart Class systems for the commissioning crew to support IOC.

FMR Constitutes: All three Hobart Class Ship Systems with up to category 5 trials, testing and certification completed and all sustainment arrangements in place to provide materiel support to the Hobart Class.

The DMO is happy to discuss this recommendation further with the Committee upon request.

| Fundamental Input to Capability | Definition | Responsibility |
|---------------------------------|---|---|
| Personnel | All people within Defence, both military (permanent and Reserves) and civilian. The input incorporates recruiting, individual training and all conditions of service and employment, including entitlements, salaries and wages, superannuation and allowances. | Capability Manager |
| Organisation | Flexible functional groupings with an appropriate balance of competency, structure and command and control to accomplish their tasks. This input also includes critical organisations that directly support the ADF effort. | Capability Manager |
| Collective Training | A defined training regime undertaken by organisations that is validated against the preparedness requirements for operations, derived from Government guidance. The regime is to include frequency and depth of competency in skills with a particular emphasis on long-term readiness critical war fighting skills. | DMO for contracted training and training artefacts of new or upgraded mission and support systems |
| Major Systems | Systems that have a unit cost of A\$1million or more, or have significant Defence policy or joint Service implications designed to enhance Defence's ability to engage military power. Input includes, but is not limited to, ships, tanks, missile systems, armoured personnel carriers, major surveillance or electronic systems, and aircraft. | DMO |
| Supplies | Supplies needed for Defence to operate including stock holdings, provisioning lead times, serviceability and configuration status. | DMO |
| Facilities | Buildings, structures, property, plant, equipment, training areas, civil engineering works, through life maintenance and utilities necessary to support capabilities, both at the home base and at a deployed location. Input may involve direct ownership or leasing. | DMO for equipment and systems Defence Support Group for facilities |
| Support | Infrastructure and services from the wider national support base within Australia or offshore which are integral to the maintenance of Defence effort. The input is encompassing and could | Supplies to DMO for mission and support systems and System Program Offices |

| | | |
|------------------------|--|---|
| | originate from civil/private industry/contractors, other Government agencies and international support base agencies. | |
| Command and Management | Written guidance such as regulations, instructions, publications, directions, doctrine, tactical level procedures and preparedness documents required for Defence to support decision making, administration and operations. Input also includes funding not readily attributable to any other FIC element (for example, discretionary funding). | Capability Manager DMO for logistics systems and ensuring authorised engineering and maintenance organisations are in place |

Recommendation No. 8 paragraph 3.115

That DMO maintain the ability to publish project maturity scores in future Major Projects Reports until these are no longer required by the guidelines endorsed by the Joint Committee of Public Accounts and Audit.

Response: Agree

As previously advised, the DMO has developed the Materiel Implementation Risk Assessment and this is currently used in Government Approval Submissions. However, the Project Maturity Scores offer a simplified representation of a project status in relation to its schedule milestones throughout its development and acquisition stages. Until advised otherwise by the Committee, the DMO will continue to publish project maturity scores in the MPR.

Recommendation No. 9 paragraph 4.26

That all future Major Projects Reports, including the 2013-14 Major Project Report, include information on recently exited Major Projects, at a similar level to Tables 2.1 to 2.3 on pages 114 to 116 of the 2012-13 Major Project Report.

Response: Agree

The DMO intends to report all projects exited from the Major Projects Report to FOC achievement. This information will be published in the Part 2 (DMO section) of the Major Projects Report.

Example table below:

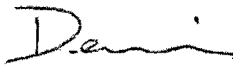
| Project | First Reported in MPR | Last Reported in MPR | Level of Development | Government Approved Budget \$m | Expenditure to Date \$m | Remaining Budget \$m | FMR Achieved | FOC Achieved/Forecast |
|--|-----------------------|----------------------|----------------------|--------------------------------|-------------------------|----------------------|--------------|-----------------------|
| Bridging Air Combat Capability Phase 1 and 2 | 2008-09 | 2012-13 | MOTS | 3556.0 | 2849.7 | 706.3 | Dec-12 | Dec-12 |

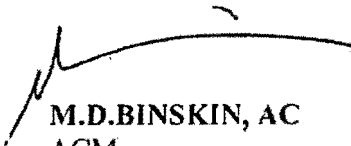
Recommendation No. 10 paragraph 4.27

The Australian National Audit Office and Defence Materiel Organisation consult as necessary to propose amendments to the 2014-15 MPR Guidelines to make provision for information on exited Major Projects.

Response: Disagree

As agreed per Recommendation 9, the information requested will be presented in Part 2, Chapter 2 (DMO section) of the Major Projects Report (example at Recommendation 9). The ANAO advised that information on exited projects will not be bound by the Guidelines or subject to the Auditor-General's opinion, but will be considered in the context of the ANAO's review.


Dennis Richardson
Secretary


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ACM
Chief of the Defence Force