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Report 436

Review of the 2011–12 Defence Materiel Organisation Major Projects Report

Joint Committee of Public Accounts and Audit

May 2013
Canberra

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Foreword

Since coming to Federal politics in 2008, it has been a personal view of mine that the Defence Materiel Organisations (DMO) is an agency that needs a lot of improvement in a number of ways. This was captured in a dissenting report made to the Defence sub-committee in 2010.¹

In recent times, my view is changing. Through oversight at many levels – and a demonstrated desire within DMO management to improve – efficiency, value for money and human management looks to be improving.

The dilemma the DMO wrestles with of delivering private sector principles to a public sector framework is laudable, but will be forever problematic. Such a logic denies a long history of administrative law and fails to admit the public sector can match, and beat, the private sector on value for money – not always, not enough, but certainly often enough to give it a chance, and often enough to not automatically assume it never happens.

The DMO itself, now more than ever, using public sector principles as first principles, is an example of where performance actually improves by doing so.

The 2011–12 Major Projects Report is the fifth to be reviewed by the Joint Committee of Public Accounts and Audit. This year's report covers 29 projects with a combined approved budget of \$47.3 billion.

The Committee is committed to ensuring the information presented in the Major Projects Report helps to maximise transparency and accountability in the Defence acquisition process for major projects managed by the DMO.

Specific areas of focus in the Committee's review of this year's report include the presentation of financial information, project schedule slippage, and governance and business processes.

1 See Joint Standing Committee on Foreign Affairs, Defence and Trade, *Review of Defence Annual Report 2008–09*, July 2010:
<http://www.aph.gov.au/Parliamentary_Business/Committees/House_of_Representatives_Committees?url=jfadt/defenceannualreport_2008_2009/report.htm> viewed 24 May 2013.

The Committee's report makes recommendations directed at:

- supporting the development of meaningful project financial assurance statements;
- disclosing information on the expenditure of project contingency funds;
- improving reporting on the DMO's sustainment of capability functions;
- improving consistency in the application of project 'maturity scores'; and
- taking a more strategic approach to business systems improvements.

The 2011–12 Major Projects Report also contains the findings of a survey of external stakeholders on the use by, and value of, the report. This survey came about as a result of a recommendation of the Committee's previous review.

Although the response rate to the survey was low, the results appear to confirm that the Major Projects Report has become a valuable asset for improving the accessibility of information on major Defence projects. The results also indicate that there is more work that can be done to improve the transparency, clarity and accuracy of information in the report, suggesting a strong case for ongoing parliamentary oversight.

On behalf of the Committee, I would like to express my appreciation for the large amount of work by the DMO and the Australian National Audit Office (ANAO) that goes into producing the Major Projects Report each year. The ANAO's role in both auditing the Project Data Summary Sheets and providing a comparative and longitudinally-focused overview of the report is invaluable.

I thank the witnesses from the DMO and the ANAO for their participation in the Committee's review.

Rob Oakeshott MP
Chair



Membership of the Committee

Chair Mr Robert Oakeshott MP

Deputy Chair Ms Yvette D’Ath MP (until 06/02/13)
Ms Gai Brodtmann MP (from 13/02/13)

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Inquiry Secretary	Mr James Nelson
Research Officer	Mr Nathan Fewkes (until 15/02/13)
Administrative Officers	Ms Jazmine Rakic Ms Louise Goss (until 28/03/13)



List of abbreviations

AMOTS	Australianised Military Off-The-Shelf
ANAO	Australian National Audit Office
COTS	Commercial Off-The-Shelf
DMO	Defence Materiel Organisation
FMR	Final Materiel Release
FOC	Final Operational Capability
IPA	Independent Project Analysis, Inc.
JCPAA	Joint Committee of Public Accounts and Audit
JPD	Joint Project Directive
MAA	Materiel Acquisition Agreement
MOTS	Military Off-The-Shelf
MPR	Major Projects Report
PDSS	Project Data Summary Sheet



List of recommendations

Recommendation 1

To help ensure that project financial assurance statements continue to be robust and meaningful, the Committee recommends that, in consultation with the Australian National Audit Office, the Defence Materiel Organisation continue to seek independent financial assurance during the development of future Major Project Reports for an appropriately selected sample of projects.

Recommendation 2

The Committee recommends that, by 20 June 2013, the Defence Materiel Organisation submit a proposal, for incorporation into the 2013-14 Major Projects Report Guidelines, on how project-level contingency fund data could be disclosed in future Major Projects Reports without being significantly prejudicial to taxpayers' interests. At a minimum, projects that have utilised contingency funds during the previous financial year or are anticipated to use contingency funds in the forthcoming financial year, and the amount of such funds, should be identified in the reports.

Recommendation 3

The Committee recommends that the Defence Materiel Organisation review its current approach to assigning maturity scores to projects to improve the consistency of their application and their consistency with the *Defence Capability Plan*.

Recommendation 4

The Committee recommends that the Defence Materiel Organisation develop a business systems improvement plan which prioritises projects, assigns completion dates and allocates senior level ownership for implementation. A progress update on achievements against the plan should be included in the 2012–13 Major Projects Report.

Recommendation 5

The Committee recommends that, by 20 June 2013, the Department of Defence reports to the Committee on how it intends to achieve greater transparency in relation to its spending on sustainment activities.

Introduction

Background

- 1.1 The aim of the Major Projects Report (MPR) is to provide the Parliament and wider Australian community with accessible, transparent and accurate information about the status of Defence's major acquisition projects, providing a basis for longitudinal analysis of project performance. The report is comprised of a series of Project Data Summary Sheets (PDSSs), an overview and summary by the Defence Materiel Organisation (DMO) and an overview and limited assurance review undertaken by the Auditor-General.
- 1.2 The 2011–12 MPR is the fifth produced by the DMO and the Australian National Audit Office (ANAO). The Joint Committee of Public Accounts and Audit (JCPAA) has reviewed the four previous MPRs and produced reports on three (2007–08; 2009–10; 2010–11).
- 1.3 The MPR came about as a result of a recommendation made in the Senate Foreign Affairs, Defence and Trade References Committee's *Report into Materiel Acquisition and Management in Defence* in 2003 that the Department of Defence (Defence) produce an annual report on progress in major defence projects, detailing cost, time and technical performance data for each project.¹
- 1.4 In December 2006 the JCPAA unanimously agreed to recommend that the ANAO receive additional funding to produce such a report. In August 2008 the JCPAA published *Report 411: Progress on equipment acquisition and financial reporting in Defence*. Chapter 5 of that report provided a broad outline of the key features deemed critical for inclusion in the MPR.

¹ Senate Foreign Affairs, Defence and Trade References Committee, *Report into Materiel Acquisition and Management in Defence*, March 2003, pp. xv-xvi.

- 1.5 The MPR is automatically referred to the JCPAA in accordance with its statutory obligation to examine all reports of the Auditor-General that are tabled in each House of the Parliament.²

Role of the committee

- 1.6 To date, the JCPAA has reviewed the MPR annually to assess the content, accessibility and transparency of the information provided on major projects. The Committee's subsequent reports have provided suggestions and recommendations to improve the format and presentation of data and ensure that the MPR fulfils its original objective to enhance transparency and accountability.
- 1.7 As well as reviewing the MPR, the Committee annually reviews and endorses the MPR Guidelines (formerly referred to as the MPR Work Plan). The MPR Guidelines include:
- the criteria for project selection and removal;
 - a list of projects selected for inclusion or removal from the report;
 - the roles and responsibilities of the DMO in the production and review of the MPR;
 - guidelines for the development of PDSSs;
 - a PDSS template; and
 - an indicative program schedule.
- 1.8 Information on the endorsed Guidelines for the 2011-12 MPR can be found in *JCPAA Report 429: Review of the 2010-11 Defence Materiel Organisation Major Projects Report*.³ Information on the Guidelines for the 2012-13 MPR can be found in Chapter 4 of this report.

Conduct of the review

- 1.9 The Committee commenced its inquiry by requesting the DMO to provide information in response to a number of written questions.
- 1.10 Including the DMO's written response, the Committee received three submissions to the inquiry, listed at Appendix A.
- 1.11 The Committee held a public hearing on 13 March 2013 in Canberra with representatives from the DMO and the ANAO. Witnesses who appeared before the Committee at this hearing are listed at Appendix B.

² *Public Accounts and Audit Committee Act 1951* (Cth), 8(1)(c).

³ *JCPAA, Report 429*, pp. 10-11.

- 1.12 A copy of this report, the submissions and a transcript of the hearing are available on the Committee's website: www.aph.gov.au/jcpaa

Report structure

- 1.13 Chapter 2 provides an overview of the 2011–12 Major Projects Report, including the findings of Auditor-General's assurance review.
- 1.14 Chapter 3 identifies and examines a range of issues identified during the Committee's review of the 2011–12 MPR, making recommendations where appropriate. The issues examined broadly relate to project cost performance, project schedule performance, and the DMO's governance and business processes.
- 1.15 Chapter 4 concerns the Committee's consideration and endorsement of the Guidelines for the 2012–13 Major Projects Report.

Major Projects Report 2011–12

Introduction

- 2.1 This chapter provides an overview of the 2011–12 Major Projects Report (MPR) and a summary of the Australian National Audit Office (ANAO)'s findings in regard to cost performance; schedule performance; capability performance; and governance and business processes.
- 2.2 The objective of the MPR is to provide:
- comprehensive information on the status of selected Major Projects, as reflected in Project Data Summary Sheets (PDSSs) prepared by the Defence Materiel Organisation (DMO);
 - the Auditor-General's formal review conclusion on the ANAO's review of the preparation of the PDSSs by the DMO;
 - ANAO analysis on the three key elements of the PDSSs – cost, schedule and capability – and in particular, longitudinal analysis across projects over time; and
 - further insights and context by the DMO on issues highlighted during the year (not included within the scope of the review by the ANAO).¹
- 2.3 The MPR consists of three parts:
- Part 1: ANAO overview;
 - Part 2: Commentary and overall analysis by the DMO; and
 - Part 3: Auditor-General's independent review report; statement by the Chief Executive Officer DMO; and the PDSSs.
- 2.4 In appendices, the report also includes a copy of the endorsed guidance for the development of PDSSs (part of the MPR Guidelines); a copy of the

1 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, pp. 16–17.

DMO's response to the Committee's recommendations on its review of the 2010-11 report; and the 'Lessons Learned' for a project that was reported on for the last time in 2010-11 MPR (AIR 5376 Phase 3.2 - F/A-18 Hornet Upgrade Structural Refurbishment).

- 2.5 The PDSSs prepared by the DMO have been refined over the years since the first MPR was developed in 2007-08. These changes have been made by the DMO and ANAO with the support of the Joint Committee of Public Accounts and Audit (JCPAA).
- 2.6 The main changes to the PDSSs for the 2011-12 MPR were the addition of a project financial assurance statement in regard to cost performance; the removal of base date dollars from project budget and expenditure history, consistent with the move to reporting financial information in an 'out-turned' format; and the addition of a graph depicting project cost and schedule status.²
- 2.7 In their current form, the PDSSs provide data in the following sections:
- Section 1 - project summary;
 - Section 2 - financial performance;
 - Section 3 - schedule performance;
 - Section 4 - project cost and schedule status;
 - Section 5 - materiel capability performance;
 - Section 6 - major risks and issues;
 - Section 7 - project maturity;
 - Section 8 - lessons learned; and
 - Section 9 - project line management.³

Major Projects included in 2011-12

- 2.8 The 2011-12 MPR reports on 29 major projects, an increase of one project on the 2010-11 MPR. The total approved budget for the 29 projects, as at 30 June 2012, was \$47.3 billion. The projects and their approved budgets appear in Table 2.1 below.
- 2.9 The inclusion of projects in the MPR was based on the following criteria:
- projects only admitted one year after Year of Decision;
 - a total approved project budget of more than \$150 million;

2 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 34.

3 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, pp. 33-34.

- a project should have at least three years of asset delivery remaining;
- a project must have at least \$50 million or 10 per cent (whichever is greater) of its budget remaining over the next two years; and
- a maximum of eight new projects in any one year.⁴

Table 2.1 2011-12 MPR projects and approved budgets at 30 June 2012

Project	DMO Abbreviation	Budget \$m
Air Warfare Destroyer Build (SEA 4000 Ph 3)	AWD Ships	7 853.1
Airborne Early Warning and Control Aircraft (AIR 5077 Ph 3)	Wedgetail	3 829.5
Multi-Role Helicopter (AIR 9000 Ph 2/4/6)	MRH90 Helicopters	3 628.4
Bridging Air Combat Capability (AIR 5349 Ph 1/2)	Super Hornet	3 538.5
Field Vehicles and Trailers (LAND 121 Ph 3)	Overlander Vehicles	3 171.2
Amphibious Ships (LHD) (JP 2048 Ph 4A/4B)	LHD Ships	3 052.1
Future Naval Aviation Combat System (AIR 9000 Ph 8)	MH-60R Seahawk	2 910.2
New Air Combat Capability (AIR 6000 Ph 2A/2B)	Joint Strike Fighter	2 334.0
Armed Reconnaissance Helicopter (AIR 87 Ph 2)	ARH Tiger Helicopters	2 028.9
F/A-18 Hornet Upgrade (AIR 5376 Ph 2)	Hornet Upgrade	1 875.5
C-17 Globemaster III Heavy Airlifter (AIR 8000 Ph 3)	C-17 Heavy Airlift	1 844.4
Air to Air Refuelling Capability (AIR 5402)	Air to Air Refuel	1 795.7
Guided Missile Frigate Upgrade Implementation (SEA 1390 Ph 2.1)	FFG Upgrade	1 449.6
Bushmaster Protected Mobility Vehicle (LAND 116 Ph 3)	Bushmaster Vehicles	1 032.1
Next Generation SATCOM Capability (JP 2008 Ph 4)	Next Gen Satellite	861.1
ANZAC Anti-Ship Missile Defence (SEA 1448 Ph 2B)	ANZAC ASMD 2B	675.8
High Frequency Modernisation (JP 2043 Ph 3A)	HF Modernisation	580.1
Additional Medium Lift Helicopters (AIR 9000 Ph 5C)	Additional Chinook	550.9
Armidale Class Patrol Boat (SEA 1444 Ph 1)	Armidales	537.2
Collins Replacement Combat System (SEA 1439 Ph 4A)	Collins RCS	449.9
Indian Ocean Region UHF SATCOM (JP 2008 Ph 5A)	UHF SATCOM	432.5
Replacement Heavyweight Torpedo (SEA 1429 Ph 2)	Hw Torpedo	425.1
Collins Class Submarine Reliability & Sustainability (SEA 1439 Ph 3)	Collins R&S	411.4
SM-1 Missile Replacement (SEA 1390 Ph 4B)	SM-2 Missile	398.8
ANZAC Anti-Ship Missile Defence (SEA 1448 Ph 2A)	ANZAC ASMD 2A	386.0
Follow On Stand Off Weapon (AIR 5418 Ph 1)	Stand Off Weapon	340.8
Artillery Replacement (LAND 17 Ph 1A)	155mm Howitzer	320.6
Battlefield Command Support (LAND 75 Ph 3.4)	Battle Comm. Sys.	305.8
Counter – Rocket, Artillery and Mortar (LAND 19 Ph 7A)	C-RAM	251.4
TOTAL		47 270.6

Source Australian National Audit Office, 2011-12 Major Projects Report, p. 15.

2.10 Twenty-seven of the projects were previously reported in the 2010-11 MPR (i.e. 'repeat' projects). The following two projects have been added:

4 DMO 2011-12 Major Projects Report Guidelines

- AIR 9000 Phase 8 – Future Naval Combat System (MH-60R Seahawk);
and
 - LAND 19 Phase 7A – Counter – Rocket, Artillery and Mortar (C-RAM).
- 2.11 The 2011-12 MPR Guidelines stipulated that projects which have achieved both Final Materiel Release (FMR) and Final Operational Capability (FOC) would be expected to be removed from future MPRs. One project was ‘exited’ from the 2011-12 after meeting this criteria:
- AIR 5376 Phase 3.2 – F/A-18 Hornet Upgrade Structural Refurbishment (Hornet Refurb).

Australian National Audit Office review

- 2.12 Although the ANAO conducts an assurance audit of the MPR, it cautions that the level of assurance is more limited than for an individual project performance audit. The ANAO does not provide any assurance in regards to PDSS data on the achievement of future dates or events, project financial assurance statements or major risks and issues. These items were excluded from the scope of the ANAO’s review.⁵
- 2.13 During its review of the 2010-11 MPR, the Committee identified the MPR as a ‘Priority Assurance Review’ under section 19A(5) of the *Auditor-General Act 1997*.⁶ This designation has allowed the ANAO full access to the information gathering powers available under the Act, without necessitating the agreement of the DMO to perform its review.⁷
- 2.14 After reviewing the PDSS data, the ANAO’s conclusion was that:
- ... nothing has come to the attention of the ANAO that causes us to believe that the information in the PDSSs, within the scope of our review, has not been prepared, in all material respects, in accordance with the 2011-12 MPR Guidelines.⁸
- 2.15 The ANAO provided more detailed analysis on the following aspects of the MPR:
- Project cost, schedule and capability performance
 - Governance and business processes.

5 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 17.

6 JCPAA, *Report 429: Review of the 2010-11 Defence Materiel Organisation Major Projects Report*, p. 33.

7 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 17.

8 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 18.

Cost performance

- 2.16 In relation to cost, the ANAO concluded that within the review period, all projects continued to operate within their approved budget.⁹
- 2.17 At 30 June 2012, the total approved budgeted costs for the 29 projects was \$47.3 billion, a net increase of \$5.9 billion compared to their Second Pass Approval approved budgeted costs (\$41.4 billion). The \$5.9 billion comprised:
- price indexation increases of \$7.5 billion;
 - real variation increases of \$2.7 billion; and
 - foreign exchange rate decreases of \$4.3 billion.¹⁰
- 2.18 While variations due to price indexation and exchange rates were 'outside the direct control of project management', real variations to budgeted costs:
- ... primarily reflect changes in the scope of projects, transfers between projects for approved equipment/capability, and budgetary adjustments such as administrative savings decisions.¹¹
- 2.19 During the 2011-12 financial year, the approved budgeted cost of the 29 Major Projects decreased by \$1.1 billion (or 2.4 per cent) due to foreign exchange decreases of \$894.6 million and real decreases of \$267.3 million.¹²

Schedule performance

- 2.20 According to the ANAO's review, maintaining major projects on schedule remained the 'most significant challenge for the DMO and its industry contractors'.¹³
- 2.21 Across the 29 major projects, 18 projects had experienced schedule slippage. Total schedule slippage to date was 859 months when compared to the initial predictions when the projects were first approved by government. This represented a 32 per cent increase on the expected schedule since the main investment decision was made (compared to 31 per cent in the 2010-11 MPR).¹⁴

9 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 18.

10 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 56.

11 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 58.

12 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 59.

13 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 20.

14 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 72.

- 2.22 In-year slippage for 2011-12 was a total of 99 months for the 27 projects that were also included in the 2010-11 MPR, representing a four per cent increase in the scheduled timeframe.¹⁵
- 2.23 According to the ANAO, 'the reasons for schedule slippage vary but primarily reflect the underestimation of both the scope and complexity of work, particularly for Australianised Military Off-the-Shelf (AMOTS) and Developmental projects'.¹⁶
- 2.24 The ANAO noted that 87 per cent of the total schedule slippage across the Major Projects covered in the 2011-12 MPR was made up of projects approved prior to the DMO's demerger from the Department of Defence in July 2005 – projects which tended to be more developmental in nature.¹⁷

Capability performance

- 2.25 The ANAO noted that '... the DMO expects to deliver almost all capabilities associated with the Major Projects in this report'.
- 2.26 The capability of a project concerns its capacity or ability to achieve a particular operational effect.¹⁸ Due to national security considerations, only the overall status from each project's capability assessment is disclosed in the MPR.¹⁹
- 2.27 Expected capability delivery had decreased from 94 per cent for projects in the 2010-11 MPR to 91 per cent in 2011-12. Although outside the scope of its formal review conclusion, the ANAO indicated that the DMO's assessment of capability to be delivered was 'in some cases overly optimistic'.²⁰
- 2.28 The ANAO added that
- ... the DMO's key capability measures should be interpreted with some caution due to their lack of rigour as a data system and the high level of uncertainty in forecasting outcomes.²¹
- and that there was
- ... not a clear underlying consistency in the identification and articulation of the [Materiel Release Milestones] and Completion Criteria'.²²

15 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 75.

16 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 25.

17 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, pp. 71, 79.

18 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 81.

19 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 85.

20 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 20.

21 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 82.

22 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 84.

Governance and business processes

2.29 The ANAO reviewed the following key governance aspects relating to major projects:

- Gate Reviews, in which DMO-appointed boards periodically assess projects at key milestones to provide assurance that the project is ready to progress to the next stage. Gate Reviews 'have emerged as the DMO's most prominent internal project assurance activity'.²³
- The management of Projects of Concern, in which projects facing significant cost, schedule or capability delivery challenges are listed in order to focus the attention of senior management on remediating issues. Six MPR projects were Projects of Concern during 2011-12.²⁴
- The Early Indicators and Warnings system, which is used to identify problems with projects early in order for appropriate action to take place to remediate them. In 2011-12, four MPR projects had Gate Reviews as a result of triggering Early Indicators and Warnings threshold criteria.²⁵
- The use of Joint Project Directives (JPDs) for projects approved by government after 1 March 2010. JPDs are designed to provide a single authoritative source of project detail, and are the base document from which all Materiel Acquisition Agreements (MAAs) will be designed.²⁶

2.30 Finally, the ANAO's overview also made the following observations regarding the application of business systems and processes:

- The large range of corporate and project management applications being used by project offices continues to result in inconsistency between information produced by risk management, financial management and document management systems. This will be an area of continuing focus for the ANAO's next review of the MPR.²⁷
- The change in supplementation policy associated with out-turned budgeting has 'emerged as a major risk or issue' for some MPR projects, for which contingency funds may need to be drawn upon:

The emergence of any indexation risk has, to some extent, changed the nature and use of the contingency budget from dealing with project risk management to broader price management ...²⁸

23 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 91.

24 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, pp. 93-94.

25 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, pp. 95-96.

26 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, pp. 96-97.

27 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, pp. 98-99.

28 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, pp. 99-101.

The Committee's review

Introduction

3.1 The Committee received evidence on the following issues relating to the 2011–12 Major Project Report (MPR):

- Cost
 - ⇒ Project financial assurance statements
 - ⇒ Contingency funds
- Schedule
 - ⇒ Slippage issues
 - ⇒ Project maturity scores
- Governance and business processes
 - ⇒ Consistency of information and system rationalisation
 - ⇒ Accountability for projects
 - ⇒ Sustainment reporting
 - ⇒ MPR stakeholder survey

Cost

Project financial assurance statements

3.2 The financial information included in the Project Data Summary Sheets (PDSSs) for each MPR project is now presented in an 'out-turned' format. This means that the forecast price indexation for the life of each project is now included in the data presented. For projects approved prior to 1 July 2010, budget variations for actual and forecast indexation continue to be itemised in PDSSs, while for projects approved after 1 July 2010 the

forecast indexation is included within the original budget approved by the Government. Out-turned budgeting requires the Defence Materiel Organisation (DMO) to manage indexation costs internally to the initially approved project budgets, rather than seeking budget supplementation as prices increase.

- 3.3 To help allay concerns about indexation no longer being disaggregated in project financial information, in 2012 the Committee accepted the DMO's proposal to provide a financial assurance statement in each PDSS with an overall assessment of the project's budgetary position.¹ In its report on the 2010-11 MPR, the Committee indicated that it would closely monitor the reliability of these project financial assurance statements over time and revisit the issue if necessary.²
- 3.4 The financial assurance statement for each of the 2011-12 MPR's 29 projects indicated that there was sufficient remaining budget for the project to be completed. However, for six projects, factors that may potentially impact on budgets in the future were also identified.³ Five of these six projects were included in an independent third party review of the procedures and controls in place to support the financial assurance statements, which helped enable the DMO's Chief Finance Officer to provide overarching assurance for the projects.⁴
- 3.5 Although project financial assurance statements were excluded from the scope of its formal review conclusion, the Australian National Audit Office (ANAO) reviewed the assurance framework. It noted that the DMO's Chief Finance Officer's overarching assessment of the project financial assurance statements was unqualified, reflecting the DMO's confidence that the projects would be completed within budget. However, the ANAO also noted that project-level assurance statements have limitations as they are based on 'current financial contractual obligations' and the known risks and expenditure estimates as at 30 June 2012.⁵
- 3.6 At its public hearing in Canberra, the Committee sought comments from the DMO and the ANAO on the value of project financial assurance statements, and whether their introduction had provided the level of assurance that was anticipated.

1 See ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, pp. 40-41.

2 JCPAA, *Report 429: Review of the 2010-11 Defence Materiel Organisation Major Projects Report*, p. 20.

3 AWD Ships, Overlander Vehicles, LHD Ships, ANZAC ASMD 2B, Additional Chinook and MRH90 Helicopters.

4 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 41.

5 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, pp. 41-42.

3.7 The DMO and the ANAO both agreed that the assurance statements were a valuable addition. The Chief Executive Officer of the DMO informed the Committee that:

The discipline of looking ahead and assuring ourselves – or otherwise, of course – that we can execute the project in the planned budget is an important piece of work and an important focus.⁶

3.8 The DMO's Chief Finance Officer told the Committee that the statements had proved 'very useful' for his management of the portfolio of projects, and that:

The level of detail that we now have visibility of is enhanced. It allows the projects themselves to do a risk assessment, in the financial sense, which has been very useful.⁷

3.9 The DMO also advised the Committee that the process underpinning the development of financial assurance statements was sustainable, and backed up by the independent assessments by Ernst & Young, which 'confirmed the projects' view'.⁸

3.10 Similarly, the Auditor-General told the Committee that the development of project financial assurance statements was 'a powerful discipline on project managers' and 'a very worthwhile addition to the report'. He pointed out that there were six projects identified as areas of concern which would need to be carefully managed, but noted that the DMO's Chief Finance Officer had provided overall assurance that there was sufficient budget within DMO to manage the concerns.⁹

Committee comment

3.11 The Committee was pleased to hear that there was strong agreement from both the ANAO and the DMO that project financial assurance statements had added value to the MPR process, and that in particular, had enabled potential risks to project budgets to be identified, assessed, and included in the report.

3.12 The process underpinning the development of the statements appears to have been robust. The gaining of independent, third party assurance for appropriately selected projects is of particular value to ensuring the integrity of the process, and the Committee wishes to see this practice

6 Mr Warren King, Chief Executive Officer, DMO, *Committee Hansard*, Canberra, 13 March 2013, p. 7.

7 Mr Steve Wearn, *Committee Hansard*, Canberra, 13 March 2013, p. 7.

8 Mr Wearn, *Committee Hansard*, Canberra, 13 March 2013, p. 7.

9 Mr McPhee, *Committee Hansard*, Canberra, 13 March 2013, p. 7.

continue for future reports. The Committee understands that the selection of five major projects for external assurance review was based on specific risk factors that had been identified for those project's budgets. The Committee expects that the DMO, in consultation with the ANAO, will continue to ensure future external review of projects for which potential budget risks have been identified.

Recommendation 1

To help ensure that project financial assurance statements continue to be robust and meaningful, the Committee recommends that, in consultation with the Australian National Audit Office, the Defence Materiel Organisation continue to seek independent financial assurance during the development of future Major Project Reports for an appropriately selected sample of projects.

Contingency funds

- 3.13 The MPR disclosed that approximately \$1.1 billion had been drawn upon from project contingency budgets in 2011-12 to retire project risks, equivalent to 2.3 per cent of the total approved project budget.¹⁰
- 3.14 As was noted in Chapter 2, the change in supplementation policy associated with out-turned budgets means that price indexation is now 'a major risk or issue in some projects', and for which contingency funds may need to be drawn upon.¹¹
- 3.15 The ANAO noted in its overview of the 2011-12 MPR that:
- ... the emergence of any indexation risk has, to some extent, changed the nature and use of the contingency budget from dealing with project risk management to broader project management, and requires project staff to have a greater understanding of the factors that influence indices and their likely movement over the life of the project.¹²
- 3.16 In a written question to the DMO prior to the public hearing, the Committee asked which projects included in the MPR had utilised contingency funds in 2011-12. The Committee also asked whether there were any barriers to the projects that have used contingency funds, or the

10 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 177.

11 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 100.

12 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 101.

amount of funds that have been used, being documented in the Project Data Summary Sheets for future MPRs.

- 3.17 The DMO response listed fifteen major projects which had used contingency funds in 2011–12,¹³ and indicated that:
- Public release of details regarding project contingency provisions could be prejudicial to taxpayers' interests. DMO experience indicates that knowledge of contingency provisions encourages some contractors to find ways to gain access to the funds, which can have negative implications for good project governance.¹⁴
- 3.18 At the public hearing, the DMO was asked to further explain the reasons for information on the use of contingency funds not being published. The DMO's Chief Executive Officer confirmed that his main concern was that 'disclosing the amount of money in each project provides an opportunity for people to go after that money'.¹⁵
- 3.19 The Committee asked the DMO to explore how the utilisation of contingency budgets could be better disclosed in the MPR, including the amount spent, why and when it was spent, and to whom the money went. In response, the DMO undertook to report back to the Committee with a proposal on how it could disclose the realisation of contingency into project expenditure.¹⁶
- 3.20 The Auditor-General was also asked to comment on how the use of contingency funds could be checked and publicly disclosed in a way that does not cause significant harm to the Commonwealth. The Auditor-General expressed his understanding of the risks to taxpayer interests referred to by the DMO, but suggested that the DMO's offer to look at the matter was 'probably the best sign of progress that we have seen for quite some time in this area'.¹⁷

Committee comment

- 3.21 The Committee understands and appreciates the DMO's concern that disclosing too much information about contingency funds could be prejudicial to taxpayers' interests.
- 3.22 However, the Committee also recognises that the nature and use of contingency funds will be of increasing importance as the out-turned budgets of projects are tested over time. Ensuring an adequate level of

13 DMO, *Submission 1*, p. 2.

14 DMO, *Submission 1*, p. 2.

15 Mr King, *Committee Hansard*, Canberra, 13 March 2013, p. 3.

16 Mr King, *Committee Hansard*, Canberra, 13 March 2013, p. 4.

17 Mr Ian McPhee, *Committee Hansard*, Canberra, 13 March 2013, p. 5.

transparency around when contingency budgets are being drawn upon is therefore a key area of interest for the Committee.

- 3.23 The Committee welcomes the DMO's willingness to develop a proposal for how the expenditure of contingency funds could be better disclosed in the MPR, and looks forward to receiving this proposal.
- 3.24 The Committee's initial opinion is that, while the DMO has legitimate concerns that the amount of contingency budget available is not disclosed to contractors, there would be less danger in disclosing information about funds that have already been spent.
- 3.25 The Committee notes that the MPR currently discloses the total contingency allocated across the 29 projects, but does not provide project-specific information. In response to a written question, however, the DMO was able to provide a list of projects for which contingency funds had been expended in 2011-12. The Committee considers that, at a minimum and in addition to any proposal for disclosing further information about actual contingency expenditure, this amount of information should be routinely included in future MPRs.

Recommendation 2

The Committee recommends that, by 20 June 2013, the Defence Materiel Organisation submit a proposal, for incorporation into the 2013-14 Major Projects Report Guidelines, on how project-level contingency fund data could be disclosed in future Major Projects Reports without being significantly prejudicial to taxpayers' interests. At a minimum, projects that have utilised contingency funds during the previous financial year or are anticipated to use contingency funds in the forthcoming financial year, and the amount of such funds, should be identified in the reports.

Schedule

Slippage issues

- 3.26 In its overview of the 2011-12 MPR, the ANAO identified a range of pressures that can contribute to schedule slippage, including actions by contractors; economic conditions impacting on workforce supply and

- demand; and procurement decisions by other nations which may impact on downstream purchases in terms of time to delivery.¹⁸
- 3.27 The DMO provided a summary in this year's MPR of actions being taken to address slippage.¹⁹ The JCPAA recommended inclusion of this information in last year's review, having regarded schedule slippage as a 'major concern' and DMO's explanations as being 'unhelpful'.²⁰
- 3.28 In the 2011–12 MPR, the DMO claimed that 'since 2000, the average level of slippage has decreased from over 50% to around 30% and ... DMO project schedules are now comparable with the private sector'.²¹
- 3.29 At the public hearing, the DMO was asked about the range of pressures contributing to schedule slippage, and the role that project scope and complexity play in this.
- 3.30 The DMO gave the Committee an overview of a review by a private sector consultant, Independent Project Analysis (IPA), benchmarking the DMO's performance in managing major projects against a sample of projects from the IPA's database of over 14 000 private sector capital projects across more than 200 companies, primarily in the processing and extractive industries. The IPA report found that the DMO performed better than the private sector on budget and capability performance.²²
- 3.31 The DMO also discussed the IPA report's findings on schedule performance. The IPA found that DMO projects suffered from schedule slippage of around 30 per cent, which was similar to the private sector. While there had been statistically significant improvements since the 2003 Defence Procurement Review (the Kinnaird Review), the DMO conceded that this was an area in which further improvement was needed.²³
- 3.32 In regard to the reasons for schedule slippage, the DMO identified the following issues and examples:²⁴

18 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 70.

19 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, pp. 139–141.

20 JCPAA, *Report 429: Review of the 2010–11 Defence Materiel Organisation Major Projects Report*, pp. 24–26.

21 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, pp. 135–136.

22 Mr King, *Committee Hansard*, Canberra, 13 March 2013, p. 5. See also ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, pp. 131–132 and DMO, 'DMO Performance', *DMO Bulletin*, Issue 6, 7 December 2012: <http://www.defence.gov.au/dmo/news/dmobulletin/2012_issue6/Page6.cfm> viewed 5 April 2013.

23 Mr King, *Committee Hansard*, Canberra, 13 March 2013, p. 5.

24 Mr King, *Committee Hansard*, Canberra, 13 March 2013, p. 6; Ms Shireane McKinnie, General Manager Joint System and Aerospace, DMO, *Committee Hansard*, Canberra, 13 March 2013, p. 6.

- The complexity of the technology. For example, the DMO's project to install developmental phased array radar onto airborne early-warning aircraft encountered a 'large range' of unexpected technical problems.
- The availability of platforms for modification, particularly for projects that are upgrading existing platforms. As availability is driven by 'operational tempos', the deployment of assets into theatre will mean they are not accessible and schedules may need to be adjusted. Examples given of projects where this has occurred included the Collins replacement combat system and upgrades to the P-3C aircraft.
- Underestimation of the maturity of a system and the amount of development required. For example, when the decision was made to acquire MRH 90 helicopters:
 - ... it was assumed it had been offered to Defence as a mature capability and it was not as mature as had been assessed. So it took longer to mature that capability than was planned in the project at the start.²⁵

Committee comment

- 3.33 The Committee notes that schedule slippage remains the DMO's biggest project management challenge.²⁶ There are currently few signs of immediate improvement across the range of MPR projects, with overall slippage for MPR projects having increased slightly, in percentage terms, between 2010-11 and 2011-12.
- 3.34 However, it is encouraging that there appears to have been some progress to reduce slippage over recent years, stemming from reforms associated with the Kinnaird and Mortimer reviews and the demerger of the DMO from Defence in 2005. The ANAO's analysis has shown that the largest schedule delays continue to be associated with more developmental projects that were approved prior to 2005, and the DMO's overall schedule performance appears to be being let down by a relatively small number of older projects that have experienced excessively long schedule delays.²⁷ This observation is further evidenced by the IPA's finding that while *median* DMO schedule slippage was the same or better than industry benchmarks, *mean* slippage was worse.²⁸ The Committee hopes that overall schedule results will start to improve over the coming years as

25 Mr King, *Committee Hansard*, Canberra, 13 March 2013, p. 6

26 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 20.

27 See ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 70.

28 See DMO commentary at *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 132.

these older developmental projects eventually reach Final Operational Capability and exit the MPR.

- 3.35 The Committee welcomes the new section in the MPR outlining what DMO is doing to minimise schedule slippage, as was recommended by the Committee in its review of the 2010–11 report. Given the historical correlation between acquisition types and final schedule outcomes, the Committee is pleased to note that, in future MPRs, the consideration of Military Off-the-Shelf (MOTS) or Commercial Off-the-Shelf (COTS) options prior to acquisition will be reported on for all new developmental and 'Australianised MOTS' (AMOTS) projects.
- 3.36 The Committee appreciates that the DMO's difficulty in accessing platforms to perform upgrades has had an impact on schedules for some projects. However, the Committee was not convinced that these challenges are entirely unpredictable, and considers that the potentially limited availability of operational platforms could be better planned for during the establishment of the original project schedules.
- 3.37 The ANAO's assessment of the reasons for schedule slippage was that 'underestimation of both the scope and complexity of work' was the primary factor.²⁹ The DMO's public hearing comments about the MRH90 helicopters were that incorrect assumptions about project maturity had been made at the time of approval, leading to lengthy schedule slippage. Given the seriousness of these matters, the Committee has recently written to the Auditor-General to inform him that a performance audit of Defence's test and evaluation processes, including those that take place prior to acquisition, is an 'audit priority of the parliament'.
- 3.38 The Committee notes that the Government has recently agreed to recommendations by the Senate Foreign Affairs, Defence and Trade References Committee to require greater engagement of test and evaluation practitioners in the early stages of acquisitions.³⁰ It is hoped that, over time, these changes will reduce the chance of MRH90-type problems occurring for future procurements.

Project maturity scores

- 3.39 Project maturity scores are allocated by DMO to each project to quantify their maturity at defined milestones. The ANAO has noted that maturity scores at Second Pass Approval for projects in the 2011–12 MPR 'vary and

29 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 25.

30 Minister for Defence and Minister for Defence Materiel, 'Response to Senate Inquiry into Defence procurement', *Media Release*, 16 October 2012; See Senate Foreign Affairs, Defence and Trade References Committee, *Procurement procedures for Defence capital projects: Final report*, August 2012, pp. 210–11.

are generally inconsistent with the presentation in the DCP [Defence Capability Plan]'.³¹

- 3.40 The ANAO Overview section of the MPR included graphs produced by comparing, in percentage terms, project maturity scores to the budget expended and time elapsed for each MPR project.³² For some projects, the maturity scores were vastly higher than the proportion of budget expended and time elapsed.³³
- 3.41 In a written question, the Committee asked the DMO if where project maturity far exceeds time elapsed and budget expended, this should be viewed as an indication of an overly optimistic assessment of project maturity.
- 3.42 The DMO response suggested that the question would be more appropriately addressed to the ANAO, who performed the analysis. The DMO indicated that it would not analyse project maturity scores in this way, as it would imply a direct linear relationship between the time elapsed and the maturity score:
- While it is expected that during a project's life the maturity score indicator will increase, the indicator can also deteriorate. For example, the commercial score could decrease in the event of a major dispute or if the contractor runs into financial difficulties.³⁴
- 3.43 The DMO indicated that it had informed the ANAO of its concerns about the analysis during the preparation of the MPR.
- 3.44 In a separate written question, the Committee asked the DMO why the benchmark maturity scores used for projects in the MPR did not take into account the inherent differences in project maturity between Developmental projects and Military Off-the-Shelf (MOTS) projects. The Committee also asked how the DMO ensured that maturity scores were applied consistently for all projects, noting that some Developmental projects (such as the Joint Strike Fighter) were given higher maturity scores at Second Pass Approval than some MOTS projects (such as the Additional Chinook project).
- 3.45 The DMO advised that it had promulgated an agency-wide instruction on the use and application of maturity scores in September 2010. It added that:
- Maturity scores are a helpful tool, but they are ultimately indicative and advisory. At key points in the project lifecycle they
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31 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 68.

32 See ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, pp. 55, 67.

33 Examples include AWD Ships, Overlander Vehicles, and MH-60R Seahawk.

34 DMO, *Submission 1*, p. 3.

may help with consideration of relative risk. Where scores are lower than nominal benchmarks [they] indicate a higher relative risk exposure – but would not necessarily lead to a decision not to proceed with a project.³⁵

3.46 The response also indicated that the application of maturity scores can 'vary from project to project depending on the assumptions made by the project manager that underpin the assessment'. It suggested that the Joint Strike Fighter project's maturity score at approval reflected 'a very optimistic assessment of the project at the time' – but noted that this was done prior to the DMO's current maturity score procedures being promulgated.

3.47 While MOTS systems would 'typically' have higher scores against the key maturity attributes due to a greater level of data being available from test and evaluation, the DMO indicated that:

... until we have confirmation that Operational Test and Evaluation (OT&E) data is available to Australia the score may be lower than expected for some MOTS items.³⁶

Committee comment

3.48 The Committee notes DMO's comments in response to a written question that maturity scores should not be directly compared to time elapsed or budget expended, and understands that there is not a direct linear relationship between each of these aspects. However, the Committee argues that there is value in such analysis in order to help identify projects that may be maturing slower than expected, or where overly optimistic assessments of project maturity may have been made. The Committee supports the ANAO's ongoing use of these graphs in future MPRs.

3.49 The Committee stands by its decision to ask the DMO about comparative information which was compiled and presented by the ANAO using DMO data. The question gave the DMO the opportunity to both respond to the ANAO's analysis and to explain its reasons for disagreeing with the comparisons being made. The DMO's brief response to the Committee's question did not provide any specific reasons for project maturity scores being disproportionately high in some cases.

3.50 The Committee notes the DMO's comments that maturity scores are 'ultimately indicative and advisory'; will 'vary from project to project depending on the assumptions made by the project manager';³⁷ and 'are

35 DMO, *Submission 1*, p. 4.

36 DMO, *Submission 1*, p. 4.

37 DMO, *Submission 1*, p. 4.

not precise and are not intended to enable exact comparisons across projects'.³⁸

- 3.51 While accepting that some level of variation will be unavoidable, it is crucial that the DMO improve its consistency in this area. The 2012 Defence Capability Plan indicates that maturity scores are used to assist the Government to compare the maturity of different project options 'as a measure of the relative confidence associated with them at the time they are being considered', and that projects with higher maturity scores are considered to carry lower risk. Off-the-Shelf projects are expected to have considerably higher maturity scores at the time of decision-making than Developmental projects.³⁹ Imprecise and inconsistent maturity scores could therefore make a difference in determining which projects receive approval – decisions which can have significant long-term consequences for both budgets and defence capability.
- 3.52 The Committee welcomes the 2010 promulgation of DMO-wide instructions on the use of maturity scores, and hopes this has gone some way to improving consistency in the way that maturity scores are assessed. Noting the issues that continue to be raised by the ANAO, the Committee suggests that the DMO follow up these instructions with further action to improve consistency in the way that maturity scores are applied, and work towards alignment with the presentation of maturity scores as outlined in the Defence Capability Plan.

Recommendation 3

The Committee recommends that the Defence Materiel Organisation review its current approach to assigning maturity scores to projects to improve the consistency of their application and their consistency with the *Defence Capability Plan*.

38 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 572.

39 See Department of Defence, *Defence Capability Plan 2012: Public Version*, pp. 3-4.

Governance and business processes

Consistency of information and system rationalisation

- 3.53 The Committee noted in its review of the 2010–11 MPR that it expected to see in the next MPR 'concrete evidence of results and progress' having been made to achieve consistency of information across projects.⁴⁰
- 3.54 In its overview of the 2011–12 MPR, the ANAO noted that inconsistency of information across projects continued to be an issue. Issues with business systems were again noted by the ANAO, particularly differences between information technology systems in terms of risk management, financial management and document management. Furthermore, inconsistently recorded information has created issues for project management and decision-making.⁴¹
- 3.55 The ANAO provided an update in the 2011–12 MPR on DMO's efforts to improve its systems, noting that 'the DMO has advised that limited progress has been made overall towards rationalisation, and that further ownership and guidance would be required within the organisation in order to achieve the desired outcome'.⁴²
- 3.56 The Committee asked the DMO what was being done to achieve the level of ownership and guidance required to drive further progress towards rationalisation. The DMO informed the Committee of its recent rationalisation of risk management systems, and provided an update on its progress in migrating staff to a single records management system.
- 3.57 In relation to financial management systems, the DMO responded that:
- ... the financial data kept by each project is tailored to the individual project. Differences will occur on factors such as the number of contracts being managed, the currencies used in each of those contracts, the labour and material indices, and the use of Foreign Military Sales versus commercial contracts. All major projects record their project approval values, the expenditure to date, and remaining budget (which includes planned expenditure and remaining contingency) in Capital Equipment Program Financial Planning System (CEPPlan). CEPPlan is planned for redevelopment to modernise it and better link it to the Defence Budget and Output Reporting Information System (BORIS)

40 JCPAA, *Report 429: Review of the 2010–11 Defence Materiel Organisation Major Projects Report*, p. 22.

41 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, pp. 97–98.

42 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, pp. 99–99.

system. This redevelopment is scheduled for roll out in August 2013, subject to CFO Defence approval.⁴³

- 3.58 The response further indicated that due to large variations between projects 'it will not be possible to standardise the information held and management by all projects at all levels'.⁴⁴ Addressing the ANAO's concerns about the consistency of presentation of information, the DMO advised that:

... information is maintained by each project in accordance with the relevant project plans approved for each project. These plans provide the basis for tailoring the DMO processes to match the requirements of each project.⁴⁵

Committee comment

- 3.59 The Committee was concerned by advice provided in the MPR that 'limited progress' has been made in improving the consistency of information across projects.
- 3.60 The DMO's response to the Committee's question indicated that some rationalisation of risk management and record management systems was underway, but that due to large variations in the nature of projects full standardisation of information may not be possible. However, the Committee feels that the management systems used should be able to be consistent across projects, despite the individual nature of the projects themselves.
- 3.61 Recognising these complexities and acknowledging resource constraints, the Committee suggests that the DMO, potentially in consultation with the ANAO, develop a business systems improvement plan which prioritises projects, assigns completion dates and allocates senior level ownership for implementation. The plan should identify priority areas for rectification where the most substantial improvement is needed and is achievable.

Recommendation 4

The Committee recommends that the Defence Materiel Organisation develop a business systems improvement plan which prioritises projects, assigns completion dates and allocates senior level ownership for implementation. A progress update on achievements against the plan should be included in the 2012-13 Major Projects Report.

43 DMO, *Submission 1*, p. 5.

44 DMO, *Submission 1*, p. 5.

45 DMO, *Submission 1*, p. 5.

Accountability for projects

- 3.62 Accountability for the delivery of major projects is an area of ongoing interest to the Committee.
- 3.63 In a written question, the Committee requested from the DMO a list of all major projects approved by the Government after 1 March 2010, with details of the assignment of overall responsibility, authority and accountability for realisation of the capability system to an in-service stage. In response, the DMO provided a table of 99 projects listing the Capability Realisation Authority for each.⁴⁶
- 3.64 In another question, the Committee asked the DMO whether the 'project line management' section of each PDSS in the MPR should be taken to provide a clear answer to the question 'Where does the buck stop?' The DMO advised that:
- For projects assigned to the DMO, accountability and reporting flows from the Project Director or Project Manager through line management to the Chief Executive Officer Defence Materiel Organisation where, ultimately, 'the buck stops'.⁴⁷
- 3.65 The DMO also provided information on the 'typical allocation of responsibilities and accountabilities' of line management, including the General Manager, the Division Head, the Branch Head and the Project Director or Manager.⁴⁸
- 3.66 In a final written question on accountability assignment, the Committee asked the DMO for an example of a project that had exited the MPR, with details of accountability as allocated at each state post exit.
- 3.67 The DMO's response noted that only two projects had exited the MPR since its inception in 2007: the AIR 5376 Phase 3.2 - Hornet Refurbishment and the AIR 8000 Phase 3 - C-17 Globemaster III - Heavy Airlift. The DMO then provided general information about the responsibilities of the Capability Manager, who is 'directly accountable to the Secretary of Defence and the Chief of the Defence Force for the successful realisation of an approved new capability'.⁴⁹ The roles and responsibilities of Capability Managers were also illustrated in a diagram attached to the response.⁵⁰
- 3.68 At the public hearing, the Committee asked the DMO to provide a simple diagram that tracks how the responsibility for a project changes from the Chief Executive Officer of DMO to the Capability Manager over time.
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46 DMO, *Submission 1*, pp. [12-17].

47 DMO, *Submission 1*, p. 8.

48 DMO, *Submission 1*, p. [18-20].

49 DMO, *Submission 1*, p. 9.

50 DMO, *Submission 1*, p. [21].

- 3.69 The DMO indicated that it has now become more formalised within Defence that the Capability Manager is 'overall responsible for the capability', while the DMO is responsible for 'the materiel elements to Final Materiel Release'.⁵¹ A diagram was provided on notice illustrating this arrangement.⁵²

Committee comment

- 3.70 The allocation of responsibility across the life of a project has been an area of ongoing interest to committee members. The Committee understands there has been significant variability in accountability across projects, and was pleased to hear that the allocation of responsibilities between the DMO and Capability Managers has now become more formalised inside Defence.
- 3.71 Diagrams provided by the DMO to explain the accountability arrangements were not as simple as they could have been, and as a result, were not especially helpful. However, it is clear from the evidence as a whole that the Capability Manager is the 'key figurehead accountable for Whole of Capability' after the Second Pass approval of a project. The Capability Manager's responsibilities include coordinating the inputs to a project, including the materiel delivery that is managed and financed by the DMO.
- 3.72 The Committee notes that a recent report of the Senate Foreign Affairs, Defence and Trade References Committee made recommendations to expand the responsibility of Capability Managers, including by attributing budgetary control to them for procurement and sustainment rather than the DMO.⁵³ While the Government's response did not accept key aspects of these recommendations, it did commit to taking steps to 'ensure the primacy of the Capability Manager's role is maintained'.⁵⁴
- 3.73 The Committee welcomes any actions that have been or will be taken in light of this response to improve the clarity and outward transparency of the relationship between the DMO and the Capability Managers in regards to overall accountability for project outcomes.

51 Mr King, *Committee Hansard*, Canberra, 13 March 2013, p. 7.

52 DMO, *Submission 3*.

53 Senate Foreign Affairs, Defence and Trade References Committee, *Procurement procedures for Defence capital projects: Final report*, August 2012.

54 Minister for Defence and Minister for Defence Materiel, 'Response to Senate Inquiry into Defence procurement', *Media Release*, 16 October 2012.

Sustainment reporting

- 3.74 The DMO's overview of the MPR reported that approximately 53 per cent, of DMO's 2011–12 budget, or around \$5.4 billion, was for its sustainment program. This comprised around 115 sustainment products.⁵⁵
- 3.75 Given the importance of sustainment and the proportion of the DMO's budget attributed to it, the Committee was interested in learning whether there were any reasons why an annual consolidated report could not be produced to bring together the information on sustainment.
- 3.76 The DMO replied that it reports on the top 20 sustainment products through the Defence Annual Report, Portfolio Budget Statements and Portfolio Additional Estimates Statements. These products accounted for an average of around 70 per cent of the DMO sustainment budget.⁵⁶
- 3.77 The Committee followed up this response at the public hearing, asking the DMO why it was not able to provide an overview of 100 per cent of the DMO's sustainment activities.
- 3.78 The DMO informed the Committee that the 'first and foremost' challenge relating to reporting on sustainment activities was that performance information on sustainment was tightly linked to sensitive information about Defence's operational capability commitments.⁵⁷ The DMO elaborated that:
- Where we run into highly sensitive matters in the sustainment area is that most of the performance metrics that we have for sustainment are against the [Chief of the Defence Force's] preparedness directive, which is classified. If we were to do something similar in sustainment in terms of assessing performance against measures in a public fashion, it would be classified. We would have the same issue in sustainment metrics as we do in the measures of effectiveness issue so the value of that would be less so in terms of a public document. If we were to put a consolidated report together of how we are performing against all the sustainment activities, that would give you a public indication of preparedness, which is something we cannot do because it is classified.⁵⁸
- 3.79 Other complexities identified by the DMO relating to reporting on sustainment included the moving of funds between one capability manager's line of activity and another's, and that the nature of

55 ANAO, *2011-12 Major Projects Report: Defence Materiel Organisation*, p. 109.

56 DMO, *Submission 1*, p. 10.

57 Mr King, *Committee Hansard*, Canberra, 13 March 2013, p. 2.

58 Ms McKinnie, *Committee Hansard*, Canberra, 13 March 2013, p. 2.

sustainment activities is that they are an ongoing piece of work without a clear beginning and end.⁵⁹

- 3.80 Despite these challenges, the DMO indicated that it would be able to report on some data, such as the amount of money being spent on each of its sustainment activities. The DMO undertook to look at ways to provide more detailed information on sustainment in order to improve its transparency.⁶⁰
- 3.81 On 13 May 2013, the DMO wrote to the Committee in response to this undertaking. The response indicated that a 'major review along the same lines as the Major Projects Report would prove difficult' due to the nature of sustainment work and the classification of information. However, the DMO committed to expand its reporting in Portfolio Budget Statements and the Defence Annual Report to cover the top 30 sustainment products, rather than the top 20. This would represent reporting on around 77 per cent of current spending on sustainment.⁶¹

Committee comment

- 3.82 The Committee understands the sensitivity of some sustainment-related information, and the inherent difficulty of reporting on this. However, given the increasingly large amount of public money devoted to sustainment, the Committee considers that transparency of information is needed to the greatest extent possible without compromising national security interests.
- 3.83 The Committee welcomes the DMO's commitment to expand the number of sustainment products reported on in the Defence Annual Report and Portfolio Budget Statements. However, the Committee believes that more needs to be done to increase the depth, not just the breadth, of information provided in these reports. Current reporting provides only a high-level overview of each product, its expenditure and its performance for the relevant financial year. The Committee would like to see a proposal from the Department of Defence, in consultation with the ANAO and taking into account disclosure in other jurisdictions, on how the level of detail can be enhanced to make sustainment information more transparent to public scrutiny.

59 Mr King, *Committee Hansard*, Canberra, 13 March 2013, p. 2.

60 Mr King, *Committee Hansard*, Canberra, 13 March 2013, p. 2.

61 Defence Materiel Organisation, *Submission 4*.

Recommendation 5

The Committee recommends that, by 20 June 2013, the Department of Defence reports to the Committee on how it intends to achieve greater transparency in relation to its spending on sustainment activities.

MPR stakeholder survey

- 3.84 In its review of the 2010–11 MPR, the Committee recommended that the DMO include in the 2011–12 MPR a discussion on the use by, and value of, the report for external stakeholders such as private companies or industry associations.⁶²
- 3.85 In response to this recommendation, the DMO contracted the independent firm Ernst & Young to conduct a survey of external MPR stakeholders. A summary of the findings were published in the 2011–12 MPR.⁶³
- 3.86 In response to a written question, the DMO also provided the Committee with a detailed copy of the survey results.⁶⁴
- 3.87 The survey had been sent to 226 external stakeholders, of which 86 responded. Of the respondents, 76 per cent were from industry (including those linked to projects mentioned in the MPR) and 23 per cent were from outside the Defence Community (such as media). Only 41 respondents completed the survey in its entirety after indicating they were aware of the MPR, with the remainder either not being aware of the MPR or not fully completing the survey.⁶⁵ Ernst & Young advised the DMO that the response rate was below the level usually received for their industry based consultations.⁶⁶
- 3.88 Amongst those who responded, the survey provided the following key findings:⁶⁷
- Awareness of the MPR was high, at 66 per cent.
 - Understanding of the intent of the report was high, at 85 per cent.
 - Six attributes of the report – clarity, accuracy, accessibility, transparency, relevance and value – were rated at between six and

62 JCPAA, *Report 429: Review of the 2010–11 Defence Materiel Organisation Major Projects Report*, p. 31.

63 ANAO, *2011–12 Major Projects Report: Defence Materiel Organisation*, pp. 122–124.

64 DMO, *Submission 1*, p. 6 and *Supplementary Submission 1.1*.

65 DMO, *Supplementary Submission 1.1*, p. 10.

66 DMO, *Submission 1*, p. 6.

67 Selected findings from DMO, *Supplementary Submission 1.1*

seven out of ten. The lowest scores (around six out of ten) were for transparency, clarity, and accuracy.

- 34 per cent of respondents agreed that the quality of reports had improved over time.
- There was generally agreement that the size, number of projects and focus of the MPR were appropriate.
- The PDSSs and the DMO sections were of the most interest, followed by the ANAO Overview.
- 73 per cent of users agreed that the MPR was useful for understanding the DMO's project performance, while around 44 per cent used it as a comparison tool and to produce further reports.

3.89 Some suggestions for improvement were included in the supporting comments of respondents to the survey. The comments varied greatly and were at times conflicting – for example, some comments called for more detail to be included in the report while others called for less.⁶⁸ A small number of comments raised concerns about the accuracy of MPR information, including financial figures.⁶⁹ There were also suggestions that information on the source selection process for projects should be included in the MPR.⁷⁰

3.90 In its response to the Committee's question, the DMO said that the survey 'did not highlight any clear areas for change', and that no changes to the MPR were intended as a result of the feedback other than any made in consultation with the ANAO and with the approval of the Committee.⁷¹

Committee comment

3.91 The Committee welcomes DMO's commissioning of an external stakeholder survey to fulfil the Committee's previous recommendation to include a discussion on the use and value of the MPR.

3.92 Although the overall response rate to the survey was disappointing, the Committee was pleased to hear that the MPR was generally valued by the majority of those who did respond, and that the report has an appropriate focus.

3.93 It was unsurprising, given the primarily industry demographic, that survey respondents had the most interest in project specific information provided in the PDSSs and in overall information provided by the DMO.

68 DMO, *Supplementary Submission 1.1*, pp. 22, 40, 42.

69 DMO, *Supplementary Submission 1.1*, p. 22.

70 DMO, *Supplementary Submission 1.1*, pp. 22, 38, 42.

71 DMO, *Submission 1*, p. 6.

- 3.94 The DMO has indicated that the survey did not highlight any clear areas for change in the MPR. However, the Committee suggests that the comments of respondents and the relatively low ratings given on the transparency, clarity and accuracy of information in the report indicate that there remains room for improvement. The Committee will continue to explore potential enhancements to the format and content of the MPR during its future reviews of the report and its Guidelines, and expects both the DMO and the ANAO to actively consider and suggest improvements wherever possible.

Guidelines for the 2012–13 MPR

Introduction

- 4.1 In addition to reviewing the Major Project Report (MPR), the Committee annually considers and endorses the MPR Guidelines.
- 4.2 While the Defence Materiel Organisation (DMO) and the Australian National Audit Office (ANAO) continue to develop the MPR Guidelines jointly, the ANAO has now taken administrative responsibility for updating the Guidelines and submitting them to the Committee, as per the Committee's recommendation in its review of the 2010–11 MPR.¹
- 4.3 The MPR Guidelines for 2012–13, presented to the Committee in August 2012, include:
- the criteria for project selection and the list of projects selected for the 2012–13 MPR;
 - the role and responsibilities of the DMO in the production and review of the 2012–13 MPR;
 - guidance for the development of Project Data Summary Sheets (PDSSs);
 - the PDSS Template; and
 - an indicative MPR Program Schedule in support of Tabling in November 2013.
- 4.4 The Committee wrote to the ANAO in September 2012 to indicate its endorsement of the proposed Guidelines, subject to minor amendments.

Changes from the 2011–12 Guidelines

- 4.5 The MPR Guidelines are reviewed and amended annually in order to reflect changes to the MPR process and lessons learned, and to improve

1 See Joint Committee of Public Accounts and Audit (JCPAA) *Report 429*, p. 29.

the presentation of data. The Committee has contributed to this process with its annual review of the MPR and the Guidelines approval process.

4.6 The revisions to the Guidelines for the 2012-13 MPR included:

- updated criteria for the removal of projects from the MPR (i.e. exit criteria) based on a post Final Materiel Release (FMR) risk assessment of the timely achievement of Final Operational Capability (FOC);
- clarification of roles and responsibilities;
- a requirement for the DMO to explain in the PDSS for new projects that are not classified as Military Off-the-Shelf (MOTS) or Commercial Off-the-Shelf (COTS) how these options were explicitly considered and eliminated for particular reasons prior to final procurement decisions being made;²
- additional information on cost increases and decreases in PDSS Section 2 – Financial Performance; and
- other minor amendments to information included in PDSSs.

New projects and exiting projects

4.7 In addition to 28 'repeat' projects that appeared in the 2011-12 MPR, the 2012-13 MPR will include one 'new' project:

- Battlespace Communications System (LAND) – JNT 2072 Ph 2A

4.8 One project will be 'removed' from the MPR, and will be reported on separately from the PDSSs in the 'Lessons Learned' section of the 2012-13 MPR:

- C-17 Globemaster III Heavy Airlifter – AIR 8000 Phase 3

4.9 The Committee notes concerns raised by the DMO's Chief Executive Officer that there is limited value in certain projects, which are nearing their completion, continuing to be included in the MPR.³

4.10 The Committee wishes to ensure that a sensible approach is taken to project selection and removal. The 2012-13 Guidelines allow for projects to be removed from the MPR prior to reaching Full Operational Capability, subject to certain risk criteria having been met. This process was intended to ensure that higher risk projects continue to be reported on for as long as there is significant value being obtained from their inclusion. For lower risk projects, where there is agreement that the cost of reporting

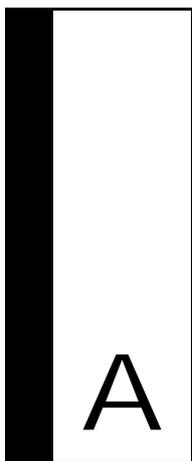
2 See JCPAA *Report 429*, p. 25.

3 Mr Warren King, Chief Executive Officer, DMO, *Committee Hansard*, Canberra, 13 March 2013, p. 1.

outweighs the value of continuing to include the project in the MPR, the agreed process enables those projects to be removed from the MPR.

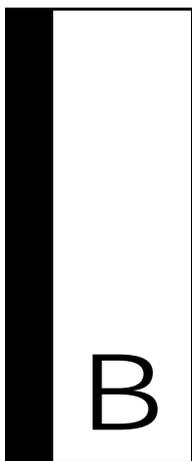
- 4.11 The Committee suggests that if the agreed process for the removal of projects from the MPR is not producing an appropriately balanced outcome, then it will consider any proposal put forward to improve those criteria during its next annual review and endorsement of the MPR Guidelines.

Rob Oakeshott MP
Chair
May 2013



Appendix A – Submissions

- 1 Defence Materiel Organisation
 - 1.1 Defence Materiel Organisation (Supplementary to Submission 1)
- 2 Australian National Audit Office
- 3 Defence Materiel Organisation
- 4 Defence Materiel Organisation



Appendix B – Public Hearing

Wednesday, 13 March 2013 - CANBERRA

Australian National Audit Office

Mr Ian McPhee, Auditor-General

Mr Michael White, Executive Director

Ms Michelle Page, Senior Director

Defence Materiel Organisation

Mr Warren King, Chief Executive Officer

Mr Harry Dunstall, Deputy Chief Executive Officer

Mr Steve Wearn, Chief Finance Officer

Ms Shireane McKinnie, General Manager

Mr Paul Way, Acting Chief Audit Executive

