

Strategic Reform Program

Background

- 2.1 The Strategic Reform Program (SRP) was initiated in the 2009 Defence White Paper '*Defending Australia in the Asia Pacific Century: Force 2030*'. The SRP comprises a "comprehensive set of reforms that will fundamentally overhaul the entire Defence enterprise, producing efficiencies and creating savings of about \$20 billion" over the next 10 years.¹
- 2.2 As outlined in Defence's 'The Strategic Defence Program – Delivering Force 2030' document the reform program has three key elements:
 - *Improved Accountability in Defence.* Providing much greater transparency – that is, visibility of how Defence manages the close to \$26 billion annual budget – will strengthen the accountability of Defence, and individuals within Defence, to the Government, to Parliament and the Australian taxpayer.
 - *Improved Defence Planning.* Improving our strategic and corporate level planning will strengthen the link between strategic planning and the definition and development of military capabilities; better control the cost of military preparedness; and tighten governance and systems to ensure that Defence accurately forecasts and manages major acquisitions.
 - *Enhance Productivity in Defence.* Implementing smarter, tighter and more cost effective business processes and practices will make sustainment and support management more efficient and

1 Department of Defence '*Defending Australia in the Asia Pacific Century: Force 2030*', p. 107

effective; improve cost effectiveness for military capability and procurement processes; and create the basis for a more efficient Defence Estate footprint.²

2.3 Defence anticipated cost reductions of \$797 million in 2009-10; and intends that the SRP will deliver more than \$1 billion in cost reductions in 2010-11 as part of the \$6.4 billion in planned cost reductions across the forward estimates.³

2.4 The Committee asked about the impact of the SRP savings for the last two financial years if the Australian dollar was 75c, not parity. Defence replied:

Exposure to foreign exchange movements is managed in accordance with the Australian Government Foreign Exchange Risk Management Guidelines.

Under this arrangement Defence is protected from the risk of foreign exchange movements on a no-win/no-loss basis.

Defence is required to return to the Government any surplus foreign exchange supplementation for an appreciation of the Australian dollar relative to other currencies.

Defence is supplemented by Government for foreign exchange losses incurred due to depreciation of the Australian dollar relative to other currencies.

Under this arrangement Defence's purchasing power is not impacted by fluctuations in foreign exchange rates and therefore there is no impact on SRP savings resulting from fluctuations in the value of the Australian dollar.

In addition, the SRP savings are mainly derived from Australian based activities and are therefore not impacted by foreign exchange movements.⁴

2 Department of Defence *'The Strategic Defence Program – Delivering Force 2030'* p. 5

3 Parliamentary Library, *Budget Review 2010-2011*, Parliamentary Library Research Paper 26 May 2010 No. 17, p. 58.

4 Department of Defence, *Submission 3*, p. 2.

Current Status

- 2.5 Documentation and hard evidence of the outcomes of the SRP were hard for the Committee to find. The Committee notes comments by the Australian Strategic Policy Institute (ASPI) as follows:

... the scarcity of information about the SRP makes it difficult to be precise about what is going to happen.⁵

... the level of disclosure surrounding the SRP is surprisingly slight.⁶

In most areas we will probably never know whether the planned savings are delivered or not.⁷

- 2.6 The Committee also notes that:

Defence ceased disclosing actual expenses by item in the 2006-07 Annual Report. It is impossible to check for reduced spending in an area in the absence of a baseline figure.⁸

- 2.7 What these statements point to is the difficulty, in an organisation as big as Defence of tracking savings. The Committee, therefore, spent much of its questioning of Defence on the idea of a 'cost conscious culture.'

A cost conscious culture

- 2.8 Regardless of savings expected or imposed by government in any given budget year or funding cycle, Defence will be well served with having a 'cost conscious culture.'

- 2.9 The Committee asked how Defence was progressing on achieving a 'cost conscious culture'. Defence stated that the SRP would require Defence to:

... produce cost reductions in Defence expenditure by \$20 billion over 10 years. That is a fairly substantial amount, even with a budget of our size. It is a very substantial amount, when you realise that a large number of areas are off limits for cost reductions. For example, military manpower and costs of that

5 Australian Strategic Policy Institute, *The Cost of Defence: ASPI Defence Budget Brief 2009-10*, May 2009, p. 117.

6 Australian Strategic Policy Institute, *The Cost of Defence: ASPI Defence Budget Brief 2009-10*, May 2009, p. 117.

7 Australian Strategic Policy Institute, *The Cost of Defence: ASPI Defence Budget Brief 2009-10*, May 2009, p. 122.

8 Australian Strategic Policy Institute, *The Cost of Defence: ASPI Defence Budget Brief 2009-10*, May 2009, p. 116.

manpower are set and we cannot reduce those in order to meet our savings targets or our cost reduction targets, so it is requiring us to operate very differently.⁹

2.10 Defence then went on to explain that:

We have a number of specific cost reduction targets and specific cost reduction means which we are using, but the reality is that we will only achieve and sustain the cost reductions we are being asked to make if we change to an organisation which is much more cost conscious in what we do.¹⁰

2.11 Defence further responded that in order to change to a more cost conscious culture there needs to be a change in people's behaviour.¹¹ Defence gave the example of a specific cost reduction measure they have implemented in relation to reducing the Defence travel budget

We are trying to reduce it both by travelling less and by being more cost conscious on air fares. Can we video con; can we not make the trip; can we send fewer people?¹²

2.12 In addition to this, cost reduction measures have been taken in the ICT area where there has been:

... a lot of work to create a system where our technologies are more integrated. We have different sorts of contracts with industry and we get more capability out of the ICT systems, so what that leads to is more value, in the form of more capability, and more functionality, but it also means that we get more value in terms of greater efficiency and less cost.¹³

2.13 Defence went on to add that they have regular reporting responsibilities to government and the Defence Strategic Reform Advisory Board which is a group of "public and private sector people experienced in change management, including the secretaries of Finance, Treasury and PM&C."¹⁴

2.14 Defence explained that in terms of achieving those cost reductions they are:

... one and two-third years into it. We achieved our cost reduction targets last year. Looking on the basis of everything so far, we are

9 Dr Ian Watt, Department of Defence, *Transcript* 25 March 2011, p. 2

10 Dr Ian Watt, Department of Defence, *Transcript* 25 March 2011, p. 2

11 Dr Ian Watt, Department of Defence, *Transcript* 25 March 2011, p. 2

12 Dr Ian Watt, Department of Defence, *Transcript* 25 March 2011, p. 2

13 Mr Brendan Sargeant, Department of Defence, *Transcript* 25 March 2011, p. 3

14 Dr Ian Watt, Department of Defence, *Transcript* 25 March 2011, p. 3

certainly well on the way to achieving them this year and we expect to do that. The targets get harder to achieve. We are looking to make cost reductions of about \$1 billion next year. I think in two years time it rises to nearly \$2 billion.¹⁵

2.15 The Committee expressed the concern that Defence overachievement on some savings is related to one-off costs with a consequent negative impact on capability.

2.16 Defence responded that:

There has been no effect on capability as a consequence of the strategic reform program, and that is our intent as we go forward. It is a fundamental principle that underpins everything that we do.¹⁶

2.17 The Committee expressed concern that in order to meet the increased cost reductions associated with the SRP efficiencies in personnel costs would have to be considered.

2.18 Defence explained that "In terms of retention, we are seeing historically probably the best retention we have ever experienced in the last 20 years."¹⁷ However:

In terms of reducing personnel costs, one of the things that we are looking at, as part of the strategic reform program, is the support areas which are currently done by military people and contractors and basically creating those positions within the Australian Public Service. The reason we do that is, if you have a look at a military person and an APS person doing the same job, it is much more expensive to use a military person to do that job.¹⁸

Part of our reform program is civilianising some of those support areas where the people are not required to deploy and where the changeover to a civilian position will not affect things like the Navy's ship-to-shore ratio.¹⁹

2.19 The Committee asked the Department to look at the cost of civilianisation of every position in 2005. That is, for example, for every military role turned into a civilianised role, how many people at what cost have now filled those roles.

15 Dr Ian Watt, Department of Defence, *Transcript* 25 March 2011, p. 3

16 Air Chief Marshal Angus Houston, Department of Defence, *Transcript* 25 March 2011, p. 5

17 Air Chief Marshal Angus Houston, Department of Defence, *Transcript* 25 March 2011, p. 11

18 Air Chief Marshal Angus Houston, Department of Defence, *Transcript* 25 March 2011, p. 11

19 Dr Ian Watt, Department of Defence, *Transcript* 25 March 2011, p. 11

2.20 Defence replied:

Over the period FY 2005-06 to FY 2009-10 there were a total of 153 enduring civilianisations excluding Navy military positions that were temporarily civilianised during this period. This resulted in an approximate saving of approximately \$18m . . .

Based on actual expenditure in FY2009-10, including remuneration and on-costs, the average total cost of a military member (excluding Star ranked officers) was \$150,375 which is higher than the average total cost of \$119,077 for a civilian employee.

The higher cost for military members arises from remuneration including allowances and additional on-costs for health, housing, removals and other costs that are not typically incurred with civilian employees.

The 2008 Audit of the Defence Budget also acknowledged that the full costs of civilian employees are significantly lower than their military equivalents.²⁰

2.21 The Committee also notes the following assessment by the Parliamentary Library:

. . . the success of the SRP could be difficult to gauge, especially for those outside Defence. Over half of the initiatives are not targeting direct cost reductions, but aim to promote a cost-conscious and business-like cultural change across the Defence organisation. There is also little indication on the public record of how any actual cost reductions will be measured or reported over the next decade, and no guarantee that the method used will remain consistent and thus allow valid comparison.²¹

2.22 The Committee is also concerned to note the following statement from the Australian National Audit Office's Audit Report No. 57 2010-2011 *Acceptance into Service of Navy Capability*:

. . .the overall picture is of a capability development system that has not consistently identified and responded, in a timely and comprehensive way, to conditions that adversely affected Navy capability acquisition and support. Opportunities to identify and mitigate cost, schedule and technical risks have been missed,

20 Department of Defence, *Submission 3*, p. 4.

21 Parliamentary Library Briefing Book, *The Defence Strategic Reform Program (SRP)* <<http://www.aph.gov.au/library/pubs/BriefingBook43p/defence-srp.htm>> viewed 4 August 2011.

resulting in chronic delays in Navy Mission Systems achieving Final Operational Capability.²²

- 2.23 As one example of a practice that is not indicative of a 'cost conscious' culture the Committee notes the levels of fraud within Defence and the way in which Defence chooses to report this with the focus on activity rather than results.
- 2.24 The Fraud and Ethics Section of the Annual Report states that:
- 216 fraud and ethics awareness presentations were delivered to over 12,000 Defence and DMO personnel across Australia. In addition over 16,000 personnel completed fraud and ethics awareness training through the Defence e-learning platform, CAMPUS.²³
- 2.25 These figures on training levels seem impressive but the figures show that fraud recovery fell from approximately 43.56% or \$300,796 recovered from a loss of \$690,452 in 2008-09 to 34.56% or \$359,393 recovered from a loss of \$1,039,721 in 2009-2010.
- 2.26 Losses due to fraud also increased by 50.58% in 2009-2010. An increase of \$349,269 from \$690,452 in 2008-2009 to \$1,039,721 in 2009-2010.
- 2.27 Defence explain these figures with detailed footnotes pointing to recovery times and difficulty in recovery from an offender but the true picture remains that, for 2009-2010, regardless of the impressive levels of "awareness presentations" Defence have lost over \$1 million to fraud which has been an increase over 2008-2009 of 50.58%.

Committee conclusions

- 2.28 The Committee acknowledge the difficulty in any organisation creating 'cultural change'. However, the Committee is concerned that:
- Defence will not be able to institute the cost conscious culture necessary, not only for the SRP, but for the Defence organisation long past 2030.

²² The Australian National Audit Office's Audit Report No. 57 2010-2011 *Acceptance into Service of Navy Capability*, p. 20.

²³ Department of Defence, *Defence Annual Report 2009-2010 Volume One*, p. 158.

- The SRP relies more on cultural change than rigorously costed savings plans.
- Creativity and innovation should be the norm in any Department. Labelling this as some kind of “new” and special program (ie. the SRP) is illusory.

2.29 However, the Committee is supportive of the SRP and endorse the following observation by the Australian Strategic Policy Institute (ASPI):

... the Strategic Reform Program deserves to be supported. The best advice from the private sector has been melded with the ideas and experience from across Defence to create a comprehensive program of reform. And all signs are that the senior leadership of the organisation is committed to making the reforms work. This is as good as it gets.²⁴

24 Australian Strategic Policy Institute, *The Cost of Defence: ASPI Defence Budget Brief 2009-10*, May 2009, p. 122.