



COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

## **SENATE**

FOREIGN AFFAIRS, DEFENCE AND TRADE LEGISLATION  
COMMITTEE

ESTIMATES

**(Additional Estimates)**

FRIDAY, 18 FEBRUARY 2005

CANBERRA

BY AUTHORITY OF THE SENATE



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**SENATE**

**FOREIGN AFFAIRS, DEFENCE AND TRADE LEGISLATION COMMITTEE**

**Friday, 18 February 2005**

**Members:** Senator Sandy Macdonald (*Chair*), Senator Hutchins (*Deputy Chair*), Senators Ferguson, Mackay, Payne and Ridgeway

**Senators in attendance:** Senators Mark Bishop, Eggleston, Ferguson, Hogg and Sandy Macdonald

**Committee met at 9.04 a.m.**

**DEFENCE PORTFOLIO**

Consideration resumed from 16 February.

**In Attendance**

Senator Hill, Minister for Defence

**Department of Defence**

**Portfolio overview and major corporate issues**

Mr Ric Smith, AO, PSM, Secretary of Defence

Vice Admiral Russ Shalders, AO, CSC, RAN, Acting Chief of the Defence Force

**Budget summary (financial statements and improvement initiatives)**

Mr Lloyd Bennett, Chief Finance Officer

Mr George Veitch, First Assistant Secretary Budgets and Financial Planning

Mr Graham Dunlop, First Assistant Secretary Financial Services

Mr Noel Dobbie, Acting Assistant Secretary Accounting Policy and Practices

Mr Jon Collings, Assistant Secretary Planning and Budgeting

**Capability development**

Lieutenant General David Hurley, AO, DSC, Chief Capability Development Group

Air Vice-Marshal Kerry Clarke, AM, Head Capability Systems

Dr Ralph Neumann, First Assistant Secretary Capability Investment and Resources

**Capital budget**

**Major capital equipment**

Dr Stephen Gumley, Chief Executive Officer Defence Materiel Organisation

Mr Norman Gray, AM, Deputy Chief Executive Officer Defence Materiel Organisation

Dr Ian Williams, Chief Finance Officer Defence Materiel Organisation

Ms Mary Kelaher, Director-General Materiel People and Performance

Air Commodore Clive Rossiter, Acting Head Aerospace Systems Division

Ms Shireane McKinnie, Head Electronic and Weapon Systems

Mr Peter Croser, Head Industry Division

Rear Admiral Trevor Ruting, AM, CSC, RAN, Head Maritime Systems Division

Mr Warren King, Program Manager Air Warfare Destroyer

Mr Kim Gillis, Program Manager Amphibious Deployment and Sustainment

Air Commodore John Harvey, Director-General New Air Combat Capability  
Ms Gillian Marks, Head General Counsel  
Mr Colin Sharp, AM, CSC, Head Land Systems  
Brigadier David McGahey, Director-General Materiel Information Systems, Chief Operating Officer Division  
Mr Mark Jenkin, Director-General Materiel Budget and Treasury, Chief Finance Division

**Major capital facilities projects**

Mr Alan Henderson, Deputy Secretary Corporate Services  
Mr Geoffrey Beck, Head of Infrastructure  
Ms Chris Bee, Assistant Secretary Strategic Planning and Estate Development  
Brigadier Peter Hutchinson, Director-General Infrastructure Asset Development  
Brigadier Jeff Davie, Director-General Regions and Bases  
Mr John Diercks, Assistant Secretary Technical Facilities Services

**Outcome 1: Command of operations in defence of Australia and its interests**

**Output 1.1: Command of operations**

**Output 1.2: Defence Force military operations and exercises**

**Output 1.3: Contribution to National Support Tasks**

Vice Admiral Russ Shalders, AO, CSC, RAN, Acting Chief of the Defence Force  
Major General Mark Evans, DSC, AM, Deputy Chief of Joint Operations  
Air Vice-Marshal Christopher Spence, AO, Commander Joint Logistics  
Air Commodore Kevin Paule, Strategic Operations Division

**Outcome 2: Navy capability for the defence of Australia and its interests**

**Output 2.1: Capability for major surface combatant operations**

**Output 2.2: Capability for naval aviation operations**

**Output 2.3: Capability for patrol boat operations**

**Output 2.4: Capability for submarine operations**

**Output 2.5: Capability for afloat support**

**Output 2.6: Capability for mine warfare**

**Output 2.7: Capability for amphibious lift**

**Output 2.8: Capability for hydrographic, meteorological and oceanographic operations**

Vice Admiral Chris Ritchie, AO, RAN, Chief of Navy  
Rear Admiral Max Hancock, RAN, Deputy Chief of Navy  
Mr Stephen Wearn, Director-General Navy Business Management

**Outcome 3: Army capability for the defence of Australia and its interests**

**Output 3.1: Capability for special forces operations**

**Output 3.2: Capability for medium combined arms operations**

**Output 3.3: Capability for light combined arms operations**

**Output 3.4: Capability for army aviation operations**

**Output 3.5: Capability for ground based air defence**

**Output 3.6: Capability for combat support operations**

**Output 3.7: Capability for regional surveillance**

**Output 3.8: Capability for operational logistic support to land forces**

**Output 3.9: Capability for motorised combined arms operations****Output 3.10: Capability for protective operations**

Lieutenant General Peter Leahy, AO, Chief of Army

Mr Lance Williamson, Director-General Corporate Management and Planning, Army

**Outcome 4: Air Force capability for the defence of Australia and its interests****Output 4.1: Capability for air combat operations****Output 4.2: Capability for combat support of air operations****Output 4.3: Capability for surveillance and response operations****Output 4.4: Capability for airlift operations**

Air Marshal Angus Houston, AO, AFC, Chief of Air Force

Ms Grace Carlisle, Assistant Secretary Resources Planning, Air Force

Air Commodore John Harvey, Director-General New Air Combat Capability

**Outcome 5: Strategic policy for the defence of Australia and its interests****Output 5.1: Strategic and international policy, activities and engagement****Output 5.2: Military strategy and capability analysis**

Mr Shane Carmody, Deputy Secretary Strategy

**Outcome 6: Intelligence for the defence of Australia and its interests****Output 6.1: Intelligence**

Mr Ron Bonighton, AM, Deputy Secretary Intelligence and Security

Major General Maurie McNarn, Director Defence Intelligence Organisation

Mr Ross Bain, Head Defence Security Authority

Brigadier Stephen Meekin, Director-General, Scientific and Technical Analysis, Defence Intelligence Organisation

**Outcome 7: Superannuation and housing support services for current and retired defence personnel****Output 7.1: Superannuation support services for current and retired defence personnel****Output 7.2: Housing assistance for current and retired defence personnel****Output 7.3: Other administered revenue and expenses**

Mr Lloyd Bennett, Chief Finance Officer

Mr George Veitch, First Assistant Secretary Budgets and Financial Planning

Mr Jon Collings, Assistant Secretary Planning and Budgeting

**Business processes****Defence Science**

Dr Roger Lough, Chief Defence Scientist

Dr Ken Anderson, First Assistant Secretary Science Policy

**Inspector-General**

Mr Claude Neumann, Inspector-General

**Chief Information Officer**

Air Vice-Marshal John Monaghan, AM, Chief Information Officer

**Corporate Services**

Mr Alan Henderson, Deputy Secretary Corporate Services

Mr Geoffrey Beck, Head Infrastructure

Ms Chris Bee, Assistant Secretary Strategic Planning and Estate Development

Brigadier Peter Hutchinson, Director-General Infrastructure Asset Development

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Mr Mark Cunliffe, Head Defence Legal  
Air Commodore Simon Harvey, Director-General Australian Defence Force Legal Services  
Dr David Lloyd, General Counsel, Defence Legal

**Coordination and Public Affairs**

Mr Michael Pezzullo, Head Coordination and Public Affairs

**People****Defence Personnel**

Rear Admiral Brian Adams, AO, RAN, Head Defence Personnel Executive

Mr Peter Sharp, First Assistant Secretary Personnel

**Department of Defence**

**CHAIR**—I declare open this meeting of the Senate Foreign Affairs, Defence and Trade Legislation Committee. I welcome back the Minister for Defence, Senator Robert Hill; Vice Admiral Shalders, Acting Chief of the Defence Force; Mr Ric Smith; and officers of the Defence organisation. The committee last met to hear the Defence organisation on Wednesday of this week. It considered part of the portfolio overview and part of the business processes and completed outcomes 1 to 3, 5 and 6. Today the committee will sit until 1 p.m. to complete the portfolio overview and the business processes, and to take evidence from Defence personnel. This will conclude the committee's consideration of the Defence portfolio. Minister, do you or Mr Smith wish to make an opening statement?

**Senator Hill**—I thought, from the other night, that you wanted to start with a more detailed analysis of the financial accounting issues, and we said we would bring along the chief financial officer to take us through the various issues. Did you want to say anything, Mr Smith?

**Mr Smith**—I will say something at the outset. I am joined by my CFO, Mr Bennett, and the CEO of the DMO, Dr Gumley.

**Senator Hill**—I invite Mr Smith to introduce the subject.

**Mr Smith**—Senator Hogg, when the matter of the financial statements came up the other night you said that you thought I should think very carefully about what I had to say to the committee. Of course I had, but I inferred from that that you were seeking some explanation of why our position had apparently deteriorated. I am happy to offer that to you, and Mr Bennett, Dr Gumley and I are very ready to answer whatever questions you might have about it.

In last year's statements there were two new elements in our qualifications. One was a deterioration with regard to inventory and the second was a problem with our property evaluations. The inventory problem reached the proportions it did for a mix of reasons. I will name four of them. First, there was the accumulated impact of a number of years of less than optimal stocktaking practices, some of them resulting from structural changes in the organisation, and inadequate discipline in the use of our stock recording systems over many years. Second, there was the effect of a high operational tempo which in turn had generated an unusual level of movement in our stores and equipment over a period of years. Third, there was the effect of the prolongation of the introduction of the DIDS contract. Fourth, there was



the short-term effect of the cutover to a necessary upgrade of our inventory management system, SDSS.

Those sorts of things could have happened and did happen in degrees in the past. But they would not have had an impact in the past on our financial statements because before the introduction of accrual accounting the value of inventory was not reflected in this way in our end-of-year statements. Incidentally, with regard to inventory, for all the Defence ministries I mentioned the other day, inventory management is one of the most difficult and vexed areas, and they are all qualified in relation to it.

The property evaluation problem arose—we have some 450 major properties and we are talking here about the valuation of every building within those properties—because, though our evaluation work is done for us by the Australian Valuation Office, an agency of the Treasury portfolio, the AVO was apparently not given the directions by us that are necessary to meet the new accounting standards, so the job was not done as it now has to be. Mr Henderson, Deputy Secretary, Corporate Services, could give you more information about that if you wish.

As to remediation plans, in response to the problems of 2003-04 we developed 12 and then it became 13 separate remediation plans. Nine of them addressed specific issues, like inventory, property valuation, personnel records and so on. The other four addressed the systemic changes which, as I said on Wednesday, are necessary for us to put in place the sorts of records and controls that are needed to meet the accrual reporting standards. So there are, we hope, some shorter term solutions to the immediate problems but some longer term systemic changes that we are making. I expect that we will achieve progress in the remediation work and I hope again, as I did last year, that we can lift some of the qualifications. Whether we can get back across the line—that is, from a ‘no opinion’ finding to an ‘except for’ finding—is an open question. I say this again for four reasons. First, I am told by the audit community that it would be unusual to make that transition happen in one year. Second, by definition, we are starting the year with an uncertain balance and it may be difficult for our accountants to persuade me that, from that starting point, we have sufficient certainty for me to conclude an opinion.

**Senator MARK BISHOP**—Starting the year with a difficult—

**Mr Smith**—Starting the year with an uncertain balance. That is because of the way we concluded last year. So it will be up to our accountants to try to persuade me that, from that uncertain starting point, we can reach enough certainty to conclude an opinion in one year. Third, as I mentioned the other day, there is the additional challenge of the Australian Equivalent for International Financial Reporting Standards. I think it is a very big and interesting issue, and we are prepared to talk to you in more detail about that if you wish. But, suffice to say, the challenges are very considerable and in some cases the new rules are still unclear to us. Finally, the fact that the ANAO are putting in so much work this year—60 per cent more than last year, as they explained to you the other day—is a measure of the rigour that we will be faced with.

Nevertheless, the effort we are making is enormous, in public service terms at least. I make that caveat ‘in public service terms at least’ because I have seen some of the figures on the

costs of accounting reform in the corporate sector. Frankly, they are talking numbers that are unaffordable in government. One of the banks that I have read about is spending \$120 million on new systems to cope with the changes. I do not think that will happen in a short time frame in the public sector.

**Senator Hill**—But a new system does not necessarily solve all the problems.

**Mr Smith**—Not necessarily either.

**Senator HOGG**—I am sorry, Minister; what was that?

**Senator Hill**—I think the view of some people is that you resolve these issues by spending a lot of money on a new system. Looking at the history of some of the banks and major corporations around the world, the huge amounts of money spent on the hugely complex new systems have just led to another series of problems.

**Mr Smith**—As well, as good as your systems are, you need a big package of training. We are certainly focusing on that end of the business too because it is the people who use them in the end who are crucial to things. My estimate is that this year we will spend not less than \$12 million on remediation and reform work—possibly more—and we will devote upwards of 600 staff years to it. This involves ADF personnel as well as civilian staff. Some might say that I should devote even more resources to this work but I am determined that, whatever the nature of the problems we face and I try to resolve, I cannot impinge on military capability or operational effectiveness. I say that because many ADF personnel, as I have said, are necessarily involved in remediation and reform work, and there is already a view developing that, in seeking the detailed level of accountability that is now required from the service chiefs, we face a risk of distracting them from their true responsibilities.

That said, I want to say again that the efforts we are making have the full support of the Chief of the Defence Force, all the service chiefs and the vice chief. We are together committed to achieving improvement in what we are trying to do. Should you wish to explore any of that further, Mr Bennett in particular is here and ready to discuss the remediation steps we are taking. Dr Gumley has responsibilities in DMO for some of these areas as well.

**Senator MARK BISHOP**—Thank you, Mr Smith. I want to say a couple of things by way of opening. Firstly, Minister, my office advised me that there has been some difficulty in arranging schedules this morning. You have had to change your diary, so I will just put on the record that you have done that and we thank you for your courtesy in doing that. Secondly, Mr Smith, I should advise you and also put on the record where Senator Hogg and I are going to be coming from, because it is not inconsistent with what you have just said by way of your statement. Senator Hogg and I have had two or three meetings since we started out on this line the other day. We have had some discussions with our colleagues in the corporate community and some of our colleagues in the not-for-profit community to get a handle on what has been going on in terms of accounts and the books and where things are at.

In particular, Senator Hogg has been following a range of issues for the last, I think, seven or eight years on this committee, and some of the issues we are now coming to—he advises me from his notes and his records—for the third time. We are both of the view, as I am sure you are, Mr Smith, that it is probably time to be putting these issues to bed finally, so we welcome your comments this morning.

I should advise you that this morning the questions I am going to be asking of your colleagues essentially go to structures that you have established within your organisation to address the problems in terms of accountancy and responsibility and things that flow from that. We are going to return to that structure we established this morning by way of questions. Every time we come back here, for the life of this parliament in terms of estimates, and ask you for an update and essentially ask the same questions, we are demonstrating to you not that we are picking for the sake of picking but that the opposition is interested in having, as you said at the end, a capable military force that is not unfairly or improperly interfered with by systems that do not work or are inappropriate.

In that context, I am not so sure that we accept your comments at the end. You said words to the effect that the accountancy or responsibility systems within ADF cannot be allowed to impinge on ADF effectiveness or military capability—that is, getting people into the field when government so directs you. We believe your organisation is capable of doing both. More importantly, if government wanted ADF to go down the path that perhaps I am reading into your comments, it would have deliberately chosen to exempt your organisation from the amendments it made back in the mid to late seventies in terms of the switch from cash accounting to accrual accounting. It chose not to. It chose to impose that across the public sector, and it is my understanding that the government's intent, then and currently, is that ADF do comply both in theory and in practice with the directions that are part of that logistic brief.

**Senator Hill**—I think we ought to pursue that because I think you might be reading a little more into what Mr Smith said than was intended.

**Mr Smith**—Yes, I think that is so. I was not talking about the ADF or the defence organisation not being compliant; I was talking about the amount of resources we can devote to remediation. That is the issue here. I think the question of ADF effectiveness in all of this, as I said the other day, is not at stake; that has been proven and demonstrated again and again. These are record-keeping issues at heart, records management issues, and getting them fixed is a big resource demand. The chiefs are cooperating, but I understand very well that they have other responsibilities than just this.

**Senator MARK BISHOP**—Thank you for that explanation, Mr Smith.

**Senator Hill**—Apart from being told to do it, we accept that accrual accounting can bring benefits because if we have a better handle on our assets it might well mean that we do not need to hold the level of stock that we hold at the moment and, therefore, we might be able to use our money more efficiently—and that is part of our responsibility; that goes to the heart of military capability. But getting to that point is proving to be very difficult in practice. That is the point.

**Senator HOGG**—Minister, just dwelling on this for a moment—and I do not want to waste too much time on this because I think we have more valuable things to do—we have been down this path before, over a long period of time. The disappointment from my perspective is that we are now talking remediation that should have taken place when the initial systems were put in. In other words, there was failure in the systems or the programs a substantial time ago.

That is the concern from my perspective, from trawling over the accounts of Defence for a long period of time now. I am interested, like you, in the most effective accounting and delivery processes being available for the sharp end, the pointy end. And that is what a lot of the pain was supposedly about over the last seven years—if I can characterise it in that way—in the reorganisations that have taken place at Defence. What I do not want to be doing is sitting here in 12 months and two years time, essentially revisiting again and again what we have revisited so many times here before. Anyway, I will leave it at that.

**Senator Hill**—There are two points. The first is that it is now clear to me that some years ago we underestimated the extent of the issue. We believed that the problems that were apparent and required certain qualifications could basically be fixed through repair mechanisms. Obviously, looking back with the benefit of hindsight, the issues were much more complex and more serious than was appreciated. I can remember coming in here over several years saying I was confident we will be better next year because we know the problem and we know the fix. But it turns out that it was actually a deeper issue than I appreciated.

The second aspect is the one that the secretary has been emphasising, and that is that the high-jump bar is not at a fixed position. Each year the high-jump bar is also being lifted, so we are not trying to achieve the standard that we required three years ago. The high-jump bar, because of the introduction of new accounting standards, new auditing requirements and so forth, is being continually lifted; therefore, the task that we have to face is even more demanding. That is an added difficulty in achieving a contemporary standard that is acceptable.

**Senator HOGG**—Can I raise one further matter before I pass back to Senator Bishop. I understand, Mr Smith, that you said there is a limit to the amount of funds and resources that in effect one can throw at this problem. There is just not an endless cash flow that one can throw at it to try and resolve the problems. But how much of the systemic problem is based in the systems, the core systems, within Defence and some of the personnel within Defence—and I am not trying to blame the people as such; it might have been underresourced, there may well have been people without the necessary credentials and qualifications to implement the systems. How much of that is involved?

**Mr Smith**—I think that is the right question, Senator, and it is why we are involved in reform as well as remediation. I think with regard to systems we talk about two things: one is management systems and the other one is the IT automated management information systems. When we come to the management systems, as I said on Wednesday, it was only a few years ago that each of the 14 groups in Defence went to monthly cash reporting. We are now moving to monthly full balance sheet reporting—that is, where the balance sheet that is reported to the Defence committee each month reflects the full value of all assets and liabilities for each group and variations in them that affect the value of their business. That is a major system change and it makes very big demands on personnel. I will be frank and say that the people we have, who have grown up on cash accounting, are having to be retrained in that area. We have a very big training program. Unfortunately some of the people we train get hijacked elsewhere in the public service because we are doing more of it than others are.

The second sort of systems, the automated systems, the IT supported systems like SDSS, frankly have not been robust enough to do what is now being asked of them. The SDS system

was first developed, I think, in the late eighties or early nineties. It did not provide all the functionality required for accrual accounting. We have had to do a couple of upgrades to get that functionality on the system. One of those was completed last year. As I have mentioned, it caused one of the hiccups for the year. But that is now in place and it is working where it works—that is, where the management of the warehouse, the work force, is prepared to use the system properly it can do the job, but it is that training and discipline issue that has to back it up.

On the question of whether the SDSS, to stay with that particular example, will cope with the move to AEIFRS, to international financial reporting standards: I doubt that it will. Then the question is: do you put another \$X million into another SDSS upgrade or not?

**Senator Hill**—We have a project for that, but we want to make sure that we get it right before we spend money on a new system—we want to ensure that it will deliver what we will be seeking in the future rather than what we were seeking in the past.

**Mr Smith**—We want to make sure that the SDSS, as it is now upgraded, is working and being used fully and effectively before we go to the next step.

**Senator HOGG**—But my very point is that all the assurances that have been given previously have not been able to be delivered by Defence—that is the problem. I am not saying it has been done in bad faith. The assurances, the projects and everything else that was outlined were never delivered. Anyway, I will leave it that.

**Mr Smith**—Senator, I will say again that I will not be back here next year saying that it is all fixed. I may not be back here next year, but if I am I will not be able to say that it is all fixed.

**Senator MARK BISHOP**—Just bear with me, Mr Smith, while we set up some basic structural things—if I ask some very basic questions or questions that you have already answered. Can you identify, in order, the areas and problems that you are facing and what you analyse are the causes, one by one, for each of those areas or problems?

**Mr Smith**—I think the best approach to that is perhaps to go through our remediation plans. Is that an appropriate way to proceed? They provide both the general and the specific because they set out the priorities.

**Senator MARK BISHOP**—What I am asking you to do is identify the problem areas, the causes of those problem areas, the proposed remedies, the people who have been tasked—

**Senator Hill**—Start with the problems, Mr Smith.

**Mr Smith**—I think the problems are, firstly, the systemic ones—the structure of our financial reporting processes and the training and management discipline required to support them. Secondly, there is the robustness of our management information systems, which I think we have progressed on. Thirdly, there is the whole issue of managing our people and giving them the skills to use the systems.

On the specific areas of concern, firstly, there is stores record accuracy, the accuracy of our information about where particular items are—which bin, which shelf, which warehouse?—and having that on the system. Let me emphasise that it is not that those things are not known by the people who use them; it is that they are not fully and accurately recorded in the system

with prices against them. Secondly, there is general stores inventory—there is a pricing issue with old stock for which we have not kept records, because we did not keep records beyond seven years. Much of our inventory is now very much older than that and we have to establish a baseline for it. Thirdly, there is what we call supply customer accounts. We have a lot of inventory in warehouses, but when items are taken out of the warehouses and sent on deployment or down to a repairer or the maintenance shop they go off the warehouse inventory and onto a supply customer account inventory. There are 29,000 of those, so getting the ownership of those—the person responsible for them—and an accurate inventory within those accounts is the third general area of priority.

Fourthly, there is explosive ordnance—not a problem with quantities and locations; that is true and fair. The problem, again, is in pricing. Fifthly, there is military leave records. Sixthly, there is civilian leave records. On these records issues—and some of this relates to inventory as well, Senator Bishop—there is an underlying problem. If your records are not right when you start—if you cannot look at the computer and support every statement of detail about accrued leave on it with documents—then rectifying it is a big problem. You cannot establish the baseline easily from which to move on to certainty. The records go back many years and reflect many transactions—for instance, I think we do 350,000 leave transactions a year. Increasingly, they will be done directly into the employee self-service systems but in the past they were done on records, and locating all the records to verify the baseline is a big challenge. As a result of those two issues and a couple of smaller ones, we have a general qualification on executive remuneration—that is, the remuneration paid to our SES officers and star rank officers—and the leave records are a part of that. Seventhly, we also have to quantify in detail the value of their parking spaces—and they vary from one officer in one location to another—the value of their cars and so on. Again, there is a records problem.

Eighthly, there is the issue of property valuations. Again, you might be interested to discuss this with Mr Henderson but I believe we ought to be able to resolve this one this year. Ninthly, there is taking our existing category A and category B audit findings and ensure that none of them grow to a qualification so that today's itches do not become tomorrow's pimples and the following year's carbuncles. That is a specific priority that we have. Those are the nine areas that I am focused on and our plans are structured around.

**Senator MARK BISHOP**—So we have got the problems. For each of those nine areas can you give us a brief summary, where you have not, of what has caused those problems—for example, with managing people and giving them skills you identified a subset of a pricing issue. Could you put a little more meat on the table so that we have a picture of the causal factors—one through nine.

**Mr Smith**—Perhaps Mr Bennett can do some of that as another perspective on it.

**Mr Bennett**—If we look at the stores record accuracy problem, which was the project we call S1, I think it arose from the fact that people were not timely in the way they entered information into the system both on the despatch and on the return of items from operations.

**Mr Smith**—That is a part of the problem.

**Mr Bennett**—Yes, that is a part of the problem. I am just trying to hit the key points. S2 is the general stores inventory pricing issue. It a little bit harder to explain but bear with me, please. The problem here is that—

**Senator MARK BISHOP**—I am sorry, Mr Smith outlined nine areas of concern, starting with the system structural problem, training and management discipline; two was robustness of information; three was managing people and giving them skills—I want you to go through the same sequence.

**Mr Smith**—The general plans.

**Mr Bennett**—With regard to the financial reporting framework, the problem we have here is a little more complex because the data quality in various systems degrades the quality of the financial reporting that we may have. So in a sense this one is a catch-all of all the problems that we have. Until we remediate all the data quality issues, we will always have a financial reporting framework problem.

**Senator MARK BISHOP**—Are the problems in poor quality data, not capturing it, losing it or inputting it?

**Mr Bennett**—It tends to be more the poor quality data, the problems of entering it, the timeliness of the data—things like that. Some of the things we have had to do to look into that are to get very clear accountabilities of things like who owns the supply customer accounts and to get very clear accountabilities established around each balance sheet item so that you can start the remediation process of the data quality. That is looking at the long-term reforms required to improve the underlying data of the financial reporting framework. I stress that technically our reports are very good, but that is the concern in that area. We are tackling that through balance sheet remediations, data reconciliation processes and training—those sorts of things are what we are doing there.

**Senator MARK BISHOP**—Are you essentially reinventing the whole reporting system of data?

**Mr Bennett**—If you have been talking to your corporate colleagues, you would probably note that a lot of those organisations are subject to things like Sarbanes-Oxley active controls, getting the truth behind the assertion the data is right. In effect we are going down exactly that same path so that we have that cascading chain of responsibilities to make sure that you have some evidence to back up what you attest is right. On top of the balance sheet reporting we are also introducing a much more rigorous end-of-month due diligence process. The idea of the end-of-month due diligence process is not only to ask people, for instance, ‘Have you revalued your land appropriately or recorded the values?’ It is to point out the relevant finance minister’s orders, the relevant accounting standards, the relevant chief executive instructions and the accounting policy so that they can inform themselves whether they know how to make sure it is right as well.

**Senator MARK BISHOP**—The second one was the robustness of the information system.

**Mr Bennett**—The issue we have here is making sure that we have the various securities and controls in place to make sure that the right people are entering the data and also making sure the right people are supervising or detecting problems in data that is entered. So it is

building into the process the preventative controls and the systems that would help to alleviate this problem as well as making sure people know how to fully exploit the existing systems as they are. The third one was in the broader training area.

**Senator MARK BISHOP**—It was managing people and giving skills, Mr Smith said.

**Mr Bennett**—Yes. Here we have mapped all of the financial management processes in Defence. We have created a process hierarchy that is around—do not quote me exactly—985 financial processes. We are mapping those against every audit finding and seeing whether it is a skills issue involved and then making sure we either ensure that people attend the correct training or that we develop appropriate training for them. In some cases that might be on-the-job training, coaching or mentoring. Then I think we move on to some of the specific remediation areas.

**Senator MARK BISHOP**—Then Mr Smith identified the stores reporting accuracy—general stores inventory and supply customer accounts.

**Mr Smith**—To clarify, the ones that Mr Bennett went through are our general remediation plans, which we call G1, G2 and G3, then we descend into the specific ones, which not surprisingly are called S1, S2 et cetera.

**Senator HOGG**—Do you have a schedule of these readily available that you can table for the committee? If you have a simple matrix, it makes it a hell of a lot easier for us.

**Mr Bennett**—It is a little bit rough.

**Senator Hill**—No, actually, it would be quite helpful, I think.

**Mr Smith**—It has some scribblings on it.

**Senator Hill**—Ignore the scribblings on it, Senator.

**Senator HOGG**—Yes, we will ignore the scribblings. We will take those as a bonus.

**Senator MARK BISHOP**—We will ignore the state secrets.

**Senator Hill**—Ignore the personal comments.

**Senator HOGG**—We will take those as a bonus. I have a general question. In all of this, who is directly responsible? Where is the direct supervision?

**Mr Smith**—Mr Bennett has responsibility for the general audit and accounting policy and for implementing some of the specific plans. In other cases, as you will see from the bit of paper that I am just getting copied for you, there is a designated senior officer at the two- or three-star, band 2, band 3 level and there are other officers named at each level. So, for instance, the inventory issues lie mostly within the vice chiefs group. Air Vice Marshal Spence, the commander of the joint logistics organisation, is responsible for those warehouses, and there is a specific project managed by Brigadier Edwards. That is shown on this document that we will give to you.

**Senator HOGG**—I understand that. I am thinking more in terms of who ensures that the remediation and the targets that you set are met. Obviously that will be devolved, but where does the ultimate power lie?



**Mr Smith**—Ultimately, of course, with me, as the chief executive officer. But I have what is called a Financial Statements Project Board, which was actually set up the year before but which we have augmented this year by adding onto it a representative of the Department of Finance and Administration who is expert in these audit and accounting issues and a private sector practitioner in audit matters. Our task is, among other things, to measure and drive these plans and to report to the minister frequently.

**Senator MARK BISHOP**—You were going to give us the causes now for the next three: stores recording accuracy, general stores and inventory, and supply customer accounts.

**Mr Bennett**—I will start with stores record accuracy, or S1 for convenience. It is ensuring the accuracy of the asset recording and ensuring that we get the timeliness of the information correct as well. That would be the simple description of the causes.

**Senator MARK BISHOP**—Why have you got a problem in terms of accuracy and timeliness? Have you never had the systems, the people, the structures, in place? Why is this a problem?

**Mr Bennett**—I think the problem—the hiccup, as the secretary referred to it last year—is that during the upgrade process the system performance degraded, the willingness of people to use the system directly dropped off and there was also a problem with very low staff morale because of the DIDS transition, so there was reasonably high absenteeism during that period.

**Senator MARK BISHOP**—Was that failure—low morale, high staff turnover, inability or refusal to input data and consequent inability to extract answers—in turn a failure of oversight, supervision and discipline that gave rise to it, or was that a failure built into the system that existed?

**Mr Bennett**—I will start answering and then pass to Dr Gumley. The system itself certainly does not prevent people from doing the right thing, so it is not endemic in the system per se. I think it is probably best if I hand over to Dr Gumley now.

**Dr Gumley**—A new system was introduced around July 2003. The software had some problems. As with virtually all new IT systems that are introduced, there were some problems, but probably one of the biggest issues was that the software was more intensive in its use of computer memory and network resources and so it ran fairly slowly. That caused frustration in a number of people in the field and we had to do a remediation project called the SDSS Get Well Program to improve, if you like, the pipes going into the bases so that more data could flow. That work has been completed now at all bases except one. We have got one more to do and that will mean that the system can operate at a proper speed.

There is nothing more frustrating when you are a computer operator than having your keystrokes taking forever to come up on the screen. Although the system was working, it was working too slowly. So people tended to get a bit frustrated with the system and either try to continue using the old system or, alternatively, do workarounds, like writing notes on backs of bits of paper and saying, ‘I’ll come back when I’ve got a bit of time to fix it.’ That compounded so we ended up with a data problem. We have worked fairly vigorously since about March 2004. It has been a year now getting the Get Well project under way and I am quite confident that good progress is being made.

**Senator Hill**—Can you give the committee some idea of the sort of volume of entries that go through the systems?

**Dr Gumley**—Yes. It is very substantial. We have probably got about half a million line items of inventory that are being updated. There are thousands of people in the field having to make these entries. Of course, when one does an operation or has to do a major upgrade on a piece of defence equipment many thousands of transactions can be required.

**Mr Smith**—Air Vice Marshal Spence, who runs the joint logistics organisation, can speak to the volume issue in some detail.

**Senator MARK BISHOP**—I am not so sure I want to go to that degree of detail today.

**Senator Hill**—I only say it because, unless you understand the enormity of the task, it is easy to think that this is a pretty simple thing that is being addressed.

**Senator MARK BISHOP**—That is right. I might come there in a moment, Air Vice Marshal. Dr Gumley, you devised the new system and put it in place. It was a lot slower and that gave rise to morale problems. I can understand how people would try to work around that, particularly if we are talking half a million entries and thousands of sites and entry input problems every day. But when the planning was devised and the pilot or the trial was done, it should have been anticipated. Was there sufficient funding allocated to do it at the outset and, when people came back six, nine, 12 or 18 months later, were the funding parameters changed and the funds allocated elsewhere? That is, was there consistency from beginning to end?

**Dr Gumley**—In my view not enough funding was allocated back in about 2001 or 2002. The proof of that is that the project had to have a number of real cost increases to recover the functionality we were seeking. That money was made available to do the Get Well remediation but the task was underestimated at the beginning.

**Senator MARK BISHOP**—Tell me—was there a problem back then in your organisation of a constant jockeying or positioning of senior people for funding for particular projects and an attitude of robbing Peter to pay Paul after a project was started or part finished?

**Dr Gumley**—I was not in defence when these decisions were made, so I am not sure I am the best person to comment.

**Mr Smith**—I have not seen that in my time there. I suppose it is the sort of thing that might naturally happen among project managers. This project has received increasing funding over the years, for which we have been criticised separately by the ANAO, but I am not aware of any particular play of this kind.

**Vice Adm. Shalders**—The only perspective I could cast on that question is that I was chair of the Defence Capability Committee at the time when this particular system was going through its Get Well period. It was allocated funds on the basis that we needed the system to be working. At the time in fact we had an operational need for the system in two respects: firstly, for the Gulf War and, secondly, for the Solomon Islands activity. Part of the Get Well program for the SDSS system had to be held in abeyance for a short period of time because of things that were occurring operationally. The funding for the project was allocated on the basis that there was a definite operational need to get it working.

**Dr Gumley**—I am not aware of funding being denied when asked for for the system.

**Senator MARK BISHOP**—Shall we move to S3, Mr Bennett?

**Mr Bennett**—We have not covered S2, general stores inventory—pricing. The problem we have with pricing—there is a time basis to this problem as well—is that we did not really move from the cash environment until the 1999-2000 period in the government sector. There were not the same requirements. The main thing was to know that you had spent the money in-year, et cetera. So there was a combination thereafter of a system which did not necessarily fix the price in the system, and after seven years some of the records were not kept. The problem arose because there was not the substantiating documentation and a control in the system that could give you a positive assurance that that was the right price. There is a difference between a positive and a negative assurance. It is for that reason that we have had a qualification in that area for some time.

**Dr Gumley**—There is also the issue of introducing new equipment into service. Quite often, we received a bundled set of the initial capability, plus spare parts and so on. Unbundling the main equipment from its component parts is a bit of a nightmare 10 or 15 years later. In my view, that problem is extraordinarily difficult to resolve because now there is no real basis for what the pricing was during the nineties.

What we are trying to do in a number of these areas is find a surrogate price, the approximate value. For example, the Americans have a massive catalogue called FEDLOG, which is used to put a price on virtually everything that the Americans buy for their military. That might be a reasonable surrogate. We have a job to convince the auditors that that is a fair surrogate and that it gives us a reasonable approach. My own view is that it is better to have the answer 90 per cent correct than to qualify everything and have it with no opinion at all. We would have reasonable management controls if we understood, plus or minus 10 per cent, what the various items cost us.

**Mr Bennett**—A lot of the work to date has been to establish confidence in that pricing. That is one of the areas where steady progress has been made, but at the moment it is becoming the law of diminishing returns in that area. That same nature of problem—if I can just jump ahead slightly—also goes through to the explosive ordnance issue. The explosive ordnance, as the secretary highlighted, is a pricing issue. Our EO is well managed in specific locations and the stores record accuracy is not common and pervasive across all warehouses. Some warehouses have been excellent in what they have done.

**Senator MARK BISHOP**—Even though it involves repetition, we might stick to the sequence. Have you finished S2, in terms of the causes? Can we go to S3, the supply customer accounts?

**Mr Bennett**—Yes. The supply customer accounts is where the materials move from the warehouse and are assigned to people, and not necessarily fully consumed. The problem we have had there is perhaps the lack of accountability that people have had over those supply customer accounts as received, so we lose visibility. Perhaps, Steve, you would like to speak further?

**Senator MARK BISHOP**—Are you talking about the issue of, say, parts or uniforms or supplies?

**Mr Bennett**—Whether it is boots, socks, tents, repairable items.

**Dr Gumley**—One of the more difficult areas is repairable items held by the supply chain. For example, many defence companies who support us prepare our equipment. So when we send it to them, they are holding a lot of our inventory at any one time. In many of our contracts they have an obligation to count and look after the inventory and to do it within the contract structure. With some of the older contracts, we are going to have to renegotiate some of our arrangements with the supply chain to ensure that proper accounting happens.

**Senator MARK BISHOP**—Is that really a surrogate proposition to identify and locate all of the stock that is in the supply chain from manufacturer source to warehouse, backwards and forwards—is that what you are saying?

**Dr Gumley**—Yes, it is. We have an obligation to account for all the inventory that we own, from where it is manufactured through to the front line field forces and then back to the manufacturer again when it needs to be repaired. So there is a constant ebb and flow of materiel going in both directions. And that perhaps makes it a little bit different from, say, a retail supermarket. Coles and Woolworths get in groceries and they are sold; they do not get a lot of returns. We have always, continually, got amounts of returns coming in and out of the system.

**Senator MARK BISHOP**—Yes. On that basis, you are more akin to someone like Brambles.

**Dr Gumley**—Yes, or an equipment hire company.

**Senator MARK BISHOP**—Yes. That is understood. Explosive ordnance is a pricing issue, you said? Anything else?

**Mr Bennett**—Yes, it is of the same nature as the general stores in military pricing that I was talking about. Given the age of some of the materiel, and the movement away from the physical to the system based, then we could not have the substantiating documentation to confirm the price sufficient to meet the positive assurance requirements.

**Senator MARK BISHOP**—But it is not just a matter of identifying substantiating the original price. It is a matter of the depreciation, the degradation and the worth of equipment over time, isn't it?

**Mr Bennett**—The item information is so that they know that it is a missile, they know its service life, they know all the conditions that apply to the rocket fuel in them—all those sorts of things. This is a pricing issue.

**Senator Hill**—And the missile may have been upgraded over the years, to new capabilities. To attach values to all of these aspects is very complex.

**Senator MARK BISHOP**—Yes.

**Dr Gumley**—The pricing issue is actually a bit deeper than that as well. When you get a missile and you have to put it, say, on an aeroplane, you might pay a supplier several million dollars to do the software integration of the missile into the aeroplane. Where you get into some fundamental accounting issues I if you actually increase the value of the platform—in other words, the aeroplane—or you increase the value of the missile, or in fact it is an item that should be expensed because a software service has gone in between. So we are facing some interesting valuation concepts that we have got to work our way through.

**Senator MARK BISHOP**—Yes. It is fascinating stuff.

**Dr Gumley**—We know where the missiles are, we know how good they are and—

**Senator MARK BISHOP**—We know what they do!

**Dr Gumley**—we know how many we have got. What we do not always have is an accurate valuation of them.

**Mr Smith**—If I could intrude here and leap ahead to the International Financial Reporting Standards, under that regime we will have to show a replacement value.

**Mr Bennett**—Or even anticipate the disposal cost 50 years hence and then discount it back.

**Mr Smith**—What, for instance, is the replacement value of an F111? I would defer to the Chief of Air Force, but it is probably the aggregate of the JSF, the air-to-air refuellers and the AWACs—interesting accounting issues.

**Senator MARK BISHOP**—The replacement cost of the F111—

**Senator Hill**—Whilst not knocking it, this is part of the problem of applying a system that has been developed for private sector businesses to a public instrumentality such as Defence.

**Mr Smith**—Particularly in the area of specialised military equipment where the rules are ours; there is not a manual you can go to globally on that.

**Senator MARK BISHOP**—But the replacement cost of the strike Air Force—the JSF, the F35s or whatever—is a different proposition to the purchase price and depreciated value of the F111, aren't they? They are totally separate propositions.

**Mr Smith**—Yes.

**Senator Hill**—But the obligation is going to be for us to give a replacement cost for the F111.

**Senator MARK BISHOP**—Yes, but that is a different issue to the auditing function that Mr Bennett is talking about in terms of pricing of all material and stores.

**Senator Hill**—Yes.

**Senator MARK BISHOP**—That is an issue for you, an issue for the government of the day.

**Mr Bennett**—Yes. In one sense it highlights what the secretary is saying—that the hurdle is raised by the complexity of accounting in our environment. It is something to look forward to!

**Senator MARK BISHOP**—We had better march along. Military leave records—have you finished S4, ordnance?

**Mr Bennett**—Yes. S5, military leave records—again, the nature of the problem we have here is that often the leave records travel with the people on the ships or into the area of operation. So, being able to pin down every record has been problematic and that is related yet again to the fact that you do not have the substantiating documentation to align with the leave recorded on the system.

**Senator MARK BISHOP**—If Corporal Smith at Leeuwin says he has got six weeks annual leave outstanding and two months paid sick leave—just a simple civilian analogy—and you want to check that, do you go to the manual records or is the system able to bring that up?

**Mr Bennett**—Certainly Brian Adams can speak to that further later, but basically it has been that sort of confirmation process—what are the diaries, what are the services records, all those sorts of things.

**Senator MARK BISHOP**—So you still have to do that manually?

**Mr Bennett**—In the civilian environment, we are progressively rolling out what is called employee self-service where you have a workflow based computer system. We will eventually be able to migrate the military into that environment as well. So I think that is a problem that is progressively being eliminated or will be eliminated.

**Mr Smith**—That requires ensuring that all military personnel—70,000—have access to a terminal, which, of course, for long periods they might not have.

**Senator MARK BISHOP**—It is a particular problem. I understand that. Is that S5?

**Mr Bennett**—That is S5 and it is effectively S6. It is the same sort of problem from the past, although you will note this year we were not subject to a limitation of scope on civilian leave records. That stuck with the military leave problem.

**Senator MARK BISHOP**—So the civilian stuff is more advanced.

**Mr Bennett**—Yes.

**Senator MARK BISHOP**—But you still need to establish a baseline, and record location is a problem.

**Mr Bennett**—To overcome that problem of the availability of document to substantiate the computer record.

**Senator MARK BISHOP**—What about S7?

**Mr Bennett**—That is the executive remuneration note. The problem here is that, for executive remuneration, in the note you have to be accurate to within the band. So there is a \$10,000 band. If you do not meet that pretty much exactly within that band, it is was they term a material by nature item, so therefore it is wrong. If one of the components of executive remuneration is leave, for instance—an executive remuneration includes star ranked officers as well as SES officers—because the leave records are wrong, by nature, your executive remuneration is suspect.

**Senator MARK BISHOP**—This is not a major task, is it?

**Mr Bennett**—No. When I say ‘not major’ the scale of checking through every component of every executive’s remuneration for Defence is a lot of work. There are some 240.

**Mr Smith**—But we can do it manually, and we do certainly seek to check and verify it manually.

**Senator MARK BISHOP**—So essentially you have a senior management team of 240 people.

**Mr Bennett**—If you allow for people acting et cetera, yes.

**Senator MARK BISHOP**—You have to identify and cost obligations and rights. Is that what you are telling me?

**Mr Bennett**—Of every star ranked officer and every SES officer and anyone who acts for a substantial period of time in that year. They have to be either star ranked or SES and earn over \$100,000. I think that \$100,000 figure has been there for some years.

**Mr Smith**—Within that chart of each person's remuneration, you show, as I said, not just the cash salary but the value of the superannuation payments made to them, the value of any other benefits paid during the year, the value of the car park and so on.

**Senator MARK BISHOP**—I appreciate that you have to value the entire cost of the employee at this level. Just off the top of my head, it does not strike me as being a major task to do so. Every decent sized company in this country has an executive of hundreds of people.

**Mr Smith**—That is true. Our people, of course, bump around all over the country often. Each time they change then the value of the car park they use changes and we have to change that figure, for instance.

**Senator MARK BISHOP**—With due respect, Mr Smith, so does every executive person in Woodside or Shell or BHP or Rio Tinto or Woolworths. They all have different grades of cars. They all have car spaces. They all have supported home levels. This is not rocket science.

**Mr Smith**—I know it is not rocket science. I am just saying that it takes a lot of time and if you can tell me that it improves military capability I would be pleased to believe that.

**Senator Hill**—But we will do it.

**Mr Smith**—We will do it.

**Senator MARK BISHOP**—Okay. Is that all on executive remuneration?

**Mr Bennett**—Yes.

**Senator MARK BISHOP**—Property evaluation?

**Mr Bennett**—The in-year problem last year was that, in the accounting standard you need to pretty much have an independent valuation performed on a regular basis. However, there is another part of the accounting standard which requires you to determine whether there has been any material significant movement in the value of assets in-year as well. That requires you to do some form of desktop review or price indexation review or whatever in-year against every such item. We have a lot of land and buildings that fall under the \$250,000 threshold and were not reviewed on that basis. Because there was a lot of movement in the property market over that period it was deemed that we were not reflecting the values accurately. It was, in total, \$1.39 billion of properties that were under the \$250,000 threshold.

**Senator Hill**—We reviewed all of those over \$250,000 but we did not review those under.

**Mr Bennett**—We also have a separate process for reviewing properties for sale. We have had properties since Federation but we have to follow the standard.

**Senator MARK BISHOP**—There is a legislative direction to you to do an annual valuation of all property holdings. Is that right?

**Mr Bennett**—Yes. There is an accounting standard which outlines that all properties are subject to that rolling independent physical review. The property value people go out there, check and look around to see what the market place is like and give us the valuation. But a part of the same accounting standard says that there might not have been much variation for one property and reviewing it on a physical three-year rolling basis is fine, but you also need to consider the total value of those items. The only way you can effectively do that is to do a desktop review and see whether, for that type of property in that location, there has been an overall material movement. That effectively means you have to at least look at it on the system once a year and do that sort of valuation review.

**Senator MARK BISHOP**—Where does that accounting standard derive from?

**Mr Bennett**—I think it is under AAS 1041, section 5.1.11.

**Senator Hill**—Didn't you find that one?

**Mr Bennett**—I do not really want to get down to such fine details.

**Senator MARK BISHOP**—This intrigues me somewhat. Before I became a member of parliament I was on a number of boards and organisations—for-profit and not-for-profit—and our advice at the time from our accountants and auditors was to value property holdings every three or five years. There was a form of depreciation—straight line or whatever. In none of the organisations I was involved in did we ever value every piece of property—what do you call it?—in-year.

**Mr Bennett**—It may be that they did not have the sort of property holdings that we have. We have something like \$13 billion in property.

**Senator MARK BISHOP**—Some of them were billion dollar superannuation funds with significant—

**Mr Bennett**—It may have been a change in standards. Again, that is exactly right. At the start of the accounting standards, at the start of the FMOs, it takes you through all of that. It gives you a process chart and tells you what type of valuation is relevant for what type of asset. It is spelled out very well. There is also that responsibility on you to look at the total value and get a sense of the total value and if there has been a significant movement in that area you need to adjust the value in-year. Really, the only way you can achieve that is to make sure you have done some sort of—as I call it—sanity check so that if you have—

**Senator Hill**—A what check?

**Mr Bennett**—A sanity check to make sure that the number is reasonable given that there have been significant variations in, say, the property market.

**Senator Hill**—How do you do that?

**Mr Bennett**—That means you do a desktop review. You look at the nature of the property, the nature of the location and say, 'Western suburbs, industrial Sydney, has probably moved by this amount.' If you think it has moved enough you should be adjusting the value. Quite



honestly, if you are not then those companies are probably facing an audit qualification—if it adds up like that.

**Senator HOGG**—Is that the same as what they call a walk-by evaluation?

**Mr Bennett**—No, the walk-by is a physical valuation where a valuer goes out, has a look at the surroundings and the nature of the building and the quality of it. That would be a simple physical valuation. This is more: you have your property portfolio in a system; you know the nature of it; and you know the location of it. So if you own a lot of houses and the housing market has moved a lot, you have to at least consider where there has been an impact and do that on a yearly basis.

**Senator HOGG**—But that requires a like with like comparison and in many cases the properties that you hold are not necessarily able to be categorised in such a way. The drill halls are a simple example. You could not compare those with anything else that might be in the surrounding area.

**Mr Bennett**—I might ask Alan to talk to the complexities of the valuation process and how you establish a fair market value.

**Senator HOGG**—No, not now. We will save that for another day.

**Mr Smith**—He is disappointed.

**Senator HOGG**—Sorry about that.

**Senator MARK BISHOP**—I understand the cause of your issue with S8.

**Senator Hill**—He wants to.

**Senator MARK BISHOP**—He wants to what?

**Senator Hill**—Tell you.

**Senator MARK BISHOP**—We have only got a certain amount of time for this.

**Mr Henderson**—I do not want to go into the entrails of the valuation processes. What I want to comment on is the minister indicated before that it is helpful to get a sense of proportion and scale in regard to the audit challenges for Defence. Senator Bishop, you said in the context of executive remuneration that it is not rocket science. Other organisations have to do these things. I will come back to those two points. In relation to scale, the Department of Defence assets account for 75 per cent of Commonwealth general government assets. Defence, from one perspective, is a giant asset machine. The bulk of large Commonwealth organisations such as Centrelink and the tax office are actually cash machines that often do not even own the buildings they reside in or the computers they work at. So we account for a huge proportion of the Commonwealth's assets in the general government sector, which is essentially the budget financed sector.

The second point is that the corporate sector have been preparing balance sheets for decades. The Commonwealth started to prepare balance sheets in the mid-nineties on an unaudited basis and, at the turn of the century, started doing them on an audited basis. So for the Commonwealth coming to terms with accrual accounting has been a huge challenge for Defence, and I think that needs to be recognised in all the discussions that we have had in relation to Defence and accrual accounting.

**Senator MARK BISHOP**—Point taken, Mr Henderson.

**Mr Bennett**—I want to make one clarification: in the corporate sector they can generally report at cost whereas under the finance minister's orders we have to report at fair value. So we probably have to do more of that yearly looking at things than perhaps the corporate sector do.

**Senator MARK BISHOP**—I take the point. Thank you for that explanation. S9, Mr Bennett.

**Mr Bennett**—That is our process of making sure that we prevent any existing findings escalating. The danger we have there is, given the size of the organisation, if people take their eye off the ball then inherently the problem grows worse. What we are doing is making sure we track every single item and every single person. One of the structural things we have done there, as well as all that the secretary has mentioned to date, is set up two project offices headed by SES Band 1 officers to assist in that process, plus I have done some restructuring in my organisation to make sure that we capture every piece of material going to ANAO to make sure there is a quality assurance process on that as well.

**Senator MARK BISHOP**—Again, S1 through to S9—can you identify the person, persons or teams tasked to do job?

**Mr Bennett**—S1, Brigadier Phil Edwards.

**Senator MARK BISHOP**—We do not need names. Chair, for the sake of the record could we have this document incorporated into *Hansard*?

**Mr Smith**—We tabled it yesterday.

**Senator MARK BISHOP**—Could you give us the time frames for each of S1 through S9 and G1 through G3?

**Mr Bennett**—Some of the projects will take some time and it is hard to determine exactly when they will end. I will start with S1, stores record accuracy. The work under way at the moment involves 100 per cent stocktakes, particularly in Moorebank. That work, I believe, is expected to be finished in March. There will be other 100 per cent stocktakes done in other warehouses.

**Senator MARK BISHOP**—When will that be concluded? What time have you allocated to your people?

**Mr Bennett**—With Moorebank it is March. I would have to confirm with others on the Bandiana stocktake.

**Mr Smith**—There are 20 other warehouses within the JLC and other warehouses outside it. That is Air Vice Marshal Spence's role.

**Senator Hill**—How many are working on the Moorebank stocktake and what is it costing?

**Mr Bennett**—There are some 166 people from an external service provider doing the 100 per cent stock take at Moorebank, and I believe—

**Senator MARK BISHOP**—Mr Bennett, we want to know—and I ask you to write these things down because we might be able to really cut to the chase—the time frame for each of

the tasks S1 through S9 and G1 through G3. Is it six months, nine months, 18 months, two years, for the entire job to be concluded—whether it is one warehouse or 30 warehouses? We want to know the time frame. We want to know for each of S1 through S10 and G1 through G3 the reporting lines through the system and the responsible individual who is to ensure it is going to occur. We want to know the costings of each—what it is going to cost to do this. We want to know the review or supervisory committee, and its composition, or the individual overseeing each of the tasks in S1 through S10 and G1 through G3. We want to know if there is any outside supervision of each of those processes in S1 through S10 and G1 through G3.

We want to know the reporting processes or guidelines for your people to follow, either to the secretary's office or the minister's office—I do not know who has got the final line of responsibility. How should they know whichever of those individuals is the senior person? We want to know what you intend to be the reporting processes: (1) to the wider community and (2) to the parliament, via committees like this, so that we are satisfied that the job is done and then we can drop the issue and move onto something else. We want to know where you are going to publish the references on those reporting processes, if you are going to—in the annual report or the PBS or statements in the parliament, so that the whole system is transparent so that we can see what you are doing and who is responsible for success and who is responsible for failure. And then in two or three years time Senator Hogg and I can perhaps move on to other jobs.

**Senator HOGG**—More esoteric issues.

**Mr Smith**—I will just answer the last question. The appropriate forum for reporting on this is obviously this estimates committee and the joint committee where we will be appearing, and that will be our main vehicle for addressing those matters to members of parliament and, through them, the public. The annual report is the right vehicle for us to record all that in print.

**Senator MARK BISHOP**—You might give consideration to putting the discussion that we have just had into a matrix, because that is what I will come back to and ask you a series of fairly standard seriatim questions every three or four months.

**Senator HOGG**—That has been done previously when we were tracking the DER. We went through a horrible process here. You people ended up putting it down concisely into a very good matrix and we were all able to relate to it quite easily.

**Mr Bennett**—Given the time today, if you would not mind if I could bring that back subsequently—all the printouts, folders and project plans.

**Senator MARK BISHOP**—I am not interested in reviewing your folders.

**Senator Hill**—No. Let me finish this one issue on the evaluation of Moorebank. We are doing a full stocktake of Moorebank, one of 20 major warehouses, although it is the largest. I was shocked to find that to do that full stocktake requires 166 persons working full time for—how many months?

**Mr Smith**—From 7 October to 31 March.

**Senator Hill**—And of course it is outdated before it is complete.

**Senator MARK BISHOP**—But to take the minister's example, you would only do that once. You are not going to spend six months of every year doing that, are you?

**Mr Smith**—We decided to re-baseline it, and that is what we did.

**Senator Hill**—But there was a quarrel with the Auditor-General as to how often that should be done.

**Mr Smith**—Yes, what is the audit requirement for 100 per cent stocktakes?

**Mr Bennett**—Again, the stocktakes in the warehouse normally need to be done on a rolling basis. To make sure that we get out of this particular problem as quickly as possible, we are doing the 100 per cent stocktake. What we will have to do subsequently, given the environment, is make sure that we do some sort of progressive mini sampling in addition, to keep on top of error rates and so forth. That can be supplemented by internal auditors as much as the warehouse officers.

**Mr Smith**—This goes down to excruciating detail. An account was given to me when I was last at Moorebank, 10 days ago, of auditors sitting on the floor counting washers, which are less than 1c each. This is an enormous amount of detail for a big warehouse. That is why it requires the input that the minister referred to.

**Mr Bennett**—If it is all right, I will come back with the Gantt chart of every project we have talked about today.

**Senator MARK BISHOP**—What is a Gantt chart?

**Mr Bennett**—The project plan, the task, the timeline, the responsible officer.

**Senator HOGG**—Can I make a minor suggestion, which might assist in the process. It is not our aim to put Defence to unnecessary work in this whole project of making it as easy and simple for both of us to understand. Maybe before you come back with a final document that you table in response to questions at estimates, we meet to see if that satisfies the requirements and then that will assist you as much as it will assist us. It just saves some argy-bargy later on. We are not looking at a complex document, I do not think.

**Senator Hill**—Even the precis is complex and complicated, but that is fine. Subject to the view of the committee, I would suggest that we work towards the tabling of these documents at the May estimates hearing. In the meantime, if the committee would like some informal meetings with officers, that is fine with me. It has even been suggested to me that you might like to visit Moorebank or some of these places to better appreciate the complexity—

**Senator HOGG**—I have visited Moorebank, so I understand—

**Senator Hill**—How many line items are at Moorebank?

**Senator HOGG**—the concept of the person sitting there counting the washers. My only worry about the 1c washers was they could be very important in holding one of our vital pieces of equipment together!

**Mr Smith**—Absolutely.

**Senator Hill**—The issue is not how many washers we have; it is what is their value.

**Senator HOGG**—Yes. They might be very valuable, even though they are worth only 1c as a line item.

**Mr Smith**—But when you have got hundreds of thousands of them, it mounts up.

**Mr Bennett**—Senator, noting that we will provide that material, as the minister has indicated in discussion, in relation to the broader question that you are asking about the reporting lines, the transparency et cetera, we provide—or are in the process of providing—a quarterly report to the Minister for Defence and the minister for finance. The independent expert will also provide an independent report in those same quarterly cycles. Internally, within Defence, we have the financial statements project board, which meets monthly. That reviews each of the projects progressively through this whole period. All work is also subject to scrutiny by the Defence Audit Committee, which is independently chaired and deputy-chaired, at which the Australian National Audit Office is also present.

We also have a process called the financial statements working group where, in the main, people at, say, the band 1 level are meeting to review the issues—any complexities or roadblocks—in each of the projects. We are trying to do that in a cycle so that nobody is caught out by any surprises before the financial statements project board. We have two project officers set up, one in CFO reporting directly to me and the secretary through the FSPB and one in DMO on the same basis. They work together. The idea of their teams of people is to rigorously review on an ongoing basis everyone's projects, everyone's activities.

What we are also doing, with help from the professional advisers, is reviewing the projects to make sure that tactically and strategically they all actually deliver the goods. So we are not just concerned about timeliness; we are concerned about effectiveness. I attend as many of those reviews with people as is possible. If there are any critical issues, they are escalated on an as-needs basis to the secretary there and then. We are also using a group that I chair called the Resource Review Group, whereby if any of the supporting financial policies or major organisational issues require debate and refinement that can be done. That tends to be at the band 2 level, in the main, or the band 1 level in the case of the services, ASRPs.

We also are reviewing progressively all the corporate governance activities, the balance sheet activities and what we call the three-on-one review process of people's ability to meet those corporate governance requirements, through the defence committee, which is chaired by the secretary and attended by all the service chiefs and deputy secretaries. The FSPB—sorry, I did not describe it before—is chaired by the secretary and attended by VCDF, the service chiefs, DMO, CSIG and me. So we have quite a comprehensive process for making sure the overarching governance frameworks, the reporting frameworks and the financial controls are remediated, as well as making sure each project is subject to that intense review by the project office, and I dare say the teams have their own review mechanisms in place as well.

**Mr Smith**—Senator, in all of this, you would appreciate that neither the resources in volume terms nor the skills are all available in the Public Service, especially in Defence. For that reason we have engaged a number of accounting firms in different parts of the work, some of it remediation, some of it quality assurance. A particular role is being played by Ernst and Young. They have a lot of experience in this work—for instance, with Telstra, which of course began, as we began, from a Public Service basis and has moved to be a corporate

enterprise. That is the journey we are on, so we have engaged Ernst and Young to help in that process.

**Senator Hill**—Ernst and Young are not only working within the process but also reporting to the secretary and separately reporting to me and the finance minister on a quarterly basis.

**Senator MARK BISHOP**—Thank you, Mr Smith.

**CHAIR**—We might take a short break.

**Senator MARK BISHOP**—Very quickly, if I can—

**CHAIR**—Certainly.

**Senator MARK BISHOP**—just to let you know where we are at: we might come back after the break and do another 15 minutes or so on the accounts and the qualifications, and then I am just going to go into routine questioning on portfolio matters.

**CHAIR**—Very good. We will take a short break and reassemble in a quarter of an hour's time.

**Proceedings suspended from 10.30 a.m. to 10.48 a.m.**

**Senator HOGG**—Mr Bennett, whilst we have welcomed the material that you have given to us this morning, could we just have a couple of quick matters clarified. We do not want lengthy explanations. That goes to the statement by the chief executive officer and the chief finance officer at 3.21, which you are familiar with. It refers to uncertainties relating to the record of value of the general stores inventory. It says that the book value of the general stores at issue is \$2.026 billion, and then that lists a number of other substantial amounts. Can you give us some idea whether that is the amount that is still at issue in this, the \$2.026 billion? How do we read this? How do we interpret it?

**Mr Bennett**—The way it is established whether there is uncertainty or not is through a sampling technique. There is a standard audit technique that is applied. It is designed to be efficient given the scale of work, and that is one of its great advantages. One of its problems for us, as it were, is that it tends to give you a pass or a fail mark. If you fail then the whole amount in question fails. So that refers to the amount in that item that has failed.

**Senator HOGG**—So that is the amount that has failed. Give us some idea of what is the pass and what is the fail. You said sampling techniques: I presume you are talking about tolerance levels and confidence levels.

**Mr Bennett**—That is right. There are error limits that they set that are based around materiality standards. The fail rate tends to be five per cent so if you have more than a five per cent error rate then you will have a fail against the population.

**Senator HOGG**—You failed on that particular item, which is \$2.026 billion. In round figures, you fail because you are out by more than a \$100 million, roughly. Is that how I interpret it?

**Mr Bennett**—The best estimate of the error was probably 10 per cent of that one.

**Senator HOGG**—Right.

**Mr Bennett**—I say 'the best estimate'.

**Senator HOGG**—The best estimate.

**Mr Bennett**—Yes. So the fail rate is five per cent but the estimate of the actual error was about 10 per cent.

**Senator HOGG**—Which is about \$200 million. So you can fail if you are out in your estimate by between \$100 million and \$200 million—and that is real money, isn't it?

**Mr Bennett**—You cannot really draw that conclusion, because of the nature of the problem. Part of the problem was that items returned from operations had not yet been put onto the system, so it may be that we were actually understating the value. In other cases, people had not recorded movement, so we may have been overstating the value. This was a case where I faced what I term a two-way error. So there was an error, there was a failure, and the nature of the error was about 10 per cent, but I could not actually put a correcting journal through to say that it was or was not overstated or understated.

**Senator HOGG**—All right. Can you tell us if the situation now has been able to clarify whether your 10 per cent fail error, if we can term it that, was in effect correct? Or have subsequent actions by you shown that it is not really 10 per cent, it is 7½ per cent, five per cent or something else?

**Mr Bennett**—I would have to say the error at that time, or as at that date, would have been that percentage, but of course through the work of the stocktaking process and then the work of the internal audit branch we are finding, to date anyway, that we are getting improved results. But at that point in time that was our best estimate of the error. Subsequent work done through the stocktaking, the MAB work, is demonstrating that some progress has been made, so error rates are coming down.

**Senator HOGG**—So I can understand the system, are you saying to us that, on an ongoing basis, you use the five per cent and/or the 10 per cent fail level, whatever it might be up to that level, to determine your success or otherwise?

**Mr Bennett**—That is my understanding of how we are judged, and that is my understanding of the materiality approach.

**Senator HOGG**—That then provides you with a trigger to say, 'We really need to take a closer look at this and try and overcome it,' or 'We understand that there are systemic problems there that we need to work through and we aim to reduce that failure rate over time.' Is that a reasonable way to put it to you?

**Mr Bennett**—It is along the lines of what we are doing, yes. In some areas where they have exceptionally good error rates of less than one per cent, they do ongoing, random, quick samples to make sure that they are on top of and minimise any potential problems.

**Senator HOGG**—All right. As I said, I do not want to dwell on this for too long. What about the \$845 million at the second dot point? That was the explosive ordnance.

**Mr Bennett**—That again goes back to the pricing issue. That was not about quantities; that was just a pricing issue.

**Dr Gumley**—And that one will be hard to fix, based on the history.

**Senator HOGG**—All right. At the third dot point, there is \$2.857 billion, so you failed there. What level did you fail at there—at five per cent?

**Mr Bennett**—Yes, again, that is the pass-fail mark.

**Senator HOGG**—Did you get to 10 per cent failure on that?

**Mr Bennett**—Again, the best estimate we have is of that order.

**Senator HOGG**—Of that order?

**Mr Bennett**—Yes.

**Senator HOGG**—Whilst five per cent is unsatisfactory, how do you view a 10 per cent fail rate? You cannot say it is twice as bad and I am not trying to imply that.

**Mr Bennett**—That is why they take the approach that at that point it is a fail, so anything beyond that point is unsatisfactory.

**Senator HOGG**—In this case, the third instance, if you are saying five per cent, my calculation says that is somewhere between \$140 million and \$285 million, and you are closer to the \$285 million variance.

**Mr Bennett**—Again part of the problem is that we do not know whether it is all one way so that it is actually within those bounds that the error may occur.

**Senator HOGG**—The land I think we have heard enough of. Does the military leave come within the five per cent to 10 per cent range?

**Mr Bennett**—It is harder for me to quote an error on that amount. This year, because we had a lot of significant remediation activity under way, it was considered not cost-effective to do a sampling exercise while that process was under way. So we just declared the value of that item as uncertain.

**Senator HOGG**—So you really cannot quantify how much the error is.

**Mr Bennett**—It was not cost-effective to determine the error rate at that point, and that was an agreed strategy from the year before.

**Senator HOGG**—This is not just a single-year problem; it has obviously been around for some time.

**Mr Bennett**—This year we will be sampling the military leave. We are looking at the exact sampling method that we will use to help us establish an absolute measure of error in that.

**Senator HOGG**—So those are the significant items where there has been a failure.

**Mr Bennett**—Yes.

**Senator HOGG**—And that is because you reached that 10 per cent level.

**Mr Bennett**—Because we exceeded the five per cent level.

**Senator HOGG**—You exceeded the five per cent but in two of the instances got to 10 per cent.

**Mr Bennett**—Our best estimate is 10 per cent.



**Senator HOGG**—That is your best estimate. And in one it just was not possible to quantify it at all.

**Mr Bennett**—Yes.

**Senator HOGG**—I do not know whether this question goes to Mr Bennett or Dr Gumley. I understand that from July the DMO will become its own agency, in effect. How will that affect what we see in the accounts? Will that be affected in any way whatsoever?

**Dr Gumley**—Yes, DMO will be entering its new life as a prescribed agency with audit qualifications and a similar type of no opinion except for audit qualifications. That is messy but it does not stop us doing the prescription of the DMO and getting on with the businesslike way we have to behave.

**Senator HOGG**—My point is, though, will the DMO accounts still be part of the overall Department of Defence accounts or will they be excised out in some way, thus adding another dimension to what we are now looking at? Will we be looking at the ballpark changing again?

**Mr Bennett**—Dr Gumley will have to report on his accounts.

**Dr Gumley**—There will be separate accounts.

**Senator HOGG**—Will we see therefore substantial amounts of money removed from within the core accounts, if I can call them that?

**Mr Smith**—Substantial values that are now on our accounts will show up on DMO's accounts.

**Senator HOGG**—Will that make it more difficult for us to trace what is happening and has been happening, and how will we cope with that?

**Mr Bennett**—The nature of the separation should be by asset class or balance sheet item, so I do not think it will make it that much more difficult to understand.

**Senator HOGG**—It is just that I have visions of when we went from a number of programs to another range of programs and we had all sorts of transitional problems in trying to interpret who owned what and where the money went. Even Defence itself had difficulties at that stage attributing the amounts to different places.

**Mr Smith**—I think that, for instance, explosive ordnance will now show up on the DMO's accounts.

**Senator HOGG**—So you are getting rid of one of your problems, Mr Smith.

**Mr Smith**—It is their problem now, Senator. In a sense I inherited it from them.

**Senator MARK BISHOP**—Would DMO be akin to something like the ABC or Telstra before it was part privatised? Would it be a completely separate, stand-alone organisation and have its own responsibilities and reporting lines?

**Mr Smith**—It will be an agency which is prescribed on a list attached to the FMA Act and, as such, it will produce separate financial statements and run separate books of account. But it will remain responsible to me under the Public Service Act. I would say that in practice we will continue to do a lot of this work together.

**Senator MARK BISHOP**—I have a couple of questions I have been asked to pursue, arising out of the evidence led by Senators Faulkner and Evans over the last couple of days. The first issue goes to Lieutenant Colonel Collins and the discussion about turning off the supply of information to INTERFET. Could I have a report on the progress or completion of Lieutenant Colonel Collins's redress of grievance process now that the Carnell report is in the hands of Defence?

**Mr Smith**—The Chief of Army is not with us today. He has handled the personnel management aspects of that redress of grievance. We thought, I am sorry, that we had dealt with his issues on Wednesday.

**Senator MARK BISHOP**—We had.

**Vice Adm. Shalders**—We can get the Deputy Chief of Army over here quite quickly. I am sure he is watching and he will be over shortly to answer that question.

**Senator MARK BISHOP**—That is fine. The other issue relates to the allegations concerning Mr Barton. I am advised that he provided a resignation letter and that is available on the *Four Corners* web site. His resignation letter was sometime towards the end of March 2004. Could we be advised whether Mr Barton was debriefed or interviewed after his resignation from the ISG and whether material from the interview or debrief arising out of his written resignation was made available for inclusion in Australian assessments of available information on weapons of mass destruction? And what did DIO do, if anything, to debrief him about his assessments and, in turn, brief the government?

**Mr Smith**—The meetings that parts of Defence had with Mr Barton after he returned to Australia and gave us his letter of 29 March we did discuss on Wednesday, but I will ask Mr Pezzullo and, if necessary, Brigadier Meekin to return to them now.

**Mr Pezzullo**—Mr Barton had a number of meetings after his return to Australia. We canvassed the one on 31 March extensively, I think, the other day. That was the one involving Ms Rowling and the group captain. That went to those issues in part. In terms of intelligence related assessments and debriefs and then his views being fed into the intelligence products that followed, which I think is the burden of your question, I might ask Brigadier Meekin to address that.

**Senator MARK BISHOP**—That debrief and interviews arising out of his letter of resignation.

**Mr Pezzullo**—Could I just be really clear. To my knowledge he had one meeting arising out of the letter of resignation, which is the one that we canvassed extensively the other day. That was on 31 March. That involved the First Assistant Secretary, International Policy, Ms Rowling, plus a group captain. That meeting was specifically about the letter of resignation dated 29 March, which I think you referred to as being on a web site. I thought I also heard you make reference to meetings involving assessments or views about the matter that the ISG was deployed for—namely weapons of mass destruction research. I thought I heard you make reference to other meetings pertaining to that.

**Senator MARK BISHOP**—I will give you the question again.

**Mr Pezzullo**—I would appreciate that.

**Senator MARK BISHOP**—The question I asked was: arising out of Mr Barton's resignation letter, was Mr Barton debriefed or interviewed after his resignation from the ISG, and was any debriefing or interview material included in Australian assessments of available information on WMD? That is the first question. The second question is: what did DIO do, if anything, to debrief him about his assessments and, in turn, brief the government?

**Senator Hill**—I am confused as to exactly what you are wanting. We talked extensively about his debriefing with Ms Rowling and the group captain on the 31st. We also mentioned in evidence the other day that he participated in a roundtable or maybe he was the principal participant in a roundtable that involved a number of agencies. That, I assume, was principally addressed to the whole issue of the work of the ISG in relation to weapons of mass destruction. That was a few days later, I think.

**Mr Pezzullo**—As I recall from my research—and Brigadier Meekin will speak to the DIO elements of this—there were a series of meetings that Mr Barton had with different agencies in the, let us say, week to 10 days following his return. I am not going here to the 31 March meeting, which was specifically about his resignation letter. He also met with intelligence officials who had an interest in weapons of mass destruction. I know the DIO spoke to him, and maybe Brigadier Meekin can speak to that. Is that where your question is going to?

**Senator MARK BISHOP**—It is, yes.

**Senator Hill**—There was the roundtable with a range of agencies. On what date was that?

**Mr Pezzullo**—There was certainly a roundtable in early April that Mr Barton told me about. Brigadier Meekin just informs me that there was certainly a DIO specific one on 30 March. So there are at least two there. I think that is what you are going to.

**Senator MARK BISHOP**—That is exactly what I am going to—those meetings arising out of his letter of resignation, the nature of the debrief, whether it went to Australian assessments of available information on WMD and whether the debrief by DIO was passed up the chain to the government.

**Senator Hill**—Brigadier Meekin, can you help us with this?

**Brig. Meekin**—Certainly. On 30 March, Mr Rod Barton volunteered to come to DIO, and a debrief—a roundtable discussion—occurred. I have seen the notes of that. I do not have them with me. They were highly classified. The debrief was with a number of members of the Defence Intelligence Organisation and another agency. The essence of the debrief, from the notes that I have seen, is that it discussed the nature of investigations of the ISG in Iraq, in particular dealing with programs of the former regime. To the best of my knowledge, there was no discussion of the circumstances of his resignation.

**Senator Hill**—Were there any other debriefs with him that you know of?

**Brig. Meekin**—I believe there was a debrief conducted during April, not at the Defence Intelligence Organisation but with another intelligence agency.

**Senator MARK BISHOP**—Can you give me a report on that debrief?

**Brig. Meekin**—No, I cannot. I did not attend and I have not seen notes from that debrief.

**Senator MARK BISHOP**—So you are just aware that there was another debrief with another intelligence agency.

**Mr Pezzullo**—I think I can assist with that. You will recall that in evidence on Wednesday I made mention of the agreed record of interview that Mr Barton and I reached on 18 June. That made reference to the meeting that we have just talked about again, which discussed the circumstances of his resignation with Ms Rowling and the group captain. I think in evidence you will find that I said that there was a roundtable in the early part of April involving another agency, which I think I described as being not within the Defence portfolio.

**Senator Hill**—You are saying the same thing. Senator Bishop is no more enlightened as to where that other meeting took place or who attended or what business it had before it.

**Senator MARK BISHOP**—All I have heard you say is that there was another debrief with another agency.

**Senator Hill**—It sounds as if there was a DIO debrief on weapons issues and there was another debrief in another agency, presumably on the same issues.

**Senator MARK BISHOP**—Was it on the same issues, Mr Pezzullo?

**Mr Pezzullo**—As Mr Barton has described it to me, yes.

**Senator MARK BISHOP**—So there are two debriefs: one to DIO and one to another agency, both relating to weapons issues arising out of his time in Iraq.

**Mr Pezzullo**—I can only speak directly to the DIO one that Brigadier Meekin has just described.

**Senator Hill**—That is what Brigadier Meekin said in relation to the DIO one and that is what Mr Barton apparently said to Mr Pezzullo in relation to the mysterious third agency.

**Senator MARK BISHOP**—Mr Barton told you that?

**Mr Pezzullo**—Yes.

**Senator MARK BISHOP**—Is there a reason why we are not naming this other agency that I am not aware of?

**Senator HOGG**—The mysterious third agency.

**Senator MARK BISHOP**—Who was it?

**Mr Pezzullo**—It is not an agency in the Defence portfolio, and I am an official of the Defence portfolio.

**Senator MARK BISHOP**—Mr Barton informed Mr Pezzullo that he voluntarily attended and briefed another agency.

**Senator FERGUSON**—That does not mean that he has to tell you; it is outside his portfolio.

**Senator MARK BISHOP**—Mr Barton briefed Mr Pezzullo in Mr Pezzullo's capacity as an officer of the defence forces on defence matters. So it is properly a matter for me to ask: what was the name of the other agency?

**Mr Pezzullo**—I will seek guidance on that from a more senior authority. It is referred to in a classified statement of interview that we went through on Wednesday. As I recall, I went through the relevant passage and at the appropriate time indicated an Australian agency.

**Senator HOGG**—How long will it take you to find out whether or not you will be able to divulge the mysterious third agency?

**Mr Pezzullo**—The answer to that lies slightly to my left.

**Senator HOGG**—‘Slightly’ is not well defined.

**Senator Hill**—I do not think that it is a big issue, but I think we should ask the other agency whether they wish to be disclosed.

**Senator HOGG**—You have it on notice.

**Senator Hill**—Somebody can pursue that with the other agency and let us know.

**Senator MARK BISHOP**—Brigadier Meekin, going to the briefing that DIO enjoyed with Mr Barton, that went to his assessments on available information concerning weapons of mass destruction?

**Brig. Meekin**—That is correct.

**Senator MARK BISHOP**—In turn, was that material passed up the line to the government?

**Brig. Meekin**—That material provided by Mr Barton—along with other material provided by other people who had been to the ISG and material we had provided to us by our allies who were involved in the ISG—formed the basis of assessments of the Defence Intelligence Organisation. They of course are distributed to government as well as a large range of customers within the Australian Defence Force and the Australian Defence Organisation.

**Senator MARK BISHOP**—So all of the material from the various sources was put together and has since been provided to the government.

**Brig. Meekin**—That is correct.

**Senator MARK BISHOP**—Thank you. I want to turn to the matter of consultants in the AR. Mr Smith, I think the AR says that the ADF spent \$201 million this year on 2,311 professional service providers and that Defence has now set a new maximum target of 360 professional service providers for the 2004-05 reporting period. What is the significance of the figure 360, if any?

**Mr Smith**—What is the significance of the figure?

**Senator MARK BISHOP**—Yes. Why is it 360 and not any other figure?

**Mr Bennett**—The general principle of the PSP number is that we have tried to establish what our total work force in any one year should be, be it full-time equivalents or professional service providers, so that in effect we can set limits on what the work force should be as our control measure.

**Senator MARK BISHOP**—It is a cap measure, is it?

**Mr Bennett**—Yes. The advantage of it is that it gives groups some flexibility, so if they have a short-term requirement for specialist skills via a PSP they can bring those on board.

**Mr Smith**—PSP is a private service provider.

**Mr Bennett**—Hopefully, over time we can skill up people and therefore remove the need for the PSP and convert that into a full-time equivalent so it is an effective work force size.

**Senator MARK BISHOP**—Have you taken any particular steps to implement this figure so that the target is attained?

**Mr Bennett**—Yes, each group has what we loosely term a work force bucket or a set of parameters, and they are measured against the total work force against each of those categories.

**Senator MARK BISHOP**—For example, if my particular work force group has got 5,000 employees—that is, 10 per cent of total employment—am I entitled to 10 per cent of PSPs? Is that the sort of approach we are talking about?

**Mr Bennett**—Yes, out of the total work force a certain number are described as PSPs. That is what you have needed to date, so we have that rolling plan but we do allow people to convert over time between the two classes to give the group head or whoever some discretion in the nature of the work force.

**Senator MARK BISHOP**—Is Defence monitoring the number of PSPs it has contracted to this since the commencement of the 2004-05 reporting period?

**Mr Bennett**—Again, we are certainly monitoring the total work force, so I assume that means we must be monitoring the PSPs. I think we do it in terms of a dollar average to estimate who the PSP is because they can be very short-term engagements.

**Mr Veitch**—The concept of the total work force is numbers of military, civilian and PSP work force allocated to each of our groups. Those targets are reviewed every year in the Defence work force plan. We agree on new numbers for the year and the future 10 years. The PSPs and the civilian staff numbers have been subject to a savings program where certain reduction targets have been set, and the achievement of those targets are reviewed on a quarterly basis by the Defence committee. Overall, our work force numbers are pretty much in order with the savings plans that we have put in place and, in the case of PSPs and civilian staff, they are tracking down to the targets we have set to start next financial year.

**Senator MARK BISHOP**—Do you have any idea of the number of PSPs that have been contracted to date?

**Mr Veitch**—When we talk about measuring PSPs, we measure them in full-time equivalent years. So if four PSPs were with us for three months, we count that as one full year equivalent. From a baseline back in 2003-04 where we had about 2,300 full-time equivalents that has trended down and the target we have set to go into next year is about 1,689 full-time equivalents. I must stress that that could mean you have got more on your books for the year for shorter periods.

**Senator MARK BISHOP**—Can you give the committee any information on the accumulated value of such contracts?

**Mr Veitch**—We have spent of the order of \$200 million on PSPs this last financial year and of a similar order the previous financial year. That is down from a number of about \$30 million higher than that back in 2002-03. When you allow for things like a reclassification of the health service providers, who are now counted in this classification, the underlying savings compared to what we spent two years ago in 2002-03 is more substantial than that.

**Senator MARK BISHOP**—So your numbers are trending down and you are intending to keep them trending down. You say the gross has come off about \$30 million over the last three years. What are your forecast figures for next financial year in terms of the gross spend?

**Mr Veitch**—I do not have the figures with me, but because there is an underlying reduction of about 1½ percentage points in real terms I would speculate the number is of the order of \$198 million—something like that.

**Senator MARK BISHOP**—Why is there an underlying reduction of 1½ per cent?

**Mr Veitch**—The savings targets we set three years ago in both the civilian and the military work force were for 1½ per cent real reduction per year for three years.

**Senator MARK BISHOP**—So these PSPs are not consultants that are contracted to do a particular job?

**Mr Veitch**—No, they are not. You might think of a consultant as someone who comes in and advises us where we have a lack of specialist skills or knowledge on a particular subject. They come in for a short term, do a review and come up with some recommendations that senior management would act upon or not. In the case of PSPs, they are more filling line positions and mostly in the case of Public Service positions (a) where we have not got sufficient people because of recruiting difficulties and the like or (b) because we cannot recruit people with those similar skills. So you will find that the PSPs tend to be in areas like IT support, project management, financial management and areas that reflect continuing pressure in the wider labour market in Australia.

**Senator MARK BISHOP**—But for all intents and purposes they are employees?

**Mr Veitch**—We treat them as if they are employees. We have a concept of a total work force between the civilian element and the PSPs. We have a policy where group heads can elect to come to our personnel area and to us in the CFO group, and they can change interchangeably between the two, provided the overall numbers do not exceed the savings targets. We have a conscious policy at the moment to substitute PSPs with more cost-effective public servants. We generally find we can get the public servant—if we can grow them and get the skills—at about half the price, so it is a cost-effective measure for us to, over time, reduce the PSPs. But I must stress that, given the demographic factors and the pressure on the labour market, this is something that we will not be able to substitute all positions in a reasonable time frame. I think we will always have some reliance on PSPs.

**Senator HOGG**—When you say ‘at half the price’, is that at half the salary cost or is that with all on-costs as well?

**Mr Veitch**—Things average out. Half is probably only an approximation. Some, for example, with particular financial or personnel skills—

**Senator HOGG**—Right, but it is a substantial saving.

**Mr Veitch**—and in the health services. There is no doubt in particular areas that a public servant costs a whole lot less than a PSP.

**Senator MARK BISHOP**—Thank you, Mr Veitch.

**Vice Adm. Shalders**—I wonder if it might be possible to return to that question on the redress of grievance? The Chief of Army is available if you are happy to take that one again.

**Senator MARK BISHOP**—Thank you, General Leahy, for coming in. It is appreciated.

**Lt Gen. Leahy**—It is a pleasure. I only briefly heard your question on the television, so if you would not mind repeating it—

**Senator MARK BISHOP**—The question was: could you give us an update on the progress or completion of Lieutenant Colonel Collins's redress of grievance process now that the Carnell report is in the hands of Defence?

**Lt Gen. Leahy**—There are two elements to the redress—

**Senator Hill**—It is a separate process to Carnell.

**Lt Gen. Leahy**—Yes, and I was about to say that—

**Senator Hill**—Lieutenant Colonel Collins adopted two parallel processes of complaint or concern. One was through the Army chain of command, which is the grievance process. The other is what I might describe as a political process of wanting his concerns reviewed. That has ended up in the Carnell report, but the grievance process is entirely separate and distinct.

**Senator MARK BISHOP**—Thank you, Minister.

**Lt Gen. Leahy**—The aspects of the complaints from Lieutenant Colonel Collins in relation to Army deal with his career management, with reports and postings and those sorts of matters. I would loosely call those career management issues. Army have been dealing with those things and, as the minister has pointed out, the separate issues have not been our responsibility. With regard to his redress of grievance for career management, I can detail that we have closed the redress of grievance and the career management recommendations have been completed with only one exception, and that relates to the finalisation of a performance appraisal report. I expect that to be finalised very soon. We have been able to make some adjustments to our career management processes that have generally satisfied Lieutenant Colonel Collins. I have spoken and corresponded with him on a number of occasions in relation to his career management and, as I said, the matter is now closed as far as we are concerned.

**Senator MARK BISHOP**—Does Lieutenant Colonel Collins regard the matter as closed in terms of his complaint about the grievance process?

**Lt Gen. Leahy**—My understanding is that he acknowledges that Army have done what we undertook to do in relation to his career management. I wait for any further correspondence from him in relation to his view—and perhaps you need to get it clearly from him—of whether the matter is closed. There is little more that Army can do in relation to his career management.

**Senator MARK BISHOP**—Has he indicated to you that he accepts the validity of your findings?



**Lt Gen. Leahy**—It is difficult to characterise across a number of aspects of career management, but I think he acknowledges that we have rectified some faults that were there. He would acknowledge that some changes have been made to our systems, that he now has a full list of reports and that he is now able to be assessed along with his peers. That is in relation to his future performance, his future postings and, possibly, promotions.

**Senator MARK BISHOP**—As far as Army is concerned, the complaint was made, the investigation has been conducted, the report has been made, Lieutenant Colonel Collins acknowledges that process has concluded and that is the end of the matter.

**Lt Gen. Leahy**—I do not think I would say that it is the end of the matter. I would say that the part within the process that Army are responsible for has been completed. Lieutenant Colonel Collins has, as all of our officers and soldiers have, a number of other avenues of redress or questioning available to him and it is now to Lieutenant Colonel Collins if he is in any way dissatisfied with these matters. There are other avenues through which he could further pursue his dissatisfaction. We have not heard of those yet.

**Senator MARK BISHOP**—Understood. Thank you. I turn now to Air Force questions on the F111 deseal/reseal project.

**Vice Adm. Shalders**—Just while the Chief of Air Force is coming to the table, I have an answer to a question asked yesterday by Senator Faulkner. Would it be convenient to pass that on now?

**CHAIR**—Certainly.

**Vice Adm. Shalders**—Senator Faulkner asked what the crew of HMAS *Kanimbla* were told about the duration of their deployment in support of Operation Sumatra Assist. The response to the question is that on the first day of their preparations, which was 30 December, the ship was told to be self-sufficient for 30 days as the duration of the deployment was not known at that time. On 4 January they received further formal advice which indicated that the commitment to Sumatra Assist was planned for 90 days. This was passed on to the ship's company through a command brief, where it was also mentioned that a review would be conducted after 30 days. At that time, 4 January, we did not know how long the deployment would last. On 4 January the ship was between Sydney and Darwin.

The ship's company on board have had that information repeated to them on a number of occasions by the ships commanding officer whilst they have been on station. In response to the many inquiries the Defence Community Organisation have received, they have been advising families that there is no finalised return date. Similarly, our National Welfare Coordination Centre has received a number of calls from families and their advice is that the duration of the deployment is unknown and it could extend to 90 days. I think that answers Senator Faulkner's question.

**Senator MARK BISHOP**—Thank you, Admiral.

**Lt Gen. Leahy**—On Wednesday Senator Bishop asked me a question about alleged Australian mass graves at Fromelles. Senator, you asked me if we could come back on Friday with some more information. Unfortunately, I cannot update you any more substantially than I did on Wednesday. Certainly, we take the information you provided in the letter to the

minister on 10 February very seriously. I will take it on notice and pursue the matters. Certainly, I will keep you informed as well.

**Senator MARK BISHOP**—Thank you, General. Air Marshal Houston, two or three days ago I had some discussions in DVA on the progress of the deseal/reseal project. That was a useful discussion. We were brought up to date. I have a couple of supplementary matters that I have been asked to pursue arising out of that. My understanding is that the government has decided to go down the path of making individual settlements to those persons who have the basis of a claim. Have any figures been determined as yet as to what the benefit might be?

**Air Marshal Houston**—What is being offered here is a lump sum benefit for exposure. In addition to that, people will have access to the statutory compensation schemes, be they Commonwealth or state. There is also the health screening proposal at a cost of \$2.1 million over five years, which will monitor the health of the various people who have registered with our advocate in Amberley.

**Senator MARK BISHOP**—Has any figure yet been determined by government for the lump sum benefit for exposure?

**Air Marshal Houston**—No figure has been determined yet. The work is ongoing. Defence and Veterans' Affairs are working on it and in due course proposals will be made to government.

**Senator MARK BISHOP**—Are you considering—tell me if this is out of line—gradations of benefit for seriousness or otherwise of exposure? Is that a path you are going down?

**Air Marshal Houston**—That has all got to be worked out. I would not want to pre-empt the process. It is a very exhaustive process that people are going through. Fairly soon proposals will be put to government.

**Senator MARK BISHOP**—There is some urgency about this?

**Air Marshal Houston**—Absolutely. The government has made it very clear to both departments that it would like us to come forth with the recommendations as soon as possible.

**Senator MARK BISHOP**—You have to work out the nitty-gritty of the scheme to be signed off by the government, then put it in place. That nitty-gritty will go to issues of levels of compensation, the notification and application processes, where people should make application, times of the payment and all that sort of material?

**Air Marshal Houston**—Again, I would say that the offer of lump sums is in recognition of exposure. It is separate to the compensation. The compensation will be available through the normal processes. Obviously after the health study there is now more information out there for people to access the compensation schemes with reference to the health study.

**Senator MARK BISHOP**—I am sorry if I misled you, but I am only talking now about the lump sum benefit for exposure. I am not talking about rights that exist under the compensation. What I am hearing you say is that you have got some sort of committee working on the detail and that that is not yet concluded. When it is it has to go to ministers for sign off and there will then be a process of public dissemination of necessary information. Is that correct?

**Air Marshal Houston**—Absolutely, and I would say in addition that obviously the interim health scheme will continue until essentially all of these matters are concluded. I will continue to do what I have done since September 2001—every six months or when there is a major development I go and talk to the various people who have been affected by this process to explain to them exactly what is going on.

**Senator MARK BISHOP**—You entered into a negotiated resolution of a matter with Mr Nathan Moore some time ago. Part of that negotiated settlement, as I recall from press reports, was that there were confidentiality agreements binding upon you, the Air Force and Mr Moore. Is that correct?

**Air Marshal Houston**—That is correct. Through most of last year there was a facilitated process that was done under the auspices of Tony Fitzgerald. There were three meetings and we reached a mutually acceptable outcome. Nathan Moore is happy and we are happy, and the terms of the agreement are confidential. I would not like to go into any detail on that in this forum but, suffice it to say, all outstanding matters have been resolved.

**Senator MARK BISHOP**—I understand that. Would it be possible for me or my office to receive a confidential briefing on the nature of that settlement?

**Air Marshal Houston**—I will check on that—provided Nathan Moore is happy with that, yes, we would be delighted to do that.

**Senator MARK BISHOP**—I think it is only fair to say that that is subject to both his knowledge and his specific approval. If you could contact him and arrange for his permission and then contact my office to do a confidential briefing, that would be good. I am receiving reports of some allegations arising out of that settlement. I do not want to go into that in a public way for the same reasons you have outlined. Is that possible?

**Air Marshal Houston**—I would be delighted.

**Senator MARK BISHOP**—Thank you. I want to turn now to some property disposals—in particular, Broodseinde barracks in Ballarat, defence estate at Maribyrnong in Victoria and a few other sundry issues.

**Air Marshal Houston**—I will ask Mr Henderson as the Deputy Secretary of Corporate Services, Mr Geoff Beck and Ms Chris Bee to assist in that.

**Senator MARK BISHOP**—Ms Bee and Mr Beck, can you give me an update on the disposal of the barracks down there in Ballarat—a time line for the sale; details of any ground contamination, whether there is any environmental review going on and future restrictions or caveats on the land; and other alternatives under review or consideration in terms of disposal of the land, such as gifting to local communities and those sorts of things?

**Ms Bee**—The Defence site, Broodseinde barracks, at Ballarat—marketing commenced late January 2005. With the marketing process, tenders close on 11 March.

**Senator MARK BISHOP**—What is the marketing process?

**Ms Bee**—We placed it in the hands of a marketing agent, so there has been advertising done. There is due diligence material provided to prospective purchasers. They then submit a

tender outlining their prices. Those tenders are to be received by the marketing agent on 11 March. They are then evaluated by Defence.

**Senator MARK BISHOP**—The marketing process is a process of obtaining tenders for sale from interested parties, is it? Can

**Ms Bee**—Indeed. It is a very standard way of selling commercial property.

**Senator MARK BISHOP**—So you are asking for bids for the land. Is that what you are doing?

**Ms Bee**—Indeed.

**Senator MARK BISHOP**—Is the department aware of any ground contamination that has occurred there?

**Ms Bee**—No. We did undertake environmental studies and there are no concerns in terms of contamination. There are no environmental issues in relation to the property.

**Senator MARK BISHOP**—Which firm did the environmental review for you?

**Ms Bee**—We engaged SKM.

**Senator MARK BISHOP**—Out of Melbourne?

**Ms Bee**—They are certainly out of Victoria.

**Senator MARK BISHOP**—When was the close tender date?

**Ms Bee**—11 March.

**Senator MARK BISHOP**—How big is the land in question?

**Ms Bee**—It is 5.1 hectares.

**Senator MARK BISHOP**—It is quite significant, then. One of the parliamentary secretaries looks after this area, doesn't she?

**Ms Bee**—Indeed. The Parliamentary Secretary to the Minister for Defence, Teresa Gambaro, is responsible for property matters.

**Senator MARK BISHOP**—Has the government made a decision to sell the property or does the option of donating the property to a community organisation or school still exist?

**Ms Bee**—Until the tenders are evaluated and the government decides what to do, those options are open. In terms of the process that is being followed to date, the defence units that were on the site moved to a newly constructed multi-user depot elsewhere in Ballarat in late 2003. Defence from that time on has had no requirement for the site. It is surplus to our requirements. In line with the Commonwealth Property Disposals Policy, Defence, like all other Commonwealth agencies, is required to sell surplus property. The disposals policy sets out that surplus property is to be sold on the open market with one exception: that we can negotiate with what is called a priority sale—which basically means not going to the open market—with state government agencies, local councils or Commonwealth funded agencies. For this particular property, in August last year, Defence wrote to the local council, Ballarat City Council, advised that the property was surplus to Defence requirements and, in line with the disposals policy, that we would be selling the property. We asked whether the council was

interested in submitting a priority sale submission. Council did not take up the offer. Indeed the council has indicated that they support residential development of the site. We also did write to the local school that is next door advising again that the property was surplus to Defence requirements and that we would be proceeding to sell the property.

**Senator MARK BISHOP**—Do you have an indicative value for the site?

**Ms Bee**—We do, but, given that we are in the middle of a marketing campaign and a tender, it would not be appropriate to speculate.

**Mr Henderson**—Could I just elaborate on one point. Ms Bee drew the distinction between open market sales and priority sales, but the basis for priority sales is market value as well. We just do not go to an open tender situation. If we have a priority sale with a state or local government, it is on the basis of market value.

**Senator MARK BISHOP**—It has been suggested to me that the department said that it would gift the land to the local college. Are you aware of that allegation in discussions, Ms Bee?

**Ms Bee**—Not at all. As I indicated before, in August we wrote to the school saying that the property was surplus to defence requirements and we would be selling it.

**Senator MARK BISHOP**—Thank you.

**Senator HOGG**—Just on the use of the land prior to 2003, was it solely restricted to military use or was there a community usage of it—the whole of it or part thereof?

**Ms Bee**—It was defence property for defence purposes. However, we did license the use of the oval that is part of the site to the school.

**Senator HOGG**—Was that prior to 2003, when the military left, or was it post that? That is what I am trying to establish.

**Ms Bee**—The school continued to be able to use the oval under a licence until mid-2004, when Defence initiated the disposal process. As part of that, we advised the school that, because the property would be sold, we would be terminating the licence and it would be a matter for the school to then take it forward in terms of the fate of the property.

**Senator HOGG**—Prior to 2003, for what period did the school have use of the oval? Was it five years, 10 years, 20 years? Was it long-term use?

**Ms Bee**—That I do not know.

**Senator HOGG**—Can you take that on notice please and find out whether there was a long-term agreement that there was a usage offered to the local school. Also, were the local school and/or the Ballarat council aware of what a priority sale means in the normal sense of business?

**Ms Bee**—The priority sale is not open for the school per se. It is a matter for either a state government agency or a local council. In writing to the local council, we did provide material explaining the priority sale.

**Senator HOGG**—Did they make any inquiry about the processes involved for a priority sale?

**Ms Bee**—No, they did not.

**Senator HOGG**—What about the state government?

**Ms Bee**—No, we have had no inquiries from the state government in relation to the property.

**Senator HOGG**—But they have been informed?

**Ms Bee**—No. We wrote to the city council.

**Senator HOGG**—Just the city council.

**Ms Bee**—Just the city council.

**Senator HOGG**—Is there any historical value in any of the land involved—not necessarily the whole of the site, but perhaps part of the site?

**Ms Bee**—A couple of the buildings are of a local significance. One was relocated from another site and we are in the process of relocating that to the new barracks, the multi-user depot. There is also on the site a mullock heap that dates back to the mining back in the mid-19th century, and the council is conscious that that will need to be taken into account in any future development of the site.

**Senator MARK BISHOP**—Are there any caveats on that land that you are aware of?

**Ms Bee**—What do you mean by caveats?

**Senator MARK BISHOP**—That restrict the use of the land or access to it.

**Ms Bee**—Not as far as I am aware. The site is zoned Commonwealth purposes. Once it is sold, the purchaser will need to seek a rezoning with the council. Those sorts of issues are really matters for the local council to take into account in that process.

**Senator MARK BISHOP**—Can we turn now to the defence estate in Maribyrnong? Can you provide an update of the process for the sale there?

**Mr Henderson**—I can give you a brief update. We are negotiating with VicUrban, which is owned by the Victorian state government. As the name suggests, they are into urban redevelopment. I think at one stage they were involved with the redevelopment of docklands. We are in a priority sale negotiation process with them. They put a proposal to us in April last year. There were a number of elements of that which we were not satisfied with and they are due to put a second detailed proposal to us early in March.

**Senator HOGG**—How long has this proposal been going on?

**Mr Henderson**—For some years.

**Senator HOGG**—That is why I am asking. It is my recollection this has been canvassed at earlier estimates.

**Mr Henderson**—Yes, it certainly has. That reflects a number of factors, including the very valuable heritage sites within that Maribyrnong site as well as serious contamination issues that will have to be addressed. We have been working through those issues with the relevant authorities.

**Senator HOGG**—So have the remediation issues been addressed? Have they been concluded—let me put it that way. I know they have been addressed, but have they been brought to a conclusion?

**Mr Henderson**—No. They have not been concluded in the sense of being sorted out, but let us put it this way—the extent of the challenge to remediate the site to an acceptable level is much better understood now.

**Senator HOGG**—Refresh my memory as to how long this process has been going on.

**Ms Bee**—The former Parliamentary Secretary to the Minister for Defence, the Hon. Fran Bailey, and the Victorian Minister for Major Projects issued a media release on 20 February 2004 announcing that the Commonwealth and the Victorian government were entering into priority sale negotiations for the site.

**Senator HOGG**—But I think there were questions raised about the site even prior to that, and I think they go to the issue of the remediation of the site.

**Ms Bee**—It is a very large site—

**Senator HOGG**—Yes. I know the site.

**Ms Bee**—and a very complex site. Defence certainly has been working on its disposal for a number of years. In terms of the remediation, over a number of years we have done extensive studies on the site and we now have a good understanding of the contamination there. It is a contaminated site, given what it was used for over an extended period of time. We have been developing remediation plans in very close consultation with the Victorian EPA. We are very conscious that they will be the approving authority for all of the remediation that is conducted and it will need to pass very close scrutiny from them as it is being done and when it is completed. The final remediation plans, though, will not be able to be settled until the future use of the site is clear and, in particular, the future use of particular aspects of the site, because the level of remediation differs for whether it is to be used for residential purposes, commercial purposes, open space or whatever. So it is actually a very long and complex process, but we are getting towards the end of it, if you like.

**Senator HOGG**—When do you expect it will end? What sort of time frame are you working to?

**Mr Henderson**—We will need to evaluate the revised proposal that VicUrban present us with early in March and then we will need to advise.

**Senator HOGG**—I am just after a ballpark figure. Are you looking at 12 months hence or is this something that still has maybe two years to play out? I am not going to hold you to it. We are just trying to get some sort of idea.

**Mr Henderson**—We will certainly be still working on this for the rest of this calendar year. If we, the government, the parliamentary secretary and the minister are not satisfied with VicUrban's offer then we will go to the open market.

**Senator MARK BISHOP**—You have said that VicUrban put a proposal to you last April and they are now going to put a new proposal in early March. What was the problem with their first proposal? Is that confidential?

**Mr Henderson**—Maybe Ms Bee can sketch out some of the issues.

**Senator MARK BISHOP**—Just the headlines, Ms Bee.

**Ms Bee**—As you would appreciate, because of the nature of the site it is a very complex process in terms of each side understanding the site and its future potential and because it is overlaid with, shall we say, commercial negotiations. There have been very detailed analysis and ongoing consultations and negotiations between the two government agencies addressing a range of issues, certainly the commercial side of things in terms of the financial transactions, and future use of the site. The key issue has been the risks to be borne by each side in future development of the property. Because of its size and, if you like, its importance as a key site in inner Melbourne, it actually is an extremely complex sale.

**Senator MARK BISHOP**—We should have a brief discussion about the payment of legal costs associated with the West Australian medical board and Dr McKenzie. Mr Cunliffe, in the findings of the West Australian board against Dr McKenzie did Dr McKenzie pay the fine of \$10,000 imposed on him or did the Department of Defence pay all or part of it?

**Mr Cunliffe**—Defence and the Commonwealth did not meet the costs of the fine.

**Senator MARK BISHOP**—Did not meet any of the costs of the fine imposed on Dr McKenzie?

**Mr Cunliffe**—The \$10,000 was not an amount that we met.

**Senator MARK BISHOP**—The board also ordered Dr McKenzie to pay 75 per cent of the board's legal costs. Do you know what that amounted to?

**Mr Cunliffe**—The amount which was advised to us as being ordered—and we of course were not a party to the matter, I stress, so our advice is at arm's length—was a figure of \$75,000.

**Senator MARK BISHOP**—And Dr McKenzie was ordered to pay 75 per cent of that \$75,000.

**Mr Cunliffe**—I think that figure is the 75 per cent. My understanding is that the figure that was expected of him was the \$75,000.

**Senator MARK BISHOP**—How much of that did Defence pay?

**Mr Cunliffe**—\$60,000.

**Senator MARK BISHOP**—Phillips Fox billed the department for, I am advised, 1,178½ hours for its services in defending Dr McKenzie. What was the cost of that?

**Mr Cunliffe**—I do not have a breakdown of the costs and I am not sure if that was the final number of hours or a report at a certain stage. The total cost of legal services which were met under the provisions of the Legal Services Directions was a figure of a little over \$377,000.

**Senator MARK BISHOP**—Was that all for Dr McKenzie or were there other legal costs?

**Mr Cunliffe**—That all related to the provisions on behalf of Dr McKenzie.

**Senator MARK BISHOP**—Is Defence aware of the costs of the female victim officer in this case?



**Mr Cunliffe**—No.

**Senator MARK BISHOP**—Has Defence met any of the costs of the female victim officer in this case?

**Mr Cunliffe**—No.

**Senator MARK BISHOP**—Why is that?

**Mr Cunliffe**—In relation to this case, the female victim officer, as you have described her, was not a party to the matter. Therefore, the provisions of the legal service directions do not come into play.

**Senator MARK BISHOP**—So do you have to be a party?

**Mr Cunliffe**—As I read the directions, the situation of a witness is that, even though she was a complainant—the matter may have flowed from her complaint—the actual proceedings were not brought by her. They were brought by the medical board.

**Senator Hill**—Perhaps you should just explain what the legal directions are—what their status is.

**Mr Cunliffe**—Certainly. In fact, I have a copy of appendix E of the Legal Services Directions, which I am happy to hand up if that would help. The Attorney-General issues those Legal Services Directions under the Judiciary Act. We are, as Commonwealth agencies generally are, required to comply with them. They set out a range of issues ranging from the Commonwealth being a model litigant to other issues such as the provision of assistance to those in Commonwealth employment who are the subject of matters, criminal or civil. Perhaps I could make that available to the committee.

**Senator MARK BISHOP**—So with regard to a person whom an officer of the Commonwealth—who is a complainant and who makes the complaint—makes a complaint about, it is proper under the legal service directions for his or her costs to be met in whole or part but not the costs of the complainant who initiates the action. Is that correct?

**Mr Cunliffe**—I do not wish to get into a broad brush characterisation of any particular set of circumstances. It is not uncommon among legal disciplinary tribunals—I understand medical but certainly legal—that a member of the public, for instance—to take it out of this particular example—may make a complaint about a lawyer's behaviour or fee charges or whatever. The Law Society or Bar Association, or whatever it might be within the jurisdiction, will then consider whether the matter raises sufficient cause for concern. If so, in general, the procedure that then results is brought by the association or the Bar Society or the Law Society or the Law Council. It is not like a civil matter, where you may sue me or some other person may sue me and therefore we are both parties. So those distinctions are quite significant, as you will read if you wish to make your way through appendix E in the Attorney's directions.

**Senator MARK BISHOP**—So they were not paid because she was not a party. Has she made an application for reimbursement of her costs?

**Mr Cunliffe**—There have been a number of applications, as I understand it, in relation to several situations which have not come up in circumstances which at least appear to us to meet the terms of the directions. When you describe them as her costs, I guess that is getting

into the individual circumstances. Perhaps it would be better not to go there. But, on the application of those directions, they have not seemed to be appropriately met by the application of those directions.

**Senator MARK BISHOP**—That is satisfactory. Thank you, Mr Cunliffe.

We might return now to the DMO for some questioning. Dr Gumley, I have a general question at the outset. Earlier you said that your start date for separation was 1 July. Will you meet that deadline on 1 July?

**Dr Gumley**—Yes. We are on track for that date.

**Senator MARK BISHOP**—What stage are you at with the implementation of the Kinnaird review? I think last December you said that at that stage you were about 60 per cent on top of it. What progress had been made since then?

**Dr Gumley**—I suspect we are around about the 75 per cent mark now. It is moving ahead quite nicely.

**Senator MARK BISHOP**—You have a timetable and schedule. Are you meeting that timetable?

**Dr Gumley**—Yes.

**Mr Smith**—The Kinnaird report embraced more than just the DMO. It covered other parts of the organisation and that is well advanced too.

**Senator MARK BISHOP**—I was interested at this stage in the DMO's interest in the Kinnaird report. What is the nature of the relationship between the DMO and the Capability Development Group?

**Dr Gumley**—The Capability Development Group specify the requirements. We are the procurement agency to go and get those requirements.

**Senator MARK BISHOP**—So you implement their decisions, to put it in a very simplistic way.

**Dr Gumley**—We do not decide what capability is needed for the ADF. The Capability Development Group and the various committees in Defence make those decisions. Once the decision is made to go and acquire a capability, it is our job to do that and then it is our job to look after it whole of life. Once we have a platform in service or something else we maintain it for the next 20 or 30 years.

**Senator MARK BISHOP**—Have any potential areas of conflict been identified between DMO and the Capability Development Group?

**Dr Gumley**—I have not seen any.

**Mr Smith**—I could say in that regard, on behalf of the rest of the organisation, that the relationship between Lieutenant General Hurley, who heads the capability group, and Dr Gumley is absolutely first rate. It is exactly what we would want.

**Senator Hill**—They even sit together!

**Senator MARK BISHOP**—Welcome, General. Has there been any suggestion that there is a misalignment or a lack of alignment between the work of the Capability Development Group and the project acquisition phases?

**Dr Gumley**—Again, I have not seen any.

**Senator MARK BISHOP**—No complaints have been made? You are not aware of any?

**Dr Gumley**—No.

**Senator MARK BISHOP**—How has industry accepted your proposed CEO letter, Dr Gumley?

**Dr Gumley**—Most of the CEOs have been quite happy to sign the letters. I have not had a problem. In fact, even more importantly, it is proving an effective management technique. I have had a couple of examples, one with an international company and one with a domestic company, where, them having signed that letter, and something having gone wrong with the project, I have been able to get on the phone and have a chat and we get it sorted out.

**Senator MARK BISHOP**—Can you just briefly put on the record the nature of that CEO letter.

**Dr Gumley**—Yes. I am asking the chief executive to write to me personally and state that the company has the resources and the wherewithal to do the contract on time, on budget, to the required capability, quality and safety. What we had found was that quite often, particularly with some of the small and middle sized projects, the most senior executive in the company was not always fully aware of some of the promises being made by some of his or her people. This is to ensure that the chief of the organisation fully understands what they are committing to and to make sure they do not double-book resources, which was happening previously.

**Senator MARK BISHOP**—So it is another way of you checking that promises can be delivered?

**Dr Gumley**—Yes.

**Senator MARK BISHOP**—And the general reaction of the CEOs has been what—one of welcoming?

**Dr Gumley**—There was a bit of nervousness initially, with people saying, ‘Why are we being asked to sign up?’ I said, ‘Because you want a contract.’

**Senator HOGG**—You might send one to the minister and the secretary!

**Mr Smith**—It is a very tidy area of business, this one!

**Senator MARK BISHOP**—I note you have recently been advertising for staff to populate the new Chief Operating Officer Division, which I understand, from Wednesday’s hearings, is now headed by Mr Lewincamp. Can you give me some idea as to what this new division is responsible for?

**Dr Gumley**—The Chief Operating Officer Division is looking after the corporate governance parts of the DMO. It is about our relationships into mainstream defence and ensuring that we remain connected at all times, because, although DMO is going to become a

prescribed agency, we will always be part of defence and we have got to make sure that, as DMO becomes more businesslike, at the same time we do not lose those connections. Ultimately we have got to work with the capability group and the armed services, do the right thing. So there are a lot of processes and organisation. We had the DMO human resources people working into that group. We had the public relations. We had various corporate governance functions, with the Kinnaird review implementation and the DMO advisory board. All of those functions are under the Chief Operating Officer Division.

**Senator MARK BISHOP**—Is the senior officer going to be Mr Lewincamp?

**Dr Gumley**—He is the chief operating officer, yes.

**Senator MARK BISHOP**—So that is essentially the liaison function, the communications function, the public relations function and the personnel function?

**Dr Gumley**—Yes.

**Senator MARK BISHOP**—Any other functions?

**Dr Gumley**—I think I have covered it.

**Senator MARK BISHOP**—Where is finance located?

**Dr Gumley**—Finance is a separate division under Dr Ian Williams.

**Senator MARK BISHOP**—Does Dr Williams report to you or does he report to Mr Bennett?

**Dr Gumley**—Sorry, one correction: the internal information systems area of DMO is also under the chief operating officer.

**Senator MARK BISHOP**—Okay. Does Dr Williams report up the line to you, or does he report over to Mr Bennett?

**Dr Gumley**—He reports to me.

**Senator MARK BISHOP**—So Dr Williams will be attending these sessions after July will he?

**Dr Gumley**—Dr Williams is here today.

**Mr Smith**—Needless to say, he works very closely with Mr Bennett.

**Senator HOGG**—I should hope so.

**Senator MARK BISHOP**—I presumed that; I just wanted to find out the line of command.

**Mr Smith**—He will continue to do so after 1 July.

**Dr Gumley**—We talked earlier about some of the financial remediation. It is going to apply equally to DMO and to Defence. We both have the same problems and we both have to sort them out together.

**Senator MARK BISHOP**—I understand. We had a private briefing earlier this year and had some discussion on those matters with Defence, which I recall. One of the issues that we discussed that day, and which has been discussed since, was that you were going to be given

freedom to pay above market rate for management employees. Have you had to use that particular tool, or right, to attract and retain staff in your organisation?

**Dr Gumley**—I do not think that it is fair to say that we are going to be paying above market rate. I think the issue is that the market rate is above what the Public Service rate is. That is an important difference. So we have not paid above market rate for anyone. We have had about a handful, perhaps four or five people, on arrangements that are a little bit more attractive than the Public Service ones.

**Senator MARK BISHOP**—And what is the cause of that—skill shortages?

**Dr Gumley**—Yes, it is skill shortages and the depth of experience required to do some of these very demanding program management jobs.

**Senator MARK BISHOP**—Is it in the IT area?

**Dr Gumley**—I have not specifically put anyone in the IT area at this stage. However, I am predicting that as one of the projects comes up, which is effectively an eventual replacement of the SDSS project, we will have to pay, on an AWA, an enhanced salary for that job.

**Senator MARK BISHOP**—You have a fairly intensive internal staff up-skilling and ongoing education program within DMO, do you not?

**Dr Gumley**—Yes. We are working very hard on the up-skilling program. We are working on certifying each of our professionals into their career disciplines, making sure that continuing education occurs for all of our professionals and making sure that their skills keep up with the rapidly changing technologies that are hitting the ADF.

**Senator MARK BISHOP**—What sort of funds have you been allocated to that task on an annual basis?

**Dr Gumley**—I do not have a figure available. I could get that for you.

**Senator MARK BISHOP**—Could you get the line item for that?

**Dr Gumley**—Yes.

**Senator MARK BISHOP**—Let us talk about the tender process for the air warfare destroyers and the amphibious ship manufacture for a while. Can we have an update on the tender process for the air warfare destroyers and the amphibious ship bids to bring us up to where we are at?

**Mr King**—There are three elements of tenders that we have—our three domain areas: a platform system designer, who will be the designer of the ship; the ship builder, who will be the constructor of the ship; and the combat system engineer—long term, but the system integrator for the electronics. We have three processes running. The ship designers were the first one let. The tenders went out last June, I think. Responses were due in on 22 November, and we have those responses in. We are currently evaluating those responses. There are two parts to that. One part was the capability of the designers to provide design support; the other was a concept design based around the needs for our air warfare destroyer.

**Senator HOGG**—How many responses were there?

**Mr King**—Three.

**Senator Hill**—Three requests.

**Mr King**—Three requests and three responses. One was from IZAR, a Spanish company; one was from Blom and Voss, a German company; and one was from Gibbs and Cox, a US company.

**Senator MARK BISHOP**—And they are currently under evaluation?

**Mr King**—That is correct. They are called evolved designs. We are also considering an existing design, which is an IZAR design.

**Senator MARK BISHOP**—When will that process be concluded?

**Mr King**—We will be making our final recommendations to government in July.

**Senator MARK BISHOP**—The second tender?

**Mr King**—The second tender was for the ship builder. We released on 18 October. The closing date was 22 December. We received three responses—one from the Australian Submarine Corporation, now known as ASC Shipbuilding; one from Tenix; and one from Northrup Grummen.

**Senator MARK BISHOP**—Where is that at?

**Mr King**—They are also under evaluation. We are completing that evaluation and making our recommendations to government in the second quarter of this year.

**Senator MARK BISHOP**—So that is fairly well advanced as well?

**Mr King**—Yes, it is.

**Senator MARK BISHOP**—And the third one?

**Mr King**—The combat system—I will shorten it to the combat system integrator, but it is known as the CSSE—was released on 25 October, closing on 10 December. We had three responses to that—BAE Systems, Raytheon Australia and Saab. They are also under evaluation. That part of the process is nearing completion.

**Senator MARK BISHOP**—The combat systems are soon to go to government?

**Mr King**—Yes. We have to complete our internal departmental processes, but from a project point of view we are completing our evaluations.

**Dr Gumley**—This project is on track.

**Senator MARK BISHOP**—Have the tender guidelines been changed at all?

**Mr King**—No, not at all.

**Senator MARK BISHOP**—Since the beginning?

**Mr King**—No.

**Senator MARK BISHOP**—Which of the tenderers are not majority Australian owned?

**Senator Hill**—I do not think that would be an appropriate question for me to ask those who are evaluating the tenders, so I am not sure that it is an appropriate question for this committee, is it? You can ask what is in the tender documents, and therefore what is the obligation of the tenderer, but I do not know how the tenderer is approaching meeting that

obligation, and I think it is between the tenderer and those who are evaluating the tenders. This is an ongoing evaluation that is taking place, and you are asking for details of one of the bidders. I do not think that is appropriate.

**Senator MARK BISHOP**—It was my understanding that the government had originally determined that the tenderers awarded the contract would be majority Australian owned and that after that decision was made and became public the government changed its position and invited non-majority Australian owned companies to tender. That is the angle I am coming from.

**Senator Hill**—That is news to me.

**Mr King**—The RFT documentation specified ownership rights requirements—Australian ownership requirements. That is in the documentation; tender responses will be evaluated against that and many other criteria.

**Senator MARK BISHOP**—Of course.

**Senator Hill**—The tender documents have not been changed.

**Senator MARK BISHOP**—Fine.

**Senator Hill**—Certainly not in relation to that—and you said not in any detail.

**Mr King**—No. We drafted the tender documents and they went out. They have not been changed.

**Senator MARK BISHOP**—In a recent media release the government announced—and this might be a question for Senator Hill and not the officials—I am advised, that it would consider a bid from the US owned defence manufacturer Northrup Grummen. I think you said they had bid for the shipbuilding. They were one of the three.

**Mr King**—I can probably answer that. I think we received three tenders. We do not block the tender box off. Tenders come in against our requests and then we evaluate those responses against the requirements of the tender. My interpretation of that announcement is—and I certainly advised the minister's office—that we have received three tenders. They are being evaluated.

**Senator MARK BISHOP**—They are being evaluated.

**Mr King**—Correct. And nothing has changed against that evaluation. We are evaluating them against the tender documents.

**Senator MARK BISHOP**—Is Northrup Grummen Australian owned or foreign owned?

**Senator Hill**—Northrup Grummen is a listed company in the United States.

**Mr King**—Yes.

**Senator Hill**—How they are bidding, I do not know.

**Senator MARK BISHOP**—The vehicle they are using to bid for the work?

**Senator Hill**—I have no idea. It is not my business at this stage.

**Senator MARK BISHOP**—I understand the point you are making. Is the nature of the vehicle that would be established to carry out the work once the tender is given a material consideration in your giving the tender?

**Mr King**—Yes, it is. We require the special purpose vehicle—the company—to execute this program to be Australian owned. There are additional requirements because that is a sort of legal structure and we require the control of that entity to be from Australia as well. We very much support the notion that this work would be managed by an Australian company.

**Senator MARK BISHOP**—You say ‘Australian owned’. If a public vehicle was listed, for example, on the ASX and it had a 10 per cent Australian shareholding and the rest elsewhere would that qualify as Australian owned?

**Mr King**—No, it would not, under our requirement.

**Senator MARK BISHOP**—What is your requirement?

**Mr King**—Our requirement is that it has to be 51 per cent Australian owned.

**Senator MARK BISHOP**—The vehicle that is used to do the work still has to be more than 51 per cent Australian owned.

**Mr King**—Correct. In addition, it has to have demonstrated management control from Australia as well.

**Senator MARK BISHOP**—Has the department done any assessment of the works required for Tenix in Victoria or for ASC in South Australia to enable either site to accommodate this project?

**Mr King**—By that do you mean additional infrastructure?

**Senator MARK BISHOP**—Yes.

**Mr King**—Yes, we have.

**Senator MARK BISHOP**—You have done that assessment. Is that ability to do the work, if awarded the tender, part of the tender assessment process?

**Senator Hill**—I think this is pretty suss, actually. There is a tender process under evaluation and you are seeking to delve into that internal process. We all know that the South Australian government and the Victorian government have been making bids, public statements and all sorts of things but in terms of exactly what has been happening through the tender process, I do not know. If I think I should keep at arm’s length from this process, I think the committee should as well.

**Senator MARK BISHOP**—All right. I asked and you answered. We might turn now to the FFG upgrade. Are you doing FFG, Dr Gumley?

**Dr Gumley**—Yes.

**Senator MARK BISHOP**—My advice is that back in June 1999 the then Minister for Defence Mr Moore announced that the Department of Defence had signed an \$897 million contract with ADI for the upgrading of the RAN’s six Adelaide class guided missile frigates? Can you confirm that?

**Dr Gumley**—Yes, that happened.



**Senator MARK BISHOP**—Can you confirm that there are now only four Adelaide class guided missile frigates to be upgraded?

**Dr Gumley**—That is correct.

**Senator MARK BISHOP**—Was there a reduction from six to four or have two been concluded already?

**Dr Gumley**—No, there is a reduction of six to four. Navy will retire the two oldest of the frigates in due course rather than upgrade them.

**Senator MARK BISHOP**—When are they to be retired?

**Dr Gumley**—You will have to ask the Chief of Navy that.

**Vice Adm. Shalders**—I will find the answer to that and get back to you shortly. I would rather get the exact months. It is on the public record, but I do not have it with me at the moment. I will find out and get back to you before we finish.

**Senator MARK BISHOP**—How long does the upgrade process take for each frigate?

**Dr Gumley**—There was a period of about four years when everyone was getting ready doing the design work. The frigates are going to roll through at about one each year.

**Senator MARK BISHOP**—One per year.

**Dr Gumley**—Yes. The first one took a lot longer than that.

**Senator MARK BISHOP**—Because you are going through the learning process, I presume.

**Dr Gumley**—Yes, but it is not just a learning process; it is also the design of the equipment, taking it through a test and trial stage, working out what works and what does not, fixing the bits that do not work and bringing the ship back into service.

**Senator MARK BISHOP**—When will the first one be done?

**Dr Gumley**—The current contract says July 2005. There is a little bit of schedule slippage against that. We are hopeful of bringing it in in July 2005, but it might be August or September.

**Senator MARK BISHOP**—Thereafter in 12-month periods?

**Dr Gumley**—Roughly 12- to 15-month periods thereafter.

**Senator MARK BISHOP**—Is the project currently on budget?

**Dr Gumley**—It is currently on budget but it is late. We were supposed to have had the first ship done a couple of years ago. The technical difficulties were greater than we expected.

**Senator MARK BISHOP**—It is part and parcel of this type of work, isn't it?

**Dr Gumley**—Yes, these sorts of projects have technical risks attached to them. There is no 100 per cent deterministic sort of solution. There is always some technical risk associated with them.

**Senator MARK BISHOP**—So there is time slippage but the project is currently on budget.

**Dr Gumley**—Yes.

**Senator MARK BISHOP**—Do you anticipate that to continue or are there too many variables for you to commit?

**Dr Gumley**—We think the project will continue. I am a little concerned there might be a bit of cost slippage towards the end if everything does not work as expected, but at the moment it is looking reasonable.

**Senator MARK BISHOP**—We are currently about two years behind schedule, you say.

**Dr Gumley**—Probably closer to 2½.

**Senator MARK BISHOP**—So you are currently 2½ years behind schedule. Do you think as you shift to ships two, three and four you will pick up any of that time?

**Dr Gumley**—No, I think it is fairly lineal after that—in other words, the technical difficulties have been ironed out on ship one and then it is about making the same thing happen on two, three and four.

**Senator Hill**—The challenge is to achieve the schedule that was reset a year or two ago when there was a major revisiting of this project.

**Senator MARK BISHOP**—If you reduce the number of ships to be refitted from six to four and your blow-out is still 2½ years, that suggests bad planning right at the outset.

**Senator Hill**—No. I think reducing from six to four is a separate issue. In the early phase, which was—what would you call it?—the development of the solution, there was considerable time slippage. It obviously proved to be much more complicated than the parties appreciated.

**Senator MARK BISHOP**—Am I wrong to say that the original upgrade was to apply to all six frigates?

**Senator Hill**—That is correct, but I will get to that—that was a subsequent decision; it is not related to the slippage of time that occurred in the development of the combat system. So at that stage, from memory, the project was revisited and schedules were determined for the integration of the system and the various other upgrades that had to be achieved within that phase of the project. That phase of the project, as I understand it, is basically on time and within budget. Supplementary to that, the government made a decision to proceed with only four upgrades instead of six. That was associated with the decision to proceed with the air warfare destroyer and so forth. So when you talk about slippages we have got to make sure we are comparing apples with apples.

**Senator MARK BISHOP**—I was making the leap in logic—wrongly, as you say—that there were originally six to be done over five years, which were then reduced to four, but we still had a significant time slippage of a third.

**Dr Gumley**—Absolutely, and the time slippage applied to the first ship, HMAS *Sydney*, being ready. That slippage has occurred. HMAS *Sydney* is at sea at the moment doing tests and trials. We hope to have them fully completed in the July-August time frame.

**Vice Adm. Shalders**—Senator, to give you the dates of the decommissioning of the first two ships, the *Canberra* will decommission in November 2005 and the *Adelaide* will

decommission in September 2006. So when the *Canberra* goes, the *Sydney* will be operational—the first ship will be operational by the time the *Canberra* goes.

**Senator MARK BISHOP**—Do you have a figure on the final estimated cost of the combat system design and software for the Adelaide class guided missile frigate, Dr Gumley?

**Dr Gumley**—The data I have here does not have that figure separated out. We will get it to you.

**Senator MARK BISHOP**—Thank you. When do you anticipate that the combat system design and software will be completed—or is it already?

**Dr Gumley**—It has already been completed.

**Senator MARK BISHOP**—Yes, it is done now.

**Dr Gumley**—Yes, and we are into the tests and trials phase. Inevitably there will be bugs and glitches, and that is what you find out during the testing phase.

**Senator MARK BISHOP**—It is designed, it is in and it is out there on the *Sydney* being trialled, and you are going to do your evaluation in due course.

**Dr Gumley**—Yes.

**Senator MARK BISHOP**—Do you have to conclude that evaluation before you upgrade the other three frigates?

**Dr Gumley**—Yes.

**Senator MARK BISHOP**—So when will the trial on the *Sydney* conclude ?

**Dr Gumley**—There are a series of trials. Some endurance tests of the software were scheduled for early February 2005, and they are under way. If the results of those tests are satisfactory, then the updated software will be installed on the HMAS *Sydney* for further trials on board. So it is all proceeding at the moment.

**Senator MARK BISHOP**—It is all a work in progress.

**Dr Gumley**—Yes.

**Senator MARK BISHOP**—I am really linking this back to the earlier discussion about the potential for further time slippage if major faults in the software and system design are identified in your trial process.

**Dr Gumley**—You have hit on the highest risk area. If anything is going to go wrong, it is going to be in the software and integration.

**Senator MARK BISHOP**—When will that trialling of the new combat system software be concluded? Is that too specific a question to ask?

**Dr Gumley**—I do not have that data here; I would need the full project plan to give you that answer. We can get you that answer.

**Senator MARK BISHOP**—If you could take that on notice, that would be good.

**Senator Hill**—But all going well, it should be in the next few months.

**Vice Adm. Shalders**—I make a point here regarding combat system software. It is constantly being updated. Of course there will be a package. That package will be constantly improved. The naval combat data system that we are replacing in those ships, right to the end of its life in service in the gulf right now, and which is being used on board the *Darwin*, is very different from the naval combat data system that those ships were commissioned with many years ago. It is a constant updating process. There will be a project test and trial schedule which will be testing out the combat system to a certain level of capability, but I would not want you to think that it will never change beyond that point. Of course we will be updating it constantly.

**Senator MARK BISHOP**—Thank you, Admiral. I both understand and accept the point you are making there. I was just exploring the potential for additional delay if problems are identified in the current trialling on the *Sydney*. I am coming at it from that angle.

**Dr Gumley**—There is potential for delay but, at the moment, things are going okay.

**Senator MARK BISHOP**—Fine. This is probably a question for you, Vice Admiral Shalders. Can you give me an overview of the role that the upgraded frigates are going to play within the Defence Capability Plan?

**Vice Adm. Shalders**—It will be a similar role to their current role. There is no change to their current role. The upgrade is bringing their capability to a level to match modern threats, so there is no change in role with the new ships.

**Senator Hill**—We have a separate project to upgrade the missile, which was part of the decision when we decided to reduce the number from six to four to upgrade the missile to the SM2.

**Dr Gumley**—I want to add to my previous answer about the software. The initial build that is going on the ships, which is being trialled now, is build 1. As Admiral Shalders mentioned earlier, there are future upgrades to come to that as well. The software keeps building on itself and there will be future build releases in 2006 and 2007.

**Senator MARK BISHOP**—Do you have to constantly upgrade the hardware as well?

**Dr Gumley**—No. These are primarily software upgrades. Sometimes you have to upgrade the hardware, but most of the hardware upgrades going on at the moment are for build 1 and then we have a series of software upgrades.

**Senator MARK BISHOP**—I turn now to the Seasprite helicopters project. Who is handling that? What is the overall status of the project?

**Senator Hill**—We thought you might miss that one today.

**Senator MARK BISHOP**—We still have 23 minutes. What is the overall status of this wonderful project?

**Air Cdre Rossiter**—With regard to the Seasprite project, eight of the 11 aircraft have been provisionally accepted. We have one still being used to complete the development and test program that is still under way. The final two are in assembly at Nowra as we speak and are expected to be delivered in the next few months.

**Senator MARK BISHOP**—So by the middle of the year or the third quarter of the year we will have 11 out of 11?

**Air Cdre Rossiter**—Correct.

**Senator MARK BISHOP**—Up and running?

**Senator Hill**—Platforms.

**Senator MARK BISHOP**—What will we have when we have all 11 delivered?

**Air Cdre Rossiter**—The configuration that has been provisionally accepted is an interim training and utility configuration. Fundamentally, the hardware is pretty well stable and, as we have just discussed, we are talking about a build process for the software. The initial load of software that has been provisionally accepted provides utility flying, the ability to conduct initial training and the ability for Navy to commence the initial operational test and evaluation program.

**Senator MARK BISHOP**—What is utility flying?

**Air Cdre Rossiter**—Just general flying.

**Senator MARK BISHOP**—I thought that utility flying might have a particular meaning.

**Vice Adm. Shalders**—It does have a particular meaning. It covers things such as stores transfers, vertical replenishment at sea and passenger delivery. It is those sorts of things as opposed to a particular tactical mission the aircraft might fly.

**Senator Hill**—Testing, landing in difficult sea states and all of that sort of thing.

**Mr Smith**—It is not cutting off half the back of the passenger cabin.

**Vice Adm. Shalders**—No.

**Senator MARK BISHOP**—What was that?

**Senator FERGUSON**—I think it was a throwaway line.

**Senator MARK BISHOP**—I thought it was but I did not quite hear it. There have been some reports that the Seasprite is not capable of carrying both extra fuel tanks and a missile. Are those reports accurate?

**Air Cdre Rossiter**—I would have to say that I cannot answer that question. I have not got that level of detail at this point in time.

**Senator MARK BISHOP**—Who has got that level of detail at this point in time?

**Air Cdre Rossiter**—I would have to take the question back and get the specialists to answer it.

**Senator MARK BISHOP**—Come on. We did provide notice that we would be asking questions on this issue and I would have thought that question was fairly predictable. What is the problem? Is it a weight issue or a location issue, a size issue?

**Air Cdre Rossiter**—I am sorry, I do not know the background to the issue you are talking about.

**Senator Hill**—We will get an answer to that.

**Senator MARK BISHOP**—The report in the *Sunday Mail* from Adelaide on 20 June—it must be authoritative coming from the *Sunday Mail* in Adelaide—says:

The Royal Australian Navy's new helicopter can carry either extra fuel tanks or a missile—but not both, according to a defence industry insider.

He says it has neither the power nor the endurance to be an effective long-range weapons platform ... That is the background.

**Senator Hill**—The missile capability will be a new capability for us. Our Seahawks do not carry a missile, so it is introducing a range capability that we have never had. How much extra fuel it can carry at the same time I do not know. Presumably there has got to be a limit.

**Senator MARK BISHOP**—The suggestion in the article and other articles is that the additional weight involved in positioning the missiles prevents the helicopter carrying out its range.

**Vice Adm. Shalders**—If I may add something: it might also be a physical configuration mismatch—if you are required to carry a fuel tank you cannot carry on the same station a missile. We can find this out very quickly. I am sure the project officer is looking at this and we will have an answer back to you.

**Senator Hill**—It carries a torpedo as well. I do not know whether that is included in this scenario.

**Senator MARK BISHOP**—That is why I asked whether it was a weight issue or a configuration issue.

**Vice Adm. Shalders**—We can find that out very quickly and get an answer to you before we finish.

**Senator Hill**—In terms of a long-range anti-ship capability, it gives us that which we have never had before.

**Senator MARK BISHOP**—I am not arguing with that. My question was—

**Senator Hill**—At what range it can operate.

**Senator MARK BISHOP**—With the extra weight. It is okay having the capability, but if you cannot get the thing to stay in the air because of the extra weight—

**Vice Adm. Shalders**—The aircraft has internal fuel, of course, and would be able to carry its weapon with its internal fuel. The debate we have here is what external fuel tanks can be strapped on whilst the weapon is there.

**Senator MARK BISHOP**—Correct.

**Vice Adm. Shalders**—But of course with the internal fuel it has significant range, as does the missile—which, as the minister says, gives us a capability we have never had before from a rotary wing platform.

**Senator MARK BISHOP**—Presumably the purpose of whacking on an extra fuel tank is to give even further additional range.

**Senator Hill**—Even further if you can, but there has got to be a limit somewhere, there has got to be a trade-off somewhere.

**Senator MARK BISHOP**—We know what we are talking about. We will get that answer. Can you comment, Air Commodore, on concerns that have been raised that on hot days the power margins used for operating the Seasprites are too narrow? Does that ring a bell with you?

**Air Cdre Rossiter**—I do not know the specifics. Again, that is a level of detail that I have not been briefed on at this stage, since taking up the acting position. It is one of the things that is being evaluated as part of the type certification process.

**Senator MARK BISHOP**—So there is some truth to that concern?

**Air Cdre Rossiter**—I really do not know the specifics at all. I just know that that type of issue is the sort of thing that is tested during the type acceptance process. Whether or not it is a concern, I really do not know.

**Senator MARK BISHOP**—Do you know what power margins are used to determine the safe landing limits for the Seasprites?

**Air Cdre Rossiter**—Again, that is a level of detail that off the top of my head I cannot recall.

**Senator MARK BISHOP**—Do you know what power margins are used for a Seasprite helicopter to take off from a naval ship on a standard summer day off the coast of Brisbane?

**Senator Hill**—I think you need a Seasprite specialist.

**Senator MARK BISHOP**—I must say I thought we had advised the committee and they had advised the department that we would be asking questions on the Seasprite.

**Senator Hill**—I assume we thought that the questions related to progress of the project, not what weight a Seasprite can carry in a particular atmospheric condition.

**Senator MARK BISHOP**—We did have some questions on the status of the project.

**Senator Hill**—You have obviously got an anti-Seasprite representative giving you a fill of—

**Senator MARK BISHOP**—There is a bit of anti-Seasprite press around!

**Senator Hill**—It has been a difficult project.

**Senator MARK BISHOP**—It is, and some of this press stuff is not right, so I am giving the officials the opportunity to put it to bed, really.

**Senator Hill**—I am sorry that we do not have a person that can provide you with that sort of detail.

**Senator MARK BISHOP**—I will ask those questions now so they are on the *Hansard*. If you could take them on notice and give us a written response in due course, it would be appreciated.

**Senator Hill**—Yes.

**Air Cdre Rossiter**—We would be happy to.

**Senator MARK BISHOP**—Could the officials come forward who have offered some assistance on the air-to-air refueller delay.

**Senator Hill**—I think Dr Gumley can do it. This is to do with the contract, I think, isn't it?

**Senator MARK BISHOP**—Yes. Dr Gumley, can you confirm that the acquisition of the five Airbus 330 refuelling aircraft has been delayed for three years.

**Dr Gumley**—No, I cannot confirm that piece of information.

**Senator MARK BISHOP**—Can you confirm any delay in the acquisition of the five Airbus 330s?

**Dr Gumley**—We signed the contract in December. I just have to get the in-service date.

**Air Cdre Rossiter**—The first aircraft is expected to be delivered in December 2008 and the final aircraft in December 2010.

**Senator MARK BISHOP**—The first one is in December 2008; what about Nos 2, 3, 4 and 5?

**Dr Gumley**—No. 2 in March 2009, No. 3 in October 2009, No. 4 in May 2010 and No. 5 in December 2010.

**Senator MARK BISHOP**—Right. And when was the contract signed?

**Dr Gumley**—December 2004.

**Senator MARK BISHOP**—So it has just been signed. Those time lines are obviously the contract time lines. Was that the original thinking of the government when it decided on this purchase plan? I have a note to the effect that there was a blow-out.

**Senator Hill**—There was one year, I think, in the negotiation of the contract, which the department decided was a more realistic outcome. Remembering that this again is a first of its type, at one time we thought we might be in step behind the UK, but that has not come to pass. We are now the lead customer. My recollection is that, in negotiating the detail of the contract, DMO believed that the EADS was a little overambitious in its predictions. Rather than find delays later in the implementation of the contract, a date was settled upon which was considered to be more realistic.

**Senator MARK BISHOP**—Yes. Because the Defence Capability Plan of 2001 had the in-service delivery date as 2006, didn't it?

**Lt Gen. Hurley**—The last in-service date was 2007 and then, as the minister said, during the contract negotiations a more realistic schedule was agreed, which takes it to December 2008.

**Senator Hill**—So it has gone from 2007 to 2008.

**Senator MARK BISHOP**—And there was a blow-out—

**Senator Hill**—I would not call that a blow-out. In fact, if it means we are now getting contracts that are going to give us greater predictability than what we have had in the past then I think that is a good thing.

**Senator MARK BISHOP**—I was trying to establish the point that the DCP, the Defence Capability Plan, in 2001 had an in-service delivery date at 2006. I think the official was disputing my assertion. Is that correct?



**Lt Gen. Hurley**—I do not have a copy of the 04-14 DCP with me. I will come back and confirm it but I believe it was deferred back to 2007 in the subsequent review of the DCP between 2001 and 2004.

**Senator MARK BISHOP**—What refuelling aircraft will be used by the ADF until such time as the series of 330s are ready? What are you going to do?

**Dr Gumley**—Continue using 707s.

**Senator MARK BISHOP**—Carry on the current practice?

**Dr Gumley**—Yes.

**Senator MARK BISHOP**—Are those vehicles going to involve extra maintenance and cost? Will they go out beyond their scheduled life?

**Dr Gumley**—Every aeroplane has maintenance costs each year you run it. It is also fair to say that the 707s are getting quite expensive to run now because they are a very old aeroplane.

**Senator MARK BISHOP**—I presume you regularly review the airworthiness of the 707 refuellers. Is that ongoing?

**Air Cdre Rossiter**—It gets formally reviewed by an airworthiness board once a year.

**Senator MARK BISHOP**—What is the airworthiness board? Is that an internal committee?

**Air Cdre Rossiter**—It is headed by two two-stars, generally retired members of the Defence Force. In this case it is a two-star from the Air Force from an operational background and one from a technical background. They sit as a board of review and they are presented with all of the evidence that provides them with the confidence to make recommendations about continuing service in an airworthiness state. So it is a regular process, part of our regulatory processes that are set up for every weapon system.

**Senator MARK BISHOP**—Because the new Airbuses will not come in until the end of 2008 through to the end of 2010 and there is either a two- or three-year delay depending where you start, are there any extra obligations upon this airworthiness board in terms of the current fleet of 707s?

**Air Cdre Rossiter**—No. It is a standing process. There is always a risk as aircraft get towards the life that we are looking at in the 707s that the unforeseen can come up, but that is the same with every aircraft that is at that sort of age. At the moment it is under appropriate fatigue management regimes and there is nothing on the horizon that suggests that we cannot support that out to meet the introduction of the new platform.

**Senator MARK BISHOP**—When was the last airworthiness review done of the 707s?

**Air Cdre Rossiter**—I cannot recall the date, but it was within the last six months, I believe.

**Senator MARK BISHOP**—And you will do another one starting, on those figures, September or October of this year.

**Air Cdre Rossiter**—Yes. It is an annual program.

**Senator MARK BISHOP**—That sounds right.

**Dr Gumley**—To come back to the question of the schedule of these programs, we are intentionally spending a bit more time up front to de-risk a lot of the projects we are doing. Occasionally it takes us a little bit longer to get into a contract, but it is better to get into a contract where you have a pretty firm delivery date than one that is fuzzy so you get multiple year slippage later on. We are heading for certainty. We have made it clear to our contracting partners that schedule is the most important thing that applies to these contracts, but it has to be a realistic schedule rather than just the somewhat vague promises that many commercial companies make at time of tender. So I am happy that we are getting a much better process in place. That was one of the prime outcomes of the Kinnaird review.

**Senator MARK BISHOP**—So you are putting a fair bit more emphasis at the early stages of the contract writing to make sure that specifications and delivery dates and time lines are (1) realistic and (2) adhered to.

**Dr Gumley**—Absolutely. And we look at what the contract is proposing and we challenge it. If we do not think it can be done, we go back to the contractor and say, ‘This does not make sense.’ So we are trying to get schedules that have a very good chance of being achieved.

**Senator MARK BISHOP**—How many of these 707 refuellers have we got?

**Air Cdre Rossiter**—There are four.

**Senator MARK BISHOP**—Are they all operational or is it sort of a three operational and one in maintenance repair type of thing?

**Air Cdre Rossiter**—They have quite a heavy maintenance load. The availability out of maintenance varies but typically we aim for around two—so 50 per cent.

**Senator MARK BISHOP**—What do we do if one or two are designated unworthy by this air review board?

**Air Cdre Rossiter**—What we would have to look at is other options.

**Senator MARK BISHOP**—What is your fall-back plan?

**Senator Hill**—That is partly why we are getting new ones.

**Senator MARK BISHOP**—But we are not getting the new ones for another three or four years, and those 707s are pretty old.

**Senator Hill**—There is no way to get the new ones sooner. We are first of type.

**Senator MARK BISHOP**—What I am asking is: what is your fall-back plan if one or more of these 707s becomes too aged? Do you have a fall-back plan?

**Air Cdre Rossiter**—The way we meet capability gaps at the moment is through leasing tankers from other sources.

**CHAIR**—Senator Bishop, we are getting very close to the end of play. If you have a very important question, you had better ask it because we are going to have close down at one o’clock and to catch planes.

**Senator MARK BISHOP**—That is a real shame. We are going to miss the helicopters and the tanks—

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**Senator Hill**—But when they were operational into Afghanistan, they performed superbly—almost 100 per cent reliability. Given the age of the platforms and so forth I think it was a great credit to the maintainers and staff responsible—those who assess the reliability. It was a really good story.

**Senator MARK BISHOP**—I am pleased to hear that.

**CHAIR**—I think we have come to the end of the estimates. Thank you, Senator Bishop. I would like to thank you, Minister, for your days here and also Mr Smith and your colleagues. Just a notice for my colleagues to go on *Hansard*: questions on notice for these hearings are to be with the secretary by close of business on Monday.

**Committee adjourned at 12.57 p.m.**