



***AUSTRALIAN GOVERNMENT RESPONSE***

***TO***

***SENATE STANDING COMMITTEE ON FOREIGN AFFAIRS,  
DEFENCE AND TRADE REFERENCES COMMITTEE'S FINAL  
REPORT:***

***PROCUREMENT PROCEDURES FOR DEFENCE CAPITAL  
PROJECTS***

October 2012

## Executive summary

1. The Government welcomes the Senate Standing Committee on Foreign Affairs, Defence and Trade References Committee's final report *Procurement procedures for Defence capital projects*. Government understands the importance of reform to Defence's capability procurement. This is why Government has already initiated action on a number of procurement reforms, including:
  - a. project management accountability;
  - b. progress with the Projects of Concern process;
  - c. reforms to Support Ship Repair and Management Practices (the Rizzo Report);
  - d. capability and procurement reforms; and
  - e. reforms in the sustainment of Australia's Collins Class submarines (the Coles Review).
2. This is also why the lessons learnt from the Coles Review will also play an important role in the development of the Future Submarine Project, including the need to take a long term view of maintenance and sustainment of the Future Submarine from the outset of the project.
3. The Government remains committed to progressing further capability development and procurement reforms that will enhance the delivery of Defence capability projects, strengthen Australian Defence industry and improve accountability. In this light, Government has carefully examined this 334 page report to see what further insights might be offered. From this review, of the report's 28 recommendations, the Government has:
  - a. agreed in full to 13 recommendations;
  - b. agreed in principle to four recommendations (Recommendations 5, 10, 11 and 19);
  - c. agreed in part to seven recommendations (Recommendations 2, 3, 4, 6, 15, 16 and 26).
4. The Government notes the report's emphasis on increasing the role of the Capability Managers, which is why the Government has also agreed Recommendations 2, 3 and 4 in part. These recommendations relate broadly to increasing and enhancing the role of Capability Managers in capability acquisition, and Defence supports this intent. In this respect, Defence has already undertaken a range of initiatives to strengthen the role of Capability Manager's in this process. However, Defence does not agree to the aspects of these recommendations that suggest transferring financial resources for acquisition to Capability Managers. Funding following government approval is provided to Defence Materiel Organisation (DMO) to improve DMO's authority and accountability for outcomes (that is, the delivery of the materiel equipment elements of a project).
5. Apart from agreeing to these 24 recommendations, for the remaining four recommendations, these were not agreed as follows:
  - a. Recommendation 9 (DMO's independence). The Committee's recommendation is inconsistent the Government's previous public advice. The DMO will continue as it is, as a prescribed agency. Both the Kinnaird and Mortimer reports have previously recommended DMO become an executive agency. However, governments of both political persuasions have not accepted these recommendations.

- b. Recommendation 13 (Capability Managers have sole responsibility for acquisition projects). Having the Capability Managers with sole responsibility for acquisition projects is contrary to the current business model approved by Government following the Kinnaird Review. A recent review undertaken by Independent Project Analysis Inc, an independent international benchmarking organisation, made the observation the current organisational structure with materiel equipment acquisition centralised in DMO is consistent with best practice. Nevertheless, cognisant of the intent of this recommendation, Defence will examine Recommendations 2, 3 and 4 to ensure the primacy of the Capability Managers is maintained in the acquisition process.
- c. Recommendation 17 (Respond publicly to the Committee's criticisms about lessons not learnt and current planning on submarines). As SEA 1000 is still pre-first pass, it is premature to respond to criticisms raised by the Committee. The project will be brought through the normal first and second pass process to ensure appropriate lessons are applied and the necessary contestability is applied to affirm this.
- d. Recommendation 20 (Publish as an addendum to its portfolio budget statements). The reporting requirements proposed by this recommendation would mix data from pre-second pass activities, when option sets are being developed, against costs detailed in an acquisition contract versus the evolving costs for the sustainment of a capability as it matures and ages. The existing Portfolio Budget Statement reporting enables data to be appropriately compared via the extant reporting mechanisms and avoids creating significant overheads with little obvious benefit.

## Overview of report

1. The Senate Standing Committee on Foreign Affairs, Defence and Trade References Committee's final report *Procurement procedures for Defence capital projects* was reviewed based on the eight specific areas and 28 recommendations contained in the report. Table 1 summarises the report's structure and the Government's response to each recommendation.

**Table 1: Summary of Recommendations**

<b>Recommendation Category</b>	<b>Recommendation No</b>	<b>Response</b>
Realignment of responsibilities	<i>Recommendation 1</i>	<b>Agree</b>
	<i>Recommendation 2</i>	<b>Agree (in part)</b>
	<i>Recommendation 3</i>	
	<i>Recommendation 4</i>	
Contestability and independence	<i>Recommendation 5</i>	<b>Agree (in principle)</b>
	<i>Recommendation 6</i>	<b>Agree (in part)</b>
	<i>Recommendation 7</i>	<b>Agree</b>
	<i>Recommendation 8</i>	<b>Agree</b>
	<i>Recommendation 9</i>	<b>Disagree</b>
	<i>Recommendation 10</i>	<b>Agree (in principle)</b>
Skilling Defence	<i>Recommendation 11</i>	<b>Agree (in principle)</b>
	<i>Recommendation 12</i>	<b>Agree</b>
	<i>Recommendation 13</i>	<b>Disagree</b>
	<i>Recommendation 14</i>	<b>Agree</b>
Future submarines SEA 1000	<i>Recommendation 15</i>	<b>Agreed (in part)</b>
	<i>Recommendation 16</i>	<b>Agreed (in part)</b>
AIR 8000 Phase 2 (Battlefield Airlift - Caribou replacement)	<i>Recommendation 17</i>	<b>Disagree</b>
	<i>Recommendation 18</i>	<b>Agree</b>
Capability development and public information	<i>Recommendation 19</i>	<b>Agree (in principle)</b>
	<i>Recommendation 20</i>	<b>Disagree</b>
T&E - building capability	<i>Recommendation 21</i>	<b>Agree</b>
	<i>Recommendation 22</i>	<b>Agree</b>
	<i>Recommendation 23</i>	<b>Agree</b>
	<i>Recommendation 24</i>	<b>Agree</b>
	<i>Recommendation 25</i>	<b>Agree</b>
Defence industry	<i>Recommendation 26</i>	<b>Agreed (in part)</b>
	<i>Recommendation 27</i>	<b>Agree</b>
	<i>Recommendation 28</i>	<b>Agree</b>

## Analysis of report's findings

2. The report suggests there is a growing disconnect between strategic guidance and capability development, confused accountabilities, poor appreciation of risk, and a need for structural reform in Defence procurement. Government supports the thrust of the report's findings and Defence is already implementing a number of initiatives which will address some of the Committee's concerns.
3. In particular, Government has already initiated action on a number of procurement reforms, including:
  - a. project management accountability;
  - b. progress with the Projects of Concern process;
  - c. reforms to Support Ship Repair and Management Practices (the Rizzo Report);
  - d. capability and procurement reforms; and
  - e. reforms in the sustainment of Australia's Collins Class submarines (the Coles Review).

4. This is also why the lessons learnt from the Coles Review will also play an important role in the development of the Future Submarine Project, including the need to take a long term view of maintenance and sustainment of the Future Submarine from the outset of the project.
5. Nevertheless, Government will draw upon the advice in the Committee's report and integrate this advice into existing reforms. Within Defence, the Capability Development and Materiel Reform Committee will progress such matters.

#### **Areas of agreement**

6. The following are areas where there is broad agreement with the report:
  - a. The need for continuous improvement, as evidenced already with a range of capability development and acquisition reforms.
  - b. Providing personnel with the right skilling to perform their duties.
  - c. Recognising there are critical skills (eg engineers) where Defence needs to attract these skilled personnel.
  - d. Where possible, encouraging longer tenures.
  - e. As per the Black Review, Defence agrees there is a need for an alignment of accountability and responsibility.
  - f. While risk management policies and procedures are in place, further training in the application of these may be worth exploring.
  - g. Building an improved test and evaluation (T&E) capability, including the development of an equal stakeholder relationship between the Services T&E organisations and the Defence Science and Technology Organisation (DSTO), enabling the early engagement (pre-first pass) of T&E activities for the identification and mitigation of risks.
7. The rationale for agreeing in principle to these four recommendations is as follows:
  - a. Recommendation 5 (Mandatory gate reviews). Recommendation 5 reflects current practice as defined in Gate Review policy documentation. However, Gate Reviews have not been held for 'DCP Entry' as there is currently no clear milestone for this event and at that point there is often little for the Defence Materiel Organisation (DMO) to review. The first clear and useful milestone is Project Initiation and Review Board (PIRB) and corresponding Project Initiation and Options Definition Gate Reviews have been instituted.
  - b. Recommendation 10 (DSTO's independent advice). While, there is no precedent for a Ministerial Directive to a Defence group head, the Chief Defence Scientist (CDS) is currently required by government to advise on technical risks for all major capability submissions. This was confirmed in the government's response to the Mortimer Report. Defence's existing processes ensure that DSTO advice is both independent and available without modification and CDS's advice on technical risks is included verbatim in the submission to Cabinet.
  - c. Recommendation 11 (DSTO and risk assessments). Defence agrees to strengthen the role of the Technical Risk Assessment (TRA) in test and evaluation (T&E) by ensuring the TRA addresses the potential for T&E. Defence is of the view that the TRA is best conducted by technical experts in DSTO and should remain as independent advice. All submissions currently presented to Government on major capital projects include advice on technical risks that are provided directly by the Chief Defence Scientist. To ensure



that the risks are appropriately described and presented, DSTO provides training in technical risk assessment and has implemented a review group to ensure the quality of TRAs.

- d. Recommendation 19 (2013 White Paper). Recommendation 19 contends that, in developing the 2013 White Paper, Defence should ensure that all procurement proposals are costed and scheduled realistically, and that industry should be comprehensively consulted prior to the inclusion of procurement proposals. Defence notes that the approach taken in the development of this White Paper is somewhat different to that used to develop the 2009 White Paper, and that procurement proposals will continue to be developed and considered through the current two-pass capability development process. Defence also considers that the way in which in the 2013 White Paper is developed, the inclusion of capability proposals and the consultation processes are properly decisions for Government.
8. The seven recommendations agreed in part are as follows:
- a. Recommendations 2, 3 and 4 (Capability Managers, DMO and Capability Development Group (CDG)). Both Kinnaird and Mortimer recommended that service chiefs should be accountable for service specific procurements in the context of a stronger assurance role to ensure that there is appropriate oversight and coordination of all elements necessary to introduce a capability. For example, Kinnaird stated that *“Capability managers will be accountable for monitoring and reporting to Government for the whole of capability from the point where government approves a particular capability option, that is at second pass approval, through to the time that the capability is retired from service. During the acquisition phase, the capability manager monitors the development of all capability elements, including equipment delivery by the DMO. This responsibility does not imply any authority to directly instruct the DMO on any aspect of its function as the manager of equipment acquisition.”* In addition, a recent review undertaken by Independent Project Analysis, an independent international benchmarking organisation, made the observation that the current organisational structure with materiel equipment acquisition centralised in DMO is consistent with best practice. However, Defence does not agree to the aspects of these recommendations that suggest transferring financial resources for acquisition to Capability Managers. Funding following government approval is provided to DMO to improve DMO’s authority and accountability for outcomes (that is, the delivery of the materiel equipment elements of a project). This approach has previously been agreed by Government following the Kinnaird review and reinforced by the Mortimer review.
  - b. Recommendation 6 (Relocation of Independent Project Performance Office). The Independent Project Performance Office (IPPO) was specifically formed in the DMO following the Mortimer Review to improve DMO’s project management performance through the provision of expert analysis, advice and assistance to DMO projects. This ensures the necessary commercial, engineering and project management expertise is readily available and brought to bear in an environment of management ownership, accountability and follow through. The relocation of the IPPO outside of DMO would diminish the effectiveness of this arrangement. The remainder of Recommendation 6 is agreed.
  - c. Recommendation 15 (streamlining and consolidation of skills). Defence does not agree to adopt in full the recommended organisational changes specified in Recommendation 13. However, Defence agrees that Strategic Policy Division and CDG should have more strategic analytical skills. Defence agrees that DMO has the resources and support to build on the efforts already under way to develop its multi-discipline skills base.

Following from the recommendations of the Black review, further work is currently being undertaken to build the skills base of CDG and DMO, including optimising the utilisation of the Capability and Technology Management College to provide better and more focused support to CDG and DMO. The Australian Public Service (APS) Job Families and business skilling initiatives will drive skill development of the military as well as the APS Strategy workforce.

- d. Recommendation 16 (Chief of Navy to manage SEA 1000). As you announced on 6 September this year, Mr David Gould has been appointed as General Manager Submarines and he has been given responsibility for the oversight of the maintenance of the current Collins Class fleet and the Future Submarine Project. Hence, the intent of this recommendation has been met, but management of SEA 1000 will be overseen by Mr Gould rather than Chief of Navy. The remainder of Recommendation 16 is agreed.
  - e. Recommendation 26 (Planning for investment). Defence recognises the importance of certainty to industry and continues to improve the planning for the Public Defence Capability Plan within the inherent limitations of the project development environment. The Public DCP is intended to provide as much information as is known within the four year Forward Estimates period. The DCP and Defence Capability Guide seek to provide as much information as possible, noting that an increasing level of uncertainty is inevitable in the outer years. The Department will engage with industry to address the level of information that can be generated and published about projects plans at early stages of their development. Although Defence regards continuity as an important aspect of maintaining the supply chain, the timely delivery of required military capabilities must remain the key feature of capability planning. Defence agrees that to the extent permissible to protect sensitive information, data on the reasoning and analysis underlying Defence's demand can be published. Defence agrees to publish information based on the most reliable cost estimates it is able to generate, noting again the inherent uncertainty for projects in the outer years.
9. Notably, Defence has agreed to Recommendations 2, 3 and 4 in part. These recommendations relate broadly to increasing and enhancing the role of Capability Managers in capability acquisition, and Defence supports this intent. In this respect, Defence has already undertaken a range of initiatives to strengthen the role of Capability Manager's in this process, as outlined in paragraphs 14 to 16 below.

#### **Aspects of report not agreed**

10. Defence has not agreed to four recommendations on the basis that some activities are no longer undertaken for very sound reasons or that, even reflecting the Committee's considered views, there are sound reasons to adopt an alternative approach in some cases.
11. The four recommendations not agreed are as follows:
  - a. Recommendation 9 - DMO becoming a statutorily independent agency. The Government has previously considered whether DMO should be an executive agency, as has past governments. In each case, the decision has been made after careful consideration to have DMO as a prescribed agency.
  - b. Recommendation 13 - Service Chiefs as sole client with the contracted suppliers. The report envisages the accountability for all service specific procurement items should be exclusively transferred with budgets to Service Chiefs, who should be responsible for all procurement and sustainment of their materiel. The Committee also envisages the movement of individuals between DMO and the Capability Manager at varying times in the project phases. This recommendation is quite contrary to the current business model approved by Government following the Kinnaird Review. A recent review undertaken

by Independent Project Analysis Inc, an independent international benchmarking organisation, made the observation the current organisational structure with materiel equipment acquisition centralised in DMO is consistent with best practice. Whilst not agreeing to Recommendation 13, Defence will examine Recommendations 2, 3, 4 and 13 to ensure the primacy of the Capability Managers' role is maintained. Defence's Capability Development and Materiel Reform Committee will progress this matter.

- c. Recommendation 17 - Respond publicly to the Committee's criticisms about lessons not learnt and current planning on submarines. As SEA 1000 is still pre-first pass, it is premature to respond to criticisms raised by the Committee. The project will be brought through the normal first and second pass process to ensure appropriate lessons are applied and the necessary contestability is applied to affirm this.
- d. Recommendation 20 - Additional PBS reporting. The reporting requirements proposed by this recommendation would mix data from pre-second pass activities, when option sets are being developed, against costs detailed in an acquisition contract versus the evolving costs for the sustainment of a capability as it matures and ages. The existing Portfolio Budget Statement reporting enables data to be appropriately compared via the extant reporting mechanisms and avoids creating significant overheads with little obvious benefit.

### Clarifications

- 12. Report contradictions. Defence considers that the report contains some internal contradictions which means that accepting one recommendation would have an adverse impact on another of the report's recommendations. For example, the recommendations to empower the Capability Managers (Recommendations 2, 3 and 13) are contrary to ensuring DMO's independence, with adequate resources (Recommendations 9 and 14). The Government understands the intent of the report and intends to take a holistic perspective to both the report's recommendations and extant reform measures. Thus, for example, Defence is already updating the Memorandum of Arrangements (MOA) between Defence and DMO. This MOA will be used to ensure the relationship between the Capability Managers and DMO is adequately described and agreed.
- 13. Capability Manager roles and joint capabilities. The report identifies that "*capability managers have been sidelined with CDG and DMO assuming key positions during the acquisition phase*" and "*capability managers require the authority that now resides with CDG as departmental coordinator and centre of power*" (both quotes from para 15.39 of the report).
- 14. Defence has recognised that there is room for improvement in this areas and has made a number of changes to its practices over the past six months to address these issues, including:
  - a. providing authority to Capability Managers through including them as a signatory, together with CDG and DMO, on Materiel Acquisition Agreements (MAAs); and
  - b. the implementation of Capability Manager Steering Groups to assist Capability Managers to review, monitor and control the process and progress for their post-second pass projects as these projects progress through the acquisition process.
- 15. The report's discussion on Capability Managers focuses on each of their capability areas. In this context, Defence is also taking a number of steps to better integrate capability to support Joint Force Operations and the Joint Force-in-Being. It is also important to recognise that while the Service Chiefs and Deputy Secretary Intelligence and Security have clear and easily identifiable responsibilities for the delivery of capabilities and materiel that will be operated in the maritime, land, air and intelligence environments, there are some joint capabilities that do not fit neatly within any one of their areas of responsibility alone.



16. This is particularly the case for joint command, control, communication, computer, intelligence, surveillance, reconnaissance, electronic warfare and ICT-dependent operational capabilities. Under Defence's Capability Coordination Model, a Capability Coordinator is designated to ensure delivery of a cohesive joint capability that will meet the needs of the Capability Managers and Chief of Joint Operations. Where this model is invoked, the Capability Coordinator is required to engage closely with the Services and Groups to ensure their requirements are understood, and that all parties are kept informed of any issues and the status of the capability. The Vice Chief of Defence Force, as the Joint Capability Authority, is responsible for:
- a. ensuring that new and extant capabilities are developed in accordance with joint concepts and doctrine;
  - b. appointing Capability Coordinators to be responsible for the delivery of joint capabilities that service the ADF and Defence; and
  - c. providing the conceptual basis for the future joint force and integration of its component capabilities.
17. Recommendation 18 - AIR 8000 Phase 2 Statement of Operational Requirement (SOR). This recommendation implies Air Force did not intend to conduct T&E against the approved SOR. This is not correct. As part of the acquisition process, T&E results from the United States Air Force (USAF) for the capability will be reviewed and the Aerospace Operational Support Group will conduct T&E against key requirements to provide early identification of potential issues with the AIR 8000 Phase 2 project that could delay introduction into service. Whilst formal T&E against the SOR was not conducted prior to second pass, evaluation of the capability against the requirements was completed using evidence available from both the manufacturer and USAF to further mitigate risk of any non-compliance with the SOR.
18. Paragraph 8.54 – DSTO moral hazards and conflicts of interest. Paragraph 8.54 of the report states *“there is another matter of concern with potential conflicts of interest or moral hazard in that the opportunities for collaborative activities and funding have in the past driven DSTO to recommend a course of action that may not be in Defence's best interest”*, without any reference or further details to validate this statement. Defence refutes this statement. As both a developer and an adviser on technology to Defence, DSTO recognises the potential conflict of interest and has established an independent Probity Board to advise the Chief Defence Scientist on how to manage any potential conflicts, including through independent review of DSTO's advice.

### **Way ahead**

19. There are aspects of this report where its advice can be incorporated into existing reform activities. The governance and oversight of all these activities will be provided by the Capability Development and Materiel Reform Committee, which is chaired by the Chief Executive Officer Defence Materiel Organisation. Such an approach avoids creating unnecessary, duplicative reporting mechanisms.