

Chapter 1

The terms of the inquiry

Background to inquiry

1.1 In 2009, the Minister for Defence (the minister) released the Defence White Paper, *Defending Australia in the Asia Pacific Century: Force 2030*. This document sets out an ambitious acquisition program, including twelve submarines to be assembled in South Australia. According to one analyst, the scale, complexity and sophistication of the capability priorities needed to build Force 2030 would require 'sound plans and lots of money'.¹

1.2 It should be noted, however, that for many years the Australian Defence Organisation's (Defence) program for the procurement of major capital assets has been dogged by delays and cost overruns. Indeed, a number of the projects in the White Paper that have progressed to the Defence Capability Plan (DCP) stage and beyond have experienced significant problems that have warranted their placement on the Defence Materiel Organisation (DMO) list of projects of concern. This list contains high profile projects that are experiencing significant cost and/or schedule troubles that require close monitoring in order to get the projects back on track. The projects in the White Paper on this list include the:

- Anzac Anti-Ship Missile Defence upgrade (added 2008, removed November 2011);
- Wedgetail AEW&C aircraft (added January 2008);
- Tactical Unmanned Aerial Vehicle (added September 2008, removed December 2011)
- KC-30A air-to-air refuelling craft (added October 2010);
- Joint Air-to-Surface Standoff Missile (added November 2010, removed December 2011); and
- MRH-90 Helicopter (formally added November 2011).

1.3 The Tiger Armed Reconnaissance Helicopter was on the list of projects of concern but was remediated and removed from the list in April 2008 before the White Paper was produced.

1.4 There are also other projects that have or are experiencing difficulties including the Air Warfare Destroyer (AWD) and the F-35 Joint Strike Fighter. With regard to the AWDs, adjustments had to be made to the construction program to

1 Mark Thomson, 'Defence Funding and Planning: Promises and Secrets', *Security Challenges*, vol. 5, no. 2, (Winter 2009), p. 89.

relieve workload pressure on the shipyards which are expected to reduce the two-year delay in the project by twelve months. The F-35 Joint Strike Fighter has experienced serious setbacks at an early stage of its development in the United States. The minister stated in July 2011 that there were 'a range of unknowns' in this highly complex, high development project and that they were starting to 'rub up' against Defence's 'pre-planning for slippage on schedule and on cost'. According to the minister:

In terms of schedule, there'll be an exhaustive review done before the end of this year, so I think by the first quarter of next year, we'll be in a much better position to know whether we need to start really seriously planning for a gap in capability, and cost will also be impacted upon by future decisions in terms generally of United States Defence budget cuts.²

1.5 For some major acquisitions, problems have emerged during their in-service or sustainment stage. The well publicised ones at the moment include the:

- landing platform ship where troubles such as extensive corrosion have resulted in the early decommissioning of HMAS *Manoora* and HMAS *Kanimbla* (decommissioned 25 November) and HMAS *Tobruk* undergoing maintenance for most of 2011; and
- Collins Class Submarine Sustainment Project, which is experiencing serious 'technically complex problems', and was added to the projects of concern list in November 2008. It remains there today.³

1.6 It is in this context of Defence's troubled acquisition and sustainment programs and the ambitious procurement schedule in the White Paper that, on 9 February 2011, the Senate referred the following matter to the Senate Foreign Affairs, Defence and Trade References Committee for inquiry and report:

That the committee inquire into and report by 30 November 2011 upon procurement procedures for items identified in the Defence White Paper, *Defending Australia in the Asia Pacific Century: Force 2030* and in particular:

- a. assess the procurement procedures utilised for major defence capital projects currently underway or foreshadowed in the Defence White Paper, including the operations of the Capability Development Group and its relevant subcommittees;
- b. assess the timeline proposed for defence modernisation and procurement outlined in the Defence White Paper;

2 Minister for Defence, the Hon. Stephen Smith MP, 'Interview with Ali Moore', Lateline, 27 July 2011, <http://www.minister.defence.gov.au/2011/07/27/minister-for-defence-interview-with-ali-moore-lateline/> (accessed 5 December 2011).

3 Minister for Defence, the Hon. Stephen Smith MP, 'Paper presented to the Defence Senior Leadership Group', Canberra National Convention Centre, 18 November 2011, <http://www.minister.defence.gov.au/2011/11/18/minister-for-defence-paper-presented-to-the-defence-senior-leadership-group/> (accessed 5 December 2011).

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- c. assess proposals arising from the Defence accountability reviews, including, the Mortimer Review, the Pappas Review and the McKinsey Report (2010), in regards to enhancing accountability and disclosure for defence procurement; and
 - d. make recommendations for enhancing the availability of public information and parliamentary oversight and scrutiny of defence procurement in the context of guaranteed 3 per cent real growth in the Defence budget until 2017–18.

On 5 July, the terms of reference were amended to include:

- e. assess the effectiveness of the Defence Materiel Organisation including:
 - i. its role and functions;
 - ii. its processes, management structure and staffing, in particular as compared to similar organisations in the United Kingdom, the United States of America, Canada and other comparable jurisdictions and large Australian commercial enterprises;
 - iii. its full costs, assessed against the timeliness and quality of its output and the service it provides to the Australian Defence Force; and
 - iv. the extent to which it value-adds to national defence and to the long-term viability of Australian defence industries.

1.7 On 30 November, the committee sought an extension to table a preliminary report before 16 December 2011.

1.8 This preliminary report forms the basis for further investigation and analysis and will require the committee to take further evidence. It is the committee's intention to then table a final substantive report by 28 June 2012.

Conduct of inquiry

1.9 The inquiry was advertised in the *Australian*, *Australian Defence Business Review*, *Australian Defence Magazine* and through the Internet. The committee invited submissions from a wide range of Defence stakeholders including the Department of Defence and Defence Materiel Organisation, State and Territory Governments, the Defence industry, interested organisations and individuals.

1.10 The committee received 32 public and 4 confidential submissions. A list of individuals and organisations that made public submissions to the inquiry together with other information authorised for publication is at Appendix 1. The committee held public hearings in Canberra on 11 and 12 August, and 5 and 7 October 2011. Details of public hearings are referred to in Appendix 2. The submissions and Hansard

transcript of evidence may be accessed through the committee's website at http://www.aph.gov.au/senate/committee/fadt_ctte/index.htm

Key documents and references

1.11 In terms of documentation, the key Department of Defence (department) publication detailing the capability development process is the *Defence Capability Development Handbook* (DCDH). According to the foreword, the handbook serves as a 'guide' to the capability development body of knowledge, best practice and procedures for the Australian Defence organisation.⁴

1.12 Whilst primarily addressing the requirements phase of the capability life cycle, the DCDH should, according to Defence, be read in conjunction with the following three key documents:⁵

- *The Strategy Framework* (2010) published by the department and detailing the needs phase of the capability development life cycle.
- *DMO Acquisition and Sustainment Manual* (2007) published by the Defence Materiel Organisation (DMO) and detailing DMO's role in the acquisition and sustainment of capability.
- *Technical Risk Assessment Handbook* (2010) published by the Defence Science and Technology Organisation.

1.13 This report draws on all three publications. The committee is also aware of other important policy manuals, guidance documents, instructions, legislation and regulatory requirements regarding procurement including the *Defence Procurement Policy Manual* (DPPM). It is the committee's intention to identify all such relevant documentation in order to consider and draw upon it where relevant in its second substantive report.

Purpose of report

1.14 The purpose of this report is to lay the foundation for a more detailed and considered analysis in a subsequent report. In considering the intentions and broad thrust of the Defence reviews and of the capability development process, the report seeks to understand the process, identify the key adherence documents and the roles and responsibilities of the agencies and personnel involved.

1.15 In seeking to establish clarity about the capability development process, the committee raises a number of unanswered questions throughout the report. It also articulates a number of themes and issues raised in evidence regarding aspects of the process which it intends to consider and report on in the future. In taking this

4 Department of Defence, *Defence Capability Development Handbook*, August 2011, p. iv.

5 The DCDH replaces the 2006 *Defence Capability Development Manual*. Department of Defence, *Submission 21*, Attachment D, p. 27.

approach, the committee hopes that the report will stimulate further discussion. Indeed, by identifying some of the key areas of concern, the committee's intention is to generate discussion amongst all involved stakeholders and thereby attract additional evidence.

Scope of report

1.16 In light of its stated purpose, this report does not address a number of terms of reference before the committee. While it considers term of reference (c) concerning the Defence reviews and identifies key issues in relation to terms of reference (a), (b) and (d), these matters will be considered in detail in the committee's second report.

1.17 Similarly, it is the committee's intention that its second and substantive report will consider term of reference (e) concerning the Defence Materiel Organisation (DMO). As part of these future deliberations, the committee will consider the impact of DMO operating as a Prescribed Agency.

1.18 The Defence Trade Controls Bill 2011, the purpose of which is to implement the *Treaty Between the Government of Australia and the Government of the United States of America Concerning Defence Trade Cooperation* is currently before the Senate Foreign Affairs, Defence and Trade Legislation Committee. Matters of substance raised by that committee may have implications for this inquiry and will, therefore, be considered by this committee in its main report.

Challenges encountered by the committee

1.19 It only takes a cursory glance at a Defence procurement chart to see the convoluted and incomprehensible web of documents, committees and milestones that underpin the capability development and procurement process. In this report, the committee sets out to simplify this maze by identifying the key steps and those responsible for fulfilling them. In pursuit of this objective, the committee sought evidence from a wide range of Defence stakeholders and held four days of hearings with Defence agencies, industry, analysts, and observers.

1.20 From the outset, however, the committee recognised that there are a number of challenges to achieving this objective. These include:

- the layers of administrative bureaucracy and documentation which have contributed to a process which is convoluted and extremely difficult to penetrate and understand;
- the ongoing reform agenda and ever-shifting ground under which Defence operates;
- the effect of an ever-growing number of reviews which remain pertinent but limited implementation, failure to adhere to policy or inconsistent application result in failings and shortcomings which are then met with another round of reviews and committees formed to respond to them;

- reluctance on the part of the defence industry to criticise publicly Defence procurement processes given the influence Defence is able to exert over industry as a monopsony; and
- the potential for the independent voice of agencies such as DSTO and DMO to get lost in pursuit of a 'One Defence' position.

1.21 These challenges remain before the committee in trying to understand the process, its structure and people. Whilst seeking to bring coherence to the procurement process in this report, the committee identifies, at each stage of the capability development life cycle, a series of unanswered questions, concerns and issues for future clarification.

Structure of report

1.22 This report focused on the findings and recommendations of Defence reviews including the Kinnaird Review, Mortimer Review and Pappas Report before considering the response and reforms undertaken by Defence agencies to implement those recommendations.

1.23 Each chapter of the report considers a phase in the capability development and acquisition process in terms of the process, the structure or the division of responsibility and accountability between the involved agencies and the personnel involved.

1.24 Chapter 2 provides an introduction and overview to the Defence capability development and procurement context which it recognises as unique in a number of ways including the fact that the government operates as both regulator and customer.

1.25 Chapter 3 details the respective Defence reviews (Kinnaird, Mortimer and Pappas) before outlining the current range of reviews before Defence and their implications for Defence.

1.26 Chapter 4 concerning the first stage of the capability development process identifies a number of concerns raised in evidence including the transition from strategy to capability, early engagement with and input from industry, and timely consideration of capability sustainability and whole-of-life costs.

1.27 Chapter 5 details the requirements stage of the process and acknowledges the debate surrounding consideration of the military-off-the-shelf option in relation to risk and industry sustainability.

1.28 Chapter 6, concerning the acquisition phase, considers governance issues including contract management, oversight and coordination as well as commercial practices.

1.29 Chapter 7 details the sustainment phase and raises questions regarding the strategic decision making process in relation to industry capacity to maintain an

Australian Defence Force capability and the centralisation of sustainment functions to the Defence Materiel Organisation.

1.30 In trying to make its way through the maze of procurement, the committee endeavours to peel back the layers of administrative bureaucracy in order to identify the fundamental elements critical to the integrity of the process. To this end, Chapter 8 provides an overview of the key areas that the committee intends to pursue.

Note on references

1.31 References to the Committee Hansard are to the proof Hansard: page numbers may vary between the proof and the official Hansard.

Acknowledgements

1.32 The committee would like to thank the individuals and organisations who contributed to the inquiry.

