

# Chapter 1

## Introduction

### Conduct of inquiry

1.1 On 9 February 2011, the Senate referred the following terms of reference to the Foreign Affairs, Defence and Trade References Committee for inquiry and report by 30 November 2011:

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;
- (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.

1.2 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.

1.3 On 30 November, the Senate granted the committee an extension to the inquiry's reporting date to 16 December 2011. On 15 December 2011, the committee tabled out-of-session a preliminary report, which was intended as a forerunner to a more substantial report to be tabled on 28 June 2012. Following the tabling of the preliminary report, the committee wrote to all submitters drawing their attention to the report and inviting them to respond to its findings. The committee also announced the publication of the report in the *Australian* calling for comments or supplementary submissions.

1.4 Initially the committee received 32 public and 4 confidential submissions and held public and in camera hearings in Canberra. Following the tabling of the preliminary report, the committee received a further twenty-two submissions and held two days of public hearings on 12 and 13 June 2012.<sup>1</sup> As part of its public hearing program, the committee held a roundtable discussion with a number of analysts appearing in their private capacity on 12 June and a roundtable comprising six independent members of the gate review boards on 13 June 2012. (See appendix 4 for background information on the members).



*The committee held a round table of defence analysts*

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1 Submissions 37–42 and Supplementary Submissions 3A–G, 4A, 6A, 11A, 14A, 17A, 21A, 21B and 22A, 40A.



*Six independent members of the gate review boards gave evidence before the committee*

1.5 During the two days of hearings, the committee requested a substantial amount of additional information, including an assessment by the six independent members of the review boards on the strengths and weakness of the boards. The committee required some time to consider this material. On 26 June, the Senate granted the committee an extension to 23 August 2012 to report.

### ***Change in Defence personnel***

1.6 During the committee's inquiry, a number of key senior officers involved in the acquisition projects of major defence assets left the Australian Defence organisation (Defence). They included Dr Steve Gumley who retired from the position of CEO, Defence Materiel Organisation (DMO) in July 2011 and Air Marshal John Harvey, who left his position as Chief of the Capability Development Group (CCDG) toward the end of 2011.

1.7 Mr Warren King is now the CEO of DMO and Vice Admiral Peter Jones is the CCDG.

### *Developments during inquiry*

1.8 A number of major announcements were made during the inquiry that should be noted. On 3 May 2012, the Prime Minister released the final report of the Defence Force Posture Review, a fundamental component of Defence planning, which found that some adjustments should be made to meet Australia's future needs. In particular, it identified expanding maritime capabilities as 'significantly influencing Australia's future force posture'. At the same time, the Prime Minister revealed that the government would start work on a new Defence White Paper to be delivered in the first half of 2013.<sup>2</sup> The Minister for Defence (the minister) also announced numerous changes to strengthen Defence's procurement system, including reforms to project management accountability. These matters are dealt with where relevant throughout this report.

### *Reviews and references*

1.9 Numerous reviews and audits have been undertaken over the past years that have a direct bearing on Defence's procurements practices. The major references used in this report are listed in a selected bibliography at the end of the report. The key references, however, are:

- *Report of the Defence Procurement Review*, 15 August 2003 (Kinnaird Review);
- *Going to the Next Level: The Report of the Defence Procurement and Sustainment Review*, 2008 (Mortimer Review);
- *2008 Audit of the Defence Budget*, 3 April 2009 (Pappas Report);
- *Review of the Defence Accountability Framework*, January 2011 (Black Review);
- *Plan to Reform Support Ship Repair and Management Practices*, July 2011 (Rizzo Report);
- *Collins Class Sustainment Review*, Phase 1 Report, 4 November 2011 (Coles Review);
- *ANAO Major Projects reports*; and
- *ANAO Performance Audit reports* (see bibliography).

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2 Media Release, 'Prime Minister, Minister for Defence—Joint Media Release—Release of final Defence Force Posture Review report', 3 May 2012, <http://www.minister.defence.gov.au/2012/05/03/prime-minister-minister-for-defence-joint-media-release-release-of-final-defence-force-posture-review-report/> and Media Release, 'Prime Minister, Minister for Defence—Joint Media Release—New Defence White Paper 2013', 3 May 2012, <http://www.minister.defence.gov.au/2012/05/03/prime-minister-minister-for-defence-joint-media-release-new-defence-white-paper-2013/> (accessed 3 May 2012).

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## Site visits to South Australia and Western Australia

1.10 Between 5 and 8 March 2012, the committee visited a number of Defence and defence industry sites in Australia during which they received briefings from, and talked to, personnel on matters related to defence procurement. Undertaken after the committee had already considered evidence and produced a preliminary report, the visits were intended to allow committee members to test their initial findings and to explore further questions that remained unanswered.

1.11 At the AWD System Centre in South Australia, the committee spoke to people working on the Air Warfare Destroyer (AWD) Program. The committee also received a briefing on the Collins Class Submarine program, toured the submarine shipyard and inspected one of the Collins Class submarines undergoing maintenance. Members took the opportunity to inspect the Common User Facility Techport South Australia.

1.12 On the second day, the committee visited Defence Science and Technology Organisation (DSTO) Edinburgh and RAAF Edinburgh and held discussions with people from the Over the Horizon Radar System Program Office and the Maritime System Program Office. While at RAAF Edinburgh, the committee inspected two AP-3C Orion aircraft that were undergoing an upgrade. Committee members also had a long and valuable discussion with officers from the Aerospace Operational Support Group, with a special focus on the role of test and evaluation in procurement.

1.13 The following day, the committee travelled to Perth and on to HMAS *Stirling* where members spoke to personnel with the Navy Guided Weapon System Program Office and visited the Torpedo maintenance facility. While in HMAS *Stirling*, the committee also visited the Australian Maritime Warfare Centre. On the way back to Perth, the committee stopped at the office of Thales and received a briefing on a number of defence projects including the Guided Missile Frigate (FFG) upgrade.

1.14 On the fourth day, a representative from the West Australian government spoke to the committee on the state government's investment in the Australian Marine Complex Common User Facility at Henderson. The committee travelled to the facility to inspect the complex. While there, the committee toured HMAS *Toowoomba*, which was to be launched the next day after undergoing maintenance. The committee then moved on to ASC WA and was again able to observe maintenance activities associated with the Collins Class submarine.



*Committee members inspecting Techport Australia, Osborne, South Australia, which included the South Australian Government Common User Facility*



*While at the Australian Marine Complex Common User Facility, committee members toured HMAS Toowoomba*

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## *Overseas visit*

1.15 As part of a joint parliamentary delegation with the Joint Standing Committee on Foreign Affairs, Defence and Trade, four committee members travelled to the United Kingdom (UK), Spain, Germany and the United States (US) in April 2012. This visit provided them with the opportunity to inspect manufacturing sites and hold discussions with government and industry officials. The focus was on defence procurement with committee members particularly interested in learning more about projects in which Australia has a vested interest including the Joint Strike Fighter (JSF) and the MRH-90 helicopter. In light of Australia's intention to acquire 12 submarines, the committee was also keen to learn more about developments in the area of the design and construction of submarines.

1.16 Committee members greatly appreciated the efforts of those who contributed to the planning and smooth operation and overall success of the delegation trip. They thank the staff of the International and Community Relations Office, in particular, the visit coordinators, Ms Fiona Way and Mr Raymond Knight, for their administrative support. The committee is also grateful to the many organisations and individuals for their hospitality, insights and willingness to draw on their considerable experiences to assist the delegation obtain a better understanding of international developments in major defence acquisitions. For a full list of acknowledgements see the delegation report tabled in Parliament in August 2012.<sup>3</sup>

## **Scope and structure of the report**

1.17 In its preliminary report, the committee identified the main areas that it wished to pursue and the key questions that would guide further investigations. At that stage, the committee made no recommendations but did raise a number of matters that it intended to pursue. The final paragraph of the executive summary makes clear that, having highlighted long standing problems, the committee's intention was then:

...to invite comment on the underlying causes that need to be fixed if Defence's reform program is to be effective and lasting. For example, it raises questions about whether an attitudinal sea change is required involving, on the part of Defence leadership, a commitment to genuine reform and to developing skills; openness to scrutiny; and willingness to accept responsibility, to be accountable and to lead. On the other hand, entrenched structural impediments to efficient and effective leadership within Defence could be at the source of Defence's procurement problems requiring reallocation and redefinition of roles, functions and responsibilities. Indeed, the current management matrix model may need overhauling or even dismantling.<sup>4</sup>

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3 *Report on the Australian Parliamentary Delegation to the UK, Spain, Germany and the United States*, 14 April–3 May 2012, tabled in the Senate 15 August 2012.

4 Senate Foreign Affairs, Defence and Trade References Committee, *Procurement procedures for Defence capital projects*, Preliminary report, December 2011, p. xiv.

1.18 The committee has set itself the difficult task of not only identifying problems but offering solutions to the root causes of Defence's capability development woes. Thus, the central question shaping this report concerns the forces at work, including government decisions, undermining Defence's efforts to achieve high performance when acquiring major capital equipment. The committee's intention is to look beyond the symptoms which, despite a decade of reviews and reforms, still persist. It is time to put the structure that has produced the problems under the spotlight.

1.19 Throughout this report, the committee's focus is on: identifying these forces; examining the effectiveness of Defence's measures to counter them; and offering possible solutions. The dominant issues relate to:

- organisational structures—the management matrix;
- risk management;
- compliance with, and awareness of, procurement policy and guidelines;
- responsibility and accountability;
- communication, integration, and collaboration;
- contestability and independent advice;
- the skills and experience of people involved in major defence acquisition projects and the quality of analysis; and
- industry—skills, workforce and relationship with Defence.

1.20 The report is divided into six main parts and starts by presenting concrete examples of where projects have encountered significant problems. In doing so, it has relied heavily on recent Major Projects Reports, ANAO performance audits, evidence taken over the years during Senate estimates hearings, as well as domestic and overseas inspections and extensive evaluation of substance. The committee then works backward from the identification or manifestation of problems to determine their origins and the extent to which Defence could or should have anticipated, mitigated and/or prevented them. In light of Defence's claims that it has implemented reforms, the committee seeks to establish whether Defence's practices are consistent with the reforms, including the Kinnaird and Mortimer recommendations for the independence of DMO and the centralisation of authority in the capability managers.

### ***Part 1—Major acquisitions—background and context***

1.21 To answer its questions, the committee in Part I of this report reworks some ground covered in the preliminary report. The committee begins by considering the major risks, both external and internal, to a successful acquisition project. This part contains three chapters.

- *Chapter 2* looks at a number of projects that have experienced difficulties, such as schedule slippage and readjustments to original capability definition. The committee then notes the causes for the problems as identified by Defence and other sources.



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- In light of these lessons, *Chapter 3* considers the White Paper and discernible trends with projects still in their embryonic stage.
  - *Chapter 4* establishes the context in which defence organisations acquire their major capital assets. The committee considers the risks posed to the success of these projects in an era of rapid advances in technology and shifts in the world's geo-political environment. While the committee acknowledges that many of the problems arise from external factors largely beyond Defence's control, such as the sheer magnitude and complexity of defence acquisitions and political direction, it considers whether some of the problems stem from, or are exacerbated by, 'self inflicted' poor management practices. The committee also looks at Defence's unwillingness to implement recommended organisational change, resulting in increasing control by a growing Defence bureaucracy and diminution of technical skills.

### ***Part II—Compliance with, and awareness of, policy and guidelines***

1.22 The preliminary report endeavoured to describe the acquisition process from the conceptual stage through to entry to the Defence Capability Plan (DCP) to acquisition and delivery and in service operation. It found the process convoluted. To understand the process better, in Part II the committee looks at risk management, which is supposed to start with the initial capability development proposal and follow a logical sequence throughout its life. This part contains two chapters.

- *Chapter 5* establishes whether, consistent with sound management practices, Defence has an appropriate risk management policy and provides adequate guidance on identifying and mitigating risk in defence acquisition projects.
- *Chapter 6* builds on the consideration of policy and official guidelines on risk management to focus on compliance, awareness and documentation—it is concerned with the practical implementation of, and adherence to, policy and relevant manuals and handbooks.

### ***Part III—Accountability, responsibility and collaboration***

1.23 There are a number of key participants in the development and delivery of a major defence capability as well as various committees that become involved at particular stages in the acquisition process. In Part III, the committee is interested in decision-making and who takes responsibility and is held accountable for decisions and, in this management context, the relationship between the various groups engaged in procurement.

- *Chapter 7* looks at the allocation of responsibility between the various groups involved in decision-making and the extent of their accountability for decisions and project performance related to their areas of responsibility.
- *Chapter 8* recognises that there are many stakeholders involved in an acquisition project, each with their own particular interpretation of what constitutes a successful capability and on the priorities for achieving that objective. It examines how these various groups work as an integrated unit

toward delivering capability to the ADF and the extent to which that is frustrated by organisational barriers.

#### ***Part IV—Contestability and independent advice***

1.24 The committee understands that decisions on capability development are critical to Australia's national security and require extensive consultation and deep consideration. In this context:

- *Chapter 9* examines the importance of contestability and independent advice in Defence's decision-making on capability development and the way it goes about testing assumptions that underpin acquisition proposals. In this chapter, the committee looks at the White Paper and the Defence Capability Plan. As part of its discussion on contestability, the committee reflects on the debate concerning the role of the former Force Development and Analysis Division and explores the adequacy of the current model constructed in its place.
- *Chapter 10* continues the committee's consideration of contestability and independent advice but focuses on the process following first pass approval.

#### ***Part V—Right people, skills and analysis***

1.25 This part of the report recognises that many of the difficulties experienced by projects stem from technical problems—that is an underestimation of the need for developmental work and/or failure to understand the complexity of the integration of a system or a platform. In this chapter, the committee looks closely at the people engaged in Defence's procurement activities and their related skills. It acknowledges that to be a smart customer, Defence not only needs to be a knowledge based organisation but, taking account of the different stakeholders, a well integrated one and one that ensures it places the right people in the right places.

- *Chapter 11* explores the proposition that to acquire major defence assets effectively, Defence needs to have the right people in the right place at the right time. It determines whether Defence is an intelligent buyer.
- *Chapter 12* recognises that today's major defence acquisitions are technically challenging. In this chapter, the committee looks at the quality of analysis as the basis for decision-making. It uses Test and Evaluation as a tool to examine the extent to which Defence is an informed customer.

#### ***Part VI—Industry—workforce and relationship with Defence***

1.26 Part VI is concerned with defence industry as a vital partner with Defence in the success of a project. It contains two chapters:

- *Chapter 13* examines the role of defence industry in delivering capability to Australia's Defence Force (ADF) and the ways in which Defence assists industry to make that vital contribution. In the process, the committee also explores areas where Defence and industry could improve their performance. This chapter focuses on the skills in defence industry, the reliability and

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quality of information provided by Defence through the White Paper and Defence Capability Plan (DCP) and the flow of work to industry including recent trends in the approval rate for projects.

- *Chapter 14* continues to explore the ways in which Defence and industry work together to deliver capability to the ADF. The committee's main focus is on the relationship between Defence and the defence industry, including the value of engaging industry early in capability development; contracting; and risk sharing.

### ***Part VII—Conclusion***

1.27 The report's conclusion brings together the various strands running through the report and makes recommendations for improved accountability by increasing transparency in decision-making, clarifying roles and responsibilities in a complementary way, building skills and ensuring best management practices.

### **Acknowledgements**

1.28 The committee thanks all those who contributed to the inquiry, including overseas people, by making submissions, providing additional information, appearing before it to give evidence and providing such valuable feedback on the preliminary report. In particular, the committee wishes to express its gratitude to Defence, industry and state government officials who helped the committee arrange its visit to various facilities in South Australia and Western Australia and for their willingness to assist the committee. The committee notes especially the work of Mr Grant Lever from DMO who contributed greatly to the success of the visit. Finally, the committee expresses its gratitude to the analysts and the independent members of the gate review boards for participating in roundtable discussions which produced a significant amount of valuable evidence.

