

# **Defence's Administration of the Integrated Investment Program**

Department of Defence

Department of Finance

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Canberra ACT  
29 November 2022

Dear Mr Speaker  
Dear President

In accordance with the authority contained in the *Auditor-General Act 1997*, I have undertaken an independent performance audit in the Department of Defence. The report is titled *Defence's Administration of the Integrated Investment Program*. I present the report of this audit to the Parliament.

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's website — <http://www.anao.gov.au>.

Yours sincerely

A handwritten signature in black ink, which appears to read 'Grant Hehir', is positioned below the 'Yours sincerely' text.

Grant Hehir  
Auditor-General

The Honourable the President of the Senate  
The Honourable the Speaker of the House of Representatives  
Parliament House  
Canberra ACT

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For further information contact:  
**Australian National Audit Office**  
**GPO Box 707**  
**Canberra ACT 2601**

**Phone: (02) 6203 7300**  
**Email: [ag1@anao.gov.au](mailto:ag1@anao.gov.au)**

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### **Audit team**

David Rowlands  
Fraser McEachan  
Corné Labuschagne  
Qing Xue  
Sally Ramsey

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# Audit snapshot

## Auditor-General Report No.7 2022–23

*Defence's Administration of the Integrated Investment Program*



### Why did we do this audit?

- ▶ To provide independent assurance on the Department of Defence's (Defence's) processes for managing its Integrated Investment Program (the IIP) and transparency in relation to the project costs reported in the two public editions of the IIP released since 2016.



### What did we find?

- ▶ Defence's administration of the Integrated Investment Program since 2016 has been partly effective.
- ▶ While Defence has established a largely effective governance, control and approval framework for the management of the Program, it has not established an effective framework to guide its public reporting on the Program.



### Key facts

- ▶ The IIP contains all elements of defence investment, including: new weapons, platforms, systems and enabling equipment; facilities and infrastructure; workforce; information and communications technology; science and technology.
- ▶ The IIP is managed by Defence and reviewed biannually by the government.
- ▶ Defence has released two public editions of the IIP, the *2016 Integrated Investment Program* and the *2020 Force Structure Plan*.



### What did we recommend?

- ▶ The Auditor-General made six recommendations aimed at improving Defence's governance and control framework for the management of the IIP and establishing elements of a framework to support public reporting on the IIP.
- ▶ Defence agreed to five of the six recommendations

\$134.1 bn

is the value of new IIP project proposals approved from 2016 to 2022.

70%

of the Defence annual budget is expected to be allocated to the IIP by the end of the decade.

2%

Defence funding first reached this proportion of Australia's Gross Domestic Product in 2020–21.

# Summary and recommendations

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## Background

1. The Integrated Investment Program (IIP or Program) is a comprehensive program of capability-related projects proposed by the Department of Defence (Defence). Defence has reported that:

The IIP contains all elements of the Government's defence investment, including new weapons, platforms, systems and enabling equipment; facilities and infrastructure; workforce; information and communications technology; and science and technology.<sup>1</sup>

2. The Program was developed in 2015 to address a key recommendation of the 2015 *First Principles Review: Creating One Defence* (the First Principles Review). Since March 2016, a key element in maintaining the Program has been a classified and detailed spreadsheet, known internally as the IIP 'broadsheet'. To date, Defence has released two public editions of the Program, the 2016 *Integrated Investment Program* and the 2020 *Force Structure Plan*.

3. Defence's 2021–25 *Defence Corporate Plan* states that:

Defence has one of the largest capital investment programs in the Commonwealth, consisting primarily of acquisition, sustainment and support of Defence capabilities. The Integrated Investment Program includes all capital and related investments (such as materiel, estate and facilities, workforce and information and communications technology).

...

The Integrated Investment Program is reviewed annually to address strategic changes and emerging technologies and priorities.

...

The 2020 *Force Structure Plan* and the Integrated Investment Program will continue to support the acquisition and sustainment of Defence capability to meet the challenges of the future operating environment.<sup>2</sup>

4. The Defence Portfolio Budget Statements (PBS) for 2022–23 record planned expenditure for the year of \$47.98 billion, including: capability acquisition costs of \$16.26 billion, sustainment costs of \$14.98 billion and workforce costs of \$14.16 billion.<sup>3</sup> Together, acquisition and sustainment of Defence capability account for over 65 per cent of Defence's 2022–23 budget documented in the PBS.

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1 Department of Defence, *Defence Annual Report 2018–19* [Internet], 'Capital investment', p. 130, available from <https://www.defence.gov.au/sites/default/files/2021-10/AR-2018-19.pdf> [accessed 30 September 2022].

2 Department of Defence, *2021–25 Defence Corporate Plan* [Internet], p. 22, available from <https://www.defence.gov.au/sites/default/files/2021-08/2021-25-DefenceCorporatePlan.pdf> [accessed 10 March 2022]. Defence defines 'capability' as the power to achieve a desired operational effect in a nominated environment within a specified time, and to sustain that effect for a designated period.

3 Department of Defence, *Portfolio Budget Statements 2022–23* [Internet], p. 15, Table 4b, available from [https://www.defence.gov.au/sites/default/files/2022-03/2022-23\\_Defence\\_PBS\\_00\\_Complete\\_0.pdf](https://www.defence.gov.au/sites/default/files/2022-03/2022-23_Defence_PBS_00_Complete_0.pdf) [accessed 14 July 2022]. Operating costs of \$2.39 billion and Operations costs of \$193 million make up the remainder of Defence expenditure.

## **Rationale for undertaking the audit**

5. This audit was undertaken to provide independent assurance to the Parliament on Defence's processes for managing its Integrated Investment Program since 2016, and to provide transparency in relation to Defence program/project costs reported in the two public editions of the Program released since 2016.

6. The audit was identified as an audit priority of the Parliament by the Joint Committee of Public Accounts and Audit (JCPAA) in response to the ANAO's proposed 2021–22 Annual Audit Work Program.

## **Audit objective and criteria**

7. The audit objective was to examine the effectiveness of Defence's administration of the Integrated Investment Program since 2016.

8. To form a conclusion against the audit objective, the following high-level criteria were adopted:

- Has Defence established an effective governance, control and approval framework for the management of the Integrated Investment Program?
- Has Defence established an effective framework to guide its public reporting on the Integrated Investment Program?

9. The ANAO considered the arrangements used to manage and report publicly on the Integrated Investment Program, particularly public reporting of the costs of the projects that comprise the Program. In this context, the audit focused on two major projects, the former Future Submarine (Attack class) program and the ongoing Future Frigate (Hunter class) program, being two of the most expensive projects Defence has embarked upon.<sup>4</sup> The costings for these projects have also been the subject of ongoing parliamentary interest.<sup>5</sup>

10. The ANAO sought to understand the relationship between the two public documents setting out the Integrated Investment Program in 2016 and 2020 and the contemporaneous underlying confidential IIP broadsheet maintained by Defence. That is, how the two public documents were derived from the relevant iteration of the confidential broadsheet and how the public documents correspond to or map to the relevant broadsheet.

11. The ANAO did not examine how Defence calculated and assured its costings for the individual projects comprising the Integrated Investment Program. Further, the audit did not encompass Defence's processes for identifying its capability needs or how it develops programs/projects to address them.

12. References in this audit report to the IIP or Program refer to the policy, budgeting and administrative activities led by Defence as part of the Integrated Investment Program activity. References to the IIP 'broadsheet' refer to the underlying non-public (classified) document maintained by Defence, which is a key artefact used to capture information on the Program. The

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4 The programs are discussed in the body of the audit report.

5 See for example correspondence requesting that the Auditor-General examine the Future Submarine and Future Frigate program costings [Internet], available at: <https://www.anao.gov.au/work/request/future-submarine-and-future-frigate-programs> [accessed 10 June 2022].



two public versions of the Program published to date are referred to by their publication name — *2016 Integrated Investment Program* and *2020 Force Structure Plan*.

## Conclusion

13. Defence's administration of the Integrated Investment Program since 2016 has been partly effective. While Defence has established a largely effective governance, control and approval framework for the management of the Program, it has not established an effective framework to guide its public reporting on the Program.

14. Defence's management of the Program is occurring within a defined structure and at a level commensurate with its cost, importance and program risk. There is an established governance structure, an identified senior responsible officer, and a biannual process for government consideration supported by central agency guidance and review. Defence also has an appropriate process for authorising the entry of projects into the Program, requiring government agreement through the biannual process, and an appropriate process for ensuring updates and changes to the Program are approved. However, Defence cannot provide assurance over IIP broadsheet controls or content before 2021 because the broadsheets were updated manually. In 2021, Defence commenced a progressive rollout of a systemised broadsheet to automate updates, mitigate the risk of error or unauthorised change, and improve the level of assurance it can provide over the broadsheet's control framework and contents.

15. For the two public editions of the Program published to date, there was no guidance to officials on how to report publicly, and the transparency and usability of the public editions was reduced by: making it difficult to identify projects and track between public editions; omitting certain projects or aggregating projects without some explanation of the approach adopted; and using different approaches to report potential costs without explaining why. The reporting approach adopted for the Future Submarine and Future Frigate programs in the first public edition, particularly the inclusion of substantially lower minimum costs than those provisioned for in the underlying confidential IIP broadsheet, fell short of providing accurate, reliable and transparent information for users of the public document. Defence did not establish effective systems for reconciling information in the IIP broadsheet and the public editions of the Program, and did not seek arm's length verification that the costings included in the public editions accurately reflected the broadsheet costings.

## Supporting findings

### Governance, control and approval framework

16. Management of the Integrated Investment Program is occurring within a defined structure and at a level commensurate with its cost, importance and program risk. The structures include a high-level defence committee, the Investment Committee, chaired by the senior responsible officer (the Vice Chief of the Defence Force) who is accountable for the Program. The processes for managing the Program are set out in Defence's budget and capability development policies and in specific estimates memoranda and Budget Process Operational Rules (BPORs) issued by the Department of Finance (Finance). Project proposals are scrutinised by Defence's Contestability Division and central agencies (Finance and the Department of the Prime Minister

and Cabinet), before going to government for consideration. Biannual updates are provided to and considered by government. (See paragraphs 2.2 to 2.20)

17. Effective management of the Program was weakened when figures in the IIP broadsheet did not consistently encompass whole-of-life costs and the rules regarding the identification of offsets for nominally unaffordable projects were not observed. Over time, Defence has sought to improve and streamline the structure that supports the operation of the Program. (See paragraphs 2.21 to 2.42)

18. Defence currently has an appropriate process for authorising the entry of projects into the Program; that is, projects can enter only with government agreement. This occurs through government endorsement of the biannual update to the Program. However, Defence cannot systematically evidence how projects not specifically identified in the published *2016 Integrated Investment Program* originally gained authority for inclusion in the Program, as it did not maintain a log of when each project was approved for entry by the government. (See paragraphs 2.43 to 2.55)

19. Defence has appropriate processes for ensuring updates and changes to the Program are approved. Changes are recorded and logged in a budget change journal for Defence's financial system (BORIS) on a project basis. These changes are extensive. (See paragraphs 2.56 to 2.61)

20. From 2016 until recently, Defence's processes for the generation and maintenance of the IIP broadsheet have been largely manual. Controls for mitigating the risk of unauthorised changes have relied on access restrictions and Defence's management of changes has relied on project or capability managers checking for accuracy. Defence could not provide assurance over IIP broadsheet content or controls because the broadsheets were updated manually. (See paragraphs 2.62 to 2.65)

21. System changes which Defence commenced rolling out in 2021 are intended to automate updates to the IIP broadsheet that are traceable to the authority for the change. This is expected to further mitigate the risk of error or unauthorised change and improve the level of assurance that Defence can provide over the broadsheet's control framework and contents. (See paragraphs 2.66 to 2.79)

## **Public Reporting**

22. For the two public editions of the Program published to date — the *2016 Integrated Investment Program* and the *2020 Force Structure Plan* — there was no guidance to officials on how to report publicly on the Program. (See paragraphs 3.3 to 3.6)

23. The *2016 Integrated Investment Program* included a commitment to produce an online edition of the IIP to ensure industry access to current information, with periodic updates to reflect changes in the Program, and Defence advised the Parliament in February 2017 that the online version would be available within months. Defence subsequently (May 2020) advised the Defence Minister against developing a website with more detailed IIP project and program data than was about to appear in the *2020 Force Structure Plan*, on the grounds of security and commercial risk. Defence records indicate that it received no response to this advice. Defence did not publish an online edition of the IIP. (See paragraphs 3.7 to 3.14)

24. The transparency and usability of the two public editions of the Program has been reduced by:

- each public edition providing limited data, being acquisition-focused and without forecast sustainment or workforce costs for individual projects or programs;
- making it difficult to identify projects and track between public editions;
- omitting certain projects or aggregating projects without some explanation of the approach adopted; and
- using different approaches to report potential costs without explaining why, particularly where the cost range is unbounded, with no upper limit, as in the case of the Future Submarine and Future Frigate programs.

25. While Defence needs to manage security and commercial issues in its public reporting on the Program, industry has advised the ANAO that the two public editions released to date do not provide the insight industry expects. (See paragraph 3.15 to 3.37)

26. Defence's systems could not provide clear line-of-sight traceability or complete and accurate evidence — for the purposes of internal quality assurance or independent review — regarding the basis for, and accuracy of, public reporting in the *2016 Integrated Investment Program* document. (See paragraphs 3.38 to 3.44)

27. Defence has not retained records about how it developed the public *2016 Integrated Investment Program* and populated it with cost data from the contemporaneous broadsheet and could provide no means to map between the two. Therefore, Defence systems do not enable itself or an independent reviewer to trace systematically, and with confidence, the source of the data in the public document nor to assess whether there is systematic variance in the financial information contained in the broadsheet and public reporting in 2016 on its content. Through comparative analysis, the ANAO was able to identify 67 per cent of the projects in the public document by names in the Defence broadsheet with broadly consistent acquisition cost data.

28. The majority of the cost figures in the public *2016 Integrated Investment Program* accurately reflect those provided to government by Defence in the draft version of the document. Nevertheless, some anomalies exist. (See paragraphs 3.45 to 3.57)

29. The reporting approach adopted for the Future Submarine and Future Frigate programs in the *2016 Integrated Investment Program* — particularly the inclusion of substantially lower minimum costs than those provisioned for in the confidential IIP broadsheet — fell short of providing accurate, reliable and transparent information for users of the public document. For the Future Submarine, the capital cost advised to government in February 2016 (\$78 billion) was 56 per cent higher than the minimum capital cost of \$50 billion reported publicly at that time. For the Future Frigate, the figure appearing at that time in the IIP broadsheet (\$36 billion) was 20 per cent higher than the minimum cost of \$30 billion reported publicly. (See paragraphs 3.58 to 3.67)

30. On the basis of information available and advice from Defence, the ANAO did not identify any substantial differences between the second public edition of the Program (the *2020 Force Structure Plan*) and the underlying IIP broadsheet. Defence was able to provide the ANAO with a spreadsheet-based working document that helped to map between the *2020 Force Structure Plan* and the contemporaneous classified IIP broadsheet. (See paragraphs 3.68 to 3.75)

## Recommendations

**Recommendation no. 1**  
**Paragraph 2.54** The Department of Defence maintain a log of the date on which each project in the Integrated Investment Program was authorised, and by whom it was authorised.

**Department of Defence response:** *Agreed.*

**Recommendation no. 2**  
**Paragraph 2.75** The Department of Defence:

- (a) define all data elements in the broadsheet supporting the Integrated Investment Program;
- (b) prepare business rules for managing, maintaining and updating the broadsheet; and
- (c) keep systematic records of all changes and updates to the broadsheet in a manner that facilitates quality assurance and later review.

**Department of Defence response:** *Agreed.*

**Recommendation no. 3**  
**Paragraph 2.78** The Department of Defence develop an Integrated Investment Program risk management plan, to include risk management of IIP broadsheet risks and controls.

**Department of Defence response:** *Agreed.*

**Recommendation no. 4**  
**Paragraph 3.34** The Department of Defence state, in its public reports on the Integrated Investment Program, progress against its plans:

- (a) showing projects cancelled, amalgamated, slipped in timing, changed in title, scope or cost; and
- (b) publish sufficient information as to enable reconciliation of the public edition with the previous public edition.

**Department of Defence response:** *Not agreed.*

**Recommendation no. 5**  
**Paragraph 3.66** The Department of Defence define the purpose of any future public editions of the Integrated Investment Program and develop guidance for officials on the preparation and public release of IIP information to achieve the defined purpose. This guidance should also include a reporting structure that provides confidence that public reporting is accurate and transparent. Where there is a need to balance commercial or other sensitivities, public reporting should document the approach adopted.

**Department of Defence response:** *Agreed.*

**Recommendation no. 6** For future public editions of the Integrated Investment Program, the Department of Defence maintain sufficient internal documentation to provide clear line-of-sight traceability to the classified IIP broadsheet.

**Paragraph 3.73**

**Department of Defence response:** *Agreed.*

## Summary of the Department of Defence's response

31. Defence's summary response is provided below and its full response is included at Appendix 1. The response received from the Department of Finance is also included at Appendix 1.

Defence acknowledges the ANAO's assessment that Defence has a largely effective governance, control and approval framework for the management of the Integrated Investment Program. Significant work has been undertaken by Defence since the release of the First Principles Review which has improved Defence's ability to successfully invest in its capability.

Defence keeps the Government, Parliament, the Australian Public and Industry informed on its capability program through a range of approaches. These approaches include submissions to Government, Government Committee hearings, audits and reviews by the ANAO, Industry briefings and media releases. Any future public release of the Integrated Investment Program will be subject to consideration by Government and will consider National Security implications as well as commercial sensitivities.

32. At Appendix 2, there is a summary of improvements that were observed by the ANAO during the audit.

## Key messages from this audit for all Australian Government entities

33. Below is a summary of key messages, including instances of good practice, which have been identified in this audit and may be relevant for the operations of other Australian Government entities.

### Governance and risk management

- Major investment programs such as Defence's Integrated Investment Program require governance and risk management arrangements commensurate with their cost, importance and program risk.
- The accuracy and completeness of information provided to the Parliament, public and industry on major government investment programs is essential to supporting transparency and users of the information. Where investment programs continue over many years, progress reports should be reconcilable with previously released information.



## **Audit findings**

# 1. Background

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## Introduction

### 1.1 The Department of Defence's (Defence) *2021–25 Defence Corporate Plan* states that:

Defence has one of the largest capital investment programs in the Commonwealth, consisting primarily of acquisition, sustainment and support of Defence capabilities. The Integrated Investment Program includes all capital and related investments (such as materiel, estate and facilities, workforce and information and communications technology).

The Integrated Investment Program is reviewed annually to address strategic changes and emerging technologies and priorities. Under the *2020 Force Structure Plan*, a comprehensive assessment of the Australian Defence Force's force structure and current and future Defence capability investments has been conducted. This assessment focussed on meeting the strategic guidance set out in the 2020 Defence Strategic Update, responding to a changing strategic context, new technologies and supporting ongoing modernisation of Defence over a 20 year timeframe.

The *2020 Force Structure Plan* makes necessary adjustments to Defence capability investments set out in the *2016 Defence White Paper* and the Integrated Investment Program to ensure capability, resources and strategy remain aligned.

Defence capability investment decision-making is supported by an arm's length contestability function that forms a core element of the Defence decision support framework to ensure that investment proposals are aligned with strategy and resources.

The *2020 Force Structure Plan* and the Integrated Investment Program will continue to support the acquisition and sustainment of Defence capability to meet the challenges of the future operating environment.

### 1.2 In its *2016 Defence White Paper*, the Australian Government introduced a 10-year funding model to give Defence long-term funding certainty. The commitment outlined in the White Paper was that the Defence budget would grow to \$42.4 billion in 2020–21, reaching two per cent of Australia's GDP as projected at that time:

The Government's defence strategy is supported by increased defence funding, which will grow to two per cent of Australia's gross domestic product by 2020–21, three years ahead of the Government's 2013 election commitment.<sup>6</sup> The Government's funding plan provides \$29.9 billion more to Defence over the period to 2025–26 than previously planned, enabling approximately \$195 billion of new investment in our defence capabilities in this period.<sup>7</sup>

### 1.3 The Defence Portfolio Budget Statements (PBS) for 2022–23 record that Defence planned expenditure for the year of \$47.98 billion, including: capability acquisition costs of \$16.26 billion,

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6 ANAO comment: the Department of Finance (Finance) advised the ANAO that Defence funding first reached two per cent of GDP in 2020–21 and is projected to remain above two per cent in the medium term. The *2016 Defence White Paper* (p. 179) states that the 'Government has decided that the 10-year funding model will not be subject to any further adjustments as a result of changes in Australia's GDP growth estimates. This decoupling from GDP forecasts will avoid the need to have to regularly adjust Defence's force structure plans in response to fluctuations in Australia's GDP'.

7 Department of Defence, *2016 Defence White Paper* [Internet], available from <https://www.defence.gov.au/about/strategic-planning/2016-defence-white-paper> [accessed 10 March 2022]. The *2016 Defence White Paper* was updated in 2020 with the release of the *2020 Defence Strategic Update*.



sustainment costs of \$14.98 billion and workforce costs of \$14.16 billion.<sup>8</sup> Together, acquisition and sustainment of Defence capability account for over 65 per cent of Defence's 2022–23 budget documented in the PBS. The Defence Internal Budget Manual states that the Integrated Investment Program is expected to rise to 70 per cent of the Defence budget by the end of the decade.<sup>9</sup> This means that there is a large and increasing volume of investment decision-making for Defence and government. In April 2021, Defence stated internally that it remained in a privileged position, being afforded government-agreed funding out to 2029–30 totalling \$575 billion.

1.4 The *2016 Defence Industry Policy Statement*, which was also released with the *2016 Integrated Investment Program* and *2016 Defence White Paper*, stated that:

The initiatives in this Defence Industry Policy Statement, together with the Integrated Investment Program, are designed to provide industry with confidence to invest in the required skills, infrastructure, and technologies to support the ADF into the future.<sup>10</sup>

1.5 Since the release of the *2016 Defence White Paper*, government approval has been given to over 651 capability proposals with a combined value of about \$134.1 billion (as of mid-2022).<sup>11</sup>

## The Integrated Investment Program

1.6 The Integrated Investment Program (IIP or Program) is a comprehensive program of capability-related projects proposed by Defence. Defence has reported that:

The IIP contains all elements of the Government's defence investment, including new weapons, platforms, systems and enabling equipment; facilities and infrastructure; workforce; information and communications technology; and science and technology.<sup>12</sup>

1.7 Since March 2016, the key element in maintaining the Program has been a classified and detailed spreadsheet, known internally as the IIP 'broadsheet'. The earliest edition of the broadsheet that Defence was able to locate in its records is dated March 2016. A description of the broadsheet is provided in Box 1.

1.8 Defence has released two public editions of the Integrated Investment Program, the *2016 Integrated Investment Program* and *2020 Force Structure Plan*. These public documents (discussed further in Box 3 and Box 4) replaced Defence's public *Defence Capability Plan*, which had been published periodically.

1.9 References in this audit report to the IIP or Program refer to the policy, budgeting and administrative activities led by Defence as part of the Integrated Investment Program activity.

8 Department of Defence, *Portfolio Budget Statements 2022–23* [Internet], p. 15, Table 4b, available from [https://www.defence.gov.au/sites/default/files/2022-03/2022-23\\_Defence\\_PBS\\_00\\_Complete\\_0.pdf](https://www.defence.gov.au/sites/default/files/2022-03/2022-23_Defence_PBS_00_Complete_0.pdf) [accessed 14 July 2022]. Operating costs of \$2.39 billion and Operations costs of \$193 million make up the remainder of Defence expenditure.

9 Department of Defence, *Defence Internal Budget Manual* (version 1.0, July 2021), issued by the Chief Financial Officer, outlines the policies and major processes that must be considered in developing, managing, and reporting on the Defence Budget.

10 Department of Defence, *2016 Defence Industry Policy Statement* [Internet], p. 12, available from <https://www.defence.gov.au/sites/default/files/2021-08/2016-Defence-White-Paper.pdf> [accessed 14 July 2022].

11 See Chapter 2, Table 2.1 of this audit.

12 Department of Defence, *Defence Annual Report 2018–19* [Internet], 'Capital investment', p. 130, available from <https://www.defence.gov.au/sites/default/files/2021-10/AR-2018-19.pdf> [accessed 30 September 2022].

References to the IIP ‘broadsheet’ refer to the underlying non-public (classified) document maintained by Defence, which is a key artefact used to capture information on the Program. The two public versions of the Program published to date are referred to by their publication name — *2016 Integrated Investment Program* and *2020 Force Structure Plan*.

#### Box 1: Defence’s Integrated Investment Program ‘broadsheet’

The Integrated Investment Program ‘broadsheet’ is a spreadsheet that lists Defence projects and project ‘provisions’ in future years — a provision being the funding profile allocated to the project by Defence. Provisions in future years, in effect, earmark amounts against future budgets and are allocated across years according to the expected approval and delivery timelines.

Separately, Defence develops and refines project cost estimates, which represent the funding needed to deliver a project based on the latest available information. Following government approval of a capability submission, the project budget is set and funded from the provision. Generally, Defence has the opportunity to update project provisions twice a year to align provisions with the latest planning and cost estimates.

Since 2016, the broadsheet has been updated regularly and used internally when Defence has needed to adjust and reprioritise its plans.<sup>a</sup> In March 2016, the broadsheet listed 546 acquisition projects, rising to 729 acquisition projects in January 2022.

The broadsheet does not include information on each project’s scope, context or interdependencies. Projects are identified by Defence identification number — such as ‘SEA 5000’ for the Future Frigate (Hunter class) project. Projects are disaggregated into phases.

The broadsheet sets out cost ‘provisions’ to meet expected capital and future sustainment expenditure for the next ten years, indicative figures for the following decade and, for some long-term projects, figures for some years thereafter. The broadsheet also includes amounts to address contingencies, and totals by project. Operating and workforce costs are not included.<sup>b</sup>

For projects or project phases that have been approved by government, the broadsheet includes those approved costs, usually shorter-term. It also includes those longer-term costs which remain unapproved but reside in the Integrated Investment Program as provisions (the great majority of entries in the broadsheet).

Provisions against future budgets are ‘out-turned’ (that is, varied or adjusted) to allow for expected future price changes due to inflation and exchange rate variation.<sup>c</sup>

Note a: The latest broadsheet reviewed by the ANAO has a file name date of 25 November 2021: ‘2021.11.25 – IIP Broadsheet – 2021–22 MYEFO Price Basis and Exchange’.

Note b: Defence has advised the ANAO, in the context of the annual Defence Major Projects Report, that it is not able to provide the staff cost component of projects and its systems are not capable of calculating the cost of retaining project staff over time. See Auditor-General Report No.13 2021–22, *2020–21 Major Projects Report*, [Internet] paragraphs 1.62–1.67, available from <https://www.anao.gov.au/work/major-projects-report/major-projects-report-2020-21> [accessed 18 September 2022].

Note c: Defence states that it ‘establishes cost estimates using out-turned costs (i.e. inclusive of agreed or estimated contract price indexation) to ensure that estimates include allowances for future inflationary cost increases and foreign exchange’, see the Glossary of Defence terms in Auditor-General Report No.13 2021–22, *2020–21 Major Projects Report*, p. 109. See also Appendix 3 of this audit report, relating to out-turned dollars.

1.10 Once a project is approved by government for entry into the Program, Defence has the policy authority to bring a spending proposal for that project forward for government consideration.<sup>13</sup> Subsequently, as government considers and approves individual projects (or stages of projects), funding is unlocked from the Program provisions and moved to 'approved' status.<sup>14</sup> These arrangements are particular to Defence and are designed to accommodate the volume, cost and timeframe of Defence's acquisition program.

## Development of the Integrated Investment Program

1.11 The Integrated Investment Program was developed in 2015 to address Recommendation 2.8 of the 2015 *First Principles Review: Creating One Defence* (known as the First Principles Review). The recommendation of the First Principles Review is discussed in Box 2.

### Box 2 Defence First Principles Review — Recommendation 2.8

Defence's First Principles Review was commissioned by the Minister for Defence in 2014. The focus of the review was to ensure that Defence would be fit for purpose, able to respond to future challenges, and could deliver against its outputs with the minimum resources necessary.

The Review proposed the abolition of Defence's former Defence Capability Plan and its replacement with a 'Defence Investment Plan that incorporates all major investments'.<sup>a</sup> The Review recommended 'the development of a Defence Investment Plan which would include all capital and related investments (such as materiel, estate and facilities, workforce and information and communications technology).

The Minister for Defence announced the Australian Government's agreement (or agreement-in-principle) to the recommendations of the Review on 1 April 2015.<sup>b</sup>

Note a: Defence, *First Principles Review: Creating One Defence*, Recommendation 2.8, p. 38. See also Auditor-General Report No.34 2017–18 *Defence's Implementation of the First Principles Review*.

Note b: K Andrews (Minister for Defence), 'Minister for Defence – First Principles Review of Defence', media release, available from <https://www.minister.defence.gov.au/media-releases/2015-04-01/minister-defence-first-principles-review-defence> [accessed 14 July 2022].

1.12 The first document setting out the Integrated Investment Program was provided to government for its consideration in June 2015. The Program listed 73 elements of the proposed future force structure, comprising current and proposed capabilities. This document had a 20-year horizon, with more detailed planning focused on the first ten years and an acknowledgement that many investment decisions made in the first ten years would extend well beyond that period in their delivery. The Future Submarines (later named the Attack class) and Future Frigates (later

13 Key processes and guidance are documented in estimates memoranda issued by the Department of Finance. These are discussed at paragraphs 1.18–1.24 of this audit report. The relevant document for this particular process is Estimates Memorandum 2017/55, paragraph 12. Defence can also bring forward a project not included in the Integrated Investment Program but as a new policy proposal, consistent with the Budget Process Operational Rules discussed at paragraphs 1.25–1.30 of this audit report.

14 Defence can address unaffordability by offering offsets in other projects, by delaying acquisition, cancelling or re-scoping a project or other reprioritisation.

named the Hunter class) were cited at this time as examples of projects with a multi-decade timeline.<sup>15</sup>

1.13 Defence provided government with a more comprehensive document setting out the Integrated Investment Program in early 2016. This formed the basis of the first public edition of the Program. A second public edition of the Program was released in 2020.

### The two public editions of the Integrated Investment Program

1.14 The first public edition of the Program, the *2016 Integrated Investment Program* (see Box 3), was released by the Prime Minister and Minister for Defence alongside the *2016 Defence White Paper* on 25 February 2016.<sup>16</sup> Defence announced this event as follows on its website:

For the first time, all elements of the Government's defence investment, including new weapons, platforms, systems, and the enabling equipment, facilities, workforce, information and communications technology, and science and technology are all outlined ...<sup>17</sup>

#### Box 3: Defence's 2016 Integrated Investment Program publication

The 200 Defence acquisition projects listed in Defence's publication, the *2016 Integrated Investment Program*, are grouped into six capability streams.<sup>a</sup> Defence advised government that the six streams provided a true reflection of its integrated joint force and increasingly joint nature of Australian Defence Force operations. For each capability stream, the document provides a table of 'Indicative Acquisition Windows of Key Approved and New Programs' for the decade to 2025–26, giving the program name, a broad timeline, and a forecast of the acquisition cost for each program, expressed on an out-turned basis. There are no project identification codes (such as 'SEA 5000', the identifier for the Future Frigate design and construction project), which Defence uses frequently in other publications and on its website.<sup>b</sup>

Each chapter addresses one of the capability streams and begins with a Gantt chart, a pictorial timeline showing a list of most of the projects and their expected duration. The document's intended focus is on the first ten years of funding provisions with 'broad guidance' on a second decade to 2035–36. Two projects in this document extend beyond 20 years, the Future Submarine project and the Future Frigate project.

Note a: The six capability streams in the *2016 Integrated Investment Program* comprise: (1) Intelligence, Surveillance, Reconnaissance, Electronic Warfare, Space and Cyber; (2) Key Enablers; (3) Air and Sea Lift; (4) Maritime and Anti-Submarine Warfare; (5) Strike and Air Combat; and (6) Land Combat and Amphibious Warfare.

Note b: In the documents examined as part of this audit, the terms 'program', 'project' and 'plan' are used frequently and often interchangeably. For example, acquisition of a major platform may be referred to as a 'project' or as a 'program', comprising many projects. For simplicity, 'project' has been used by the ANAO for each of the items listed in the *2016 Integrated Investment Program* and the *2020 Force Structure Plan*, unless the context requires otherwise.

15 On 16 September 2021, the Prime Minister announced that 'Australia, the United Kingdom and the United States had agreed to the creation of an enhanced trilateral security partnership — AUKUS'. The first initiative under AUKUS was for Australia to acquire nuclear-powered submarine technology. In parallel, the Prime Minister announced that Australia would no longer proceed with the Attack class conventional submarine program. S Morrison (Prime Minister), 'Australia to pursue nuclear-powered submarines through new trilateral enhanced security partnership', media statement, available from <https://pmtranscripts.pmc.gov.au/release/transcript-44110> [accessed 8 November 2022].

16 Department of Defence, *2016 Defence White Paper* [Internet], available from <https://www.defence.gov.au/about/strategic-planning/2016-defence-white-paper> [accessed 14 July 2022].

17 Department of Defence, *2016 Defence White Paper* [Internet].

1.15 The government released a second public edition of the Integrated Investment Program — though not identified under that name — in 2020, following a review of force structure and substantial reprioritisation of Defence projects. This publication was entitled *2020 Force Structure Plan* and was released with, and in support of, the *2020 Defence Strategic Update* (Box 4).<sup>18</sup>

#### Box 4: Defence's 2020 Force Structure Plan

On 1 July 2020, the Prime Minister and Minister for Defence announced the release of the *2020 Force Structure Plan* in conjunction with the *2020 Defence Strategic Update*.<sup>a</sup>

The Force Structure Plan provided a list of 106 investment items.

The document explained that the former capability streams had been refined into five operational domains, supported by the critical enabling capabilities of the Defence enterprise. The domains were further divided into 35 capability programs, each with a dedicated capability manager. Twenty-five of these programs reside within one of the five domains, while ten span all of the domains. This is referred to as Defence's 'Capability Program Architecture'.<sup>b</sup>

A new structure had been adopted and the constituent projects were combined in a different way from the previous (2016) public document because Defence found that applying the capability streams had introduced a structure that cut across existing lines of control and accountability. The element of 'matrix management' that this introduced had caused practical difficulties in accountability and management of the IIP. Defence reorganised this structure, creating the six domains, which aligned more closely to the ongoing ADF command structure.

Like the 2016 public document, there are no project identification codes and many items in the Force Structure Plan represent aggregations of multiple, separate but related Defence capability projects.

Although the *2020 Force Structure Plan* can be seen as a successor to the *2016 Integrated Investment Program* it was not presented as an 'update' to the earlier document and made no mention of it.

Note a: S Morrison (Prime Minister), 'Address – Launch of the 2020 Defence Strategic Update', Transcripts from the Prime Minister of Australia, 1 July 2020 [Internet], available from <https://pmtranscripts.pmc.gov.au/release/transcript-42881> [accessed 14 July 2022].

Note b: The five operational domains in the 2020 Force Structure Plan are: (1) Information and Cyber; (2) Maritime; (3) Air; (4) Space; and (5) Land. Defence advised the ANAO in August 2022 that: 'On 10 January 2020, the Prime Minister agreed to the revised five Domain and 35 Capability Program structure as the method of presenting the 2020 Force Structure Plan to Government. On 20 July 2020, the Secretary of Defence and the Chief of the Defence Force issued a Joint Directive to implement this structure as the revised Capability Program Architecture (CPA).'

1.16 Following the release of the *2020 Force Structure Plan*, Defence advised the Parliament in October 2020 that:

To provide Defence (inclusive of the Australian Signals Directorate) with a stable and sustainable long-term funding for capability planning, Government agrees to a four year funding profile and endorses the subsequent six financial years for the IIP.

18 Defence states that the *2020 Force Structure Plan* details the Australian Government's intentions for new and adjusted Australian Defence Force capability investments to implement the new strategic objectives contained within the *2020 Defence Strategic Update* [Internet], available from <https://www.defence.gov.au/about/strategic-planning/2020-force-structure-plan> [accessed 14 July 2022].



The second decade funding profile for the IIP reflects Defence planning assumptions, that are subject to reprioritisation and adjustments in alignment with Defence's evolving strategic assessments. Defence will return to Government through future Force Structure Plan updates, which will be reflected in a commensurately updated IIP, to seek agreement to the funding profile for the revised planning period.<sup>19</sup>

1.17 Defence further advised the Parliament in December 2020 that the *2020 Force Structure Plan* was the product of Defence's continuous force design cycle — the Defence Capability Assessment Program (DCAP) — conducted over a two-year period; and that, as a business-as-usual approach, every second DCAP cycle would deliver a Force Structure Plan update to government. In light of this, Defence went on to state that it expected to propose an updated Force Structure Plan for government consideration in 2024.<sup>20</sup>

## Department of Finance guidance specific to the Integrated Investment Program

1.18 To support the Defence-specific budget arrangements that underpin the Integrated Investment Program, the Department of Finance (Finance) has issued detailed Defence-specific guidance. This guidance instructs Defence on the requirements for presentation of costs to government for approval, including timing and process, and for reporting on progress and seeking change to the program. The key sources of guidance are Finance estimates memoranda and the Budget Process Operational Rules (BPORs).

1.19 Finance issues estimates memoranda and the BPORs under government authority. Finance states that estimates memoranda:

... are sent by Finance to Commonwealth entities and cover matters relating to budget estimates and the reporting of actual expenses, and provide advice on: policy changes, whole-of-government processes and requirements, upcoming deadlines, and specific actions that entities must take.<sup>21</sup>

1.20 Estimates memoranda and the BPORs are periodically revised and reissued by Finance. Finance advises entities that adherence to both is mandatory.

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19 Department of Defence, 'Senate 2020–2021 Budget Estimates, Foreign Affairs, Defence and Trade Legislation Committee, 26 October 2020, answer to question on notice no. 162' [Internet], available at <https://www.apf.gov.au/api/qon/downloadattachment?attachmentId=09c16374-441f-4f4c-bb7a-7aca9c4a94ed> [accessed 1 November 2022]. Funding for ASD projects was transferred to ASD as a separate entity in the 2020–21 Budget. Defence advised the ANAO in August 2022 that: 'Unapproved projects for ASD reside with Defence budget so they can be included in strategic capability decision making (Bi-Annual / Defence Strategic Review), re-prioritisations and costings. When the project is approved by Government, the project/IIP appropriation is transferred from Defence to ASD'.

20 Defence advised the ANAO in August 2022 that: 'On 3 August 2022, the Prime Minister and Deputy Prime Minister/Minister for Defence announced an independently led review that will consider Defence's force posture and force structure. This holistic review will consider force disposition, preparedness, strategy and associated investments, including all elements of Defence's Integrated Investment Program. The purpose of the review is to consider the priority of investment in Defence capabilities and assess the Australian Defence Force's structure, posture and preparedness in order to optimise Defence capability and posture to meet the nation's security challenges over the period 2023–24 to 2032–33 and beyond. The independent review will be considered by the National Security Committee of Cabinet no later than March 2023.'

21 Department of Finance, 'PGPA glossary' [Internet], available at <https://www.finance.gov.au/about-us/glossary?page=1> [accessed 14 July 2022].

## Estimates memorandum on Defence costing requirements

1.21 For many years, Finance has maintained a specific estimates memorandum setting out the requirements for costing new Defence major capability projects. Following government agreement to the recommendations of the *First Principles Review* in April 2015, Finance issued a revised estimates memorandum to address the operation of the IIP.<sup>22</sup>

1.22 The purpose of this estimates memorandum was to set out the requirements that Defence must meet when estimating costs for proposed projects brought forward for government consideration and the quality expected of those estimates. This includes a requirement that project proposals represent the total cost of ownership over the life of the project of the assets created by the project. The estimates memorandum also set out rules governing timing and project approval, including level of authority for that approval.

1.23 In July 2017, the government agreed to a tailored, risk-based approach for approval of projects in the IIP.<sup>23</sup> Before this decision, the level of authority for project approval varied only according to estimated total project cost. The 2017 change made the approval level a function of the assessed risk (including financial risk) of the project, rather than its estimated cost. This was intended to streamline the approval process for projects in the IIP.

1.24 The July 2017 decision was reflected in a revised estimates memorandum issued by Finance on 22 November 2017.<sup>24</sup> It stated that:

The key principle that underpins the development of robust cost estimates is to provide a level of confidence, supported by documentary evidence, that the project (or defined phases of a project) is affordable from within the project's acquisition and net sustainment provisions within the DIIP [Defence Integrated Investment Program].

...

In the event the available funding provision is not sufficient for the required expenditure, the yearly source of required offsets should be identified within the submission to government.<sup>25</sup>

## Budget Process Operational Rules

1.25 The BPORs are standing rules endorsed annually by the Government, which set out the major administrative and operational arrangements that underlie the management of the Australian Government Budget. The BPORs include Defence-specific requirements for the IIP, including roles and responsibilities for reporting, consultation, the provision of advice and decision-making. The Defence Internal Budget Manual states that these Defence-specific requirements 'reflect the unique size, scale and complexity of the organisation and its activities'.

22 This was Estimates Memorandum 2015/51, issued on 17 December 2015.

23 The new process was referred to as the 'Defence Investment Approval Process', replacing the 'strengthened two-pass process' recommended by the *Defence Procurement Review 2003* (the Kinnaird Review) under which a Defence capability project was considered twice by government before receiving approval to proceed. See Auditor-General Report No.6 2013–14 *Capability Development Reform* [Internet] available from [https://www.anao.gov.au/sites/default/files/AuditReport\\_2013-2014\\_06.pdf](https://www.anao.gov.au/sites/default/files/AuditReport_2013-2014_06.pdf) [accessed 1 November 2022].

24 Finance advised the ANAO in August 2022 that it was updating EM 2017/55 and expected to release an update later in the year.

25 Estimates Memorandum 2017/55, issued on 22 November 2017.

1.26 For example, the requirements include a biannual update of the IIP to be provided to government for its consideration in both the Budget and the Mid-year Economic and Financial Outlook (MYEFO) contexts. Updates are expected to:

- advise government on how the current force structure, force posture and capability investment are aligned to deliver on the strategic settings agreed by government;
- include information on emerging risks relating to schedule, funding, scope and overall effectiveness of existing capability to respond to strategic risks; and
- seek government agreement to: early access to IIP funding; amendments to IIP funding provisions to align with changes to the strategic environment and the latest capability planning; milestone updates; project approval pathways and authority; how changes affect Defence capability; and how these changes affect Defence capability and the achievement of the government's strategic intent.<sup>26</sup>

1.27 The BPORs confer responsibility upon a key Defence committee — the Investment Committee — for advice on the approach to be adopted for projects brought forward for consideration. They provide that the National Security Committee of Cabinet (NSC) or the Prime Minister will determine the appropriate approach to government for Defence investment projects, informed by advice from the Defence Investment Committee.

1.28 Following the decision in 2017 referred to above (paragraph 1.23), the BPORs reflect the recommendation of the First Principles Review that allows for government consideration of projects in line with their risk profile. Based on criteria outlined in the BPORs, government may agree to tailor the approval authority for a project (that is, whether two ministers or the Government collectively will approve the proposal) and the approval pathway (that is, how many times a proposal is considered by government).<sup>27</sup> These arrangements allow approval to be expedited as a combined pass under a set of criteria or to an authority other than NSC where risk is considered low.<sup>28</sup>

1.29 Finance advised the ANAO that:

The adoption of a risk-based approach, rather than a financial value or threshold, sought to:

- focus National Security Committee of Cabinet (NSC) consideration on high risk and complex proposals; and

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26 Estimates Memorandum 2022/22, Interim Budget Process Operational Rules, effective 14 June 2022.

27 Department of Defence 2015, *First Principles Review: Creating One Defence* [Internet], p. 39, available at <https://www.defence.gov.au/about/reviews-inquiries/first-principles-review-creating-one-defence#:~:text=The%20First%20Principles%20Review%20was,and%20become%20an%20integrated%20organisation> [accessed 1 November 2022].

28 Defence advised the ANAO in August 2022 that project SEA 1900 Phase 1 (ADF Diving, Hyperbaric Mission Support Systems) is an example of expedited approval, and that: 'This project was tailored for a Combined Pass approval pathway and a two-minister approval authority, due to the simple and low-risk acquisition process for the ongoing sustainment for existing equipment'.



- support efficient delivery of the IIP by considering lower risk projects through Combined Pass and/or by the Minister for Finance and the Minister for Defence (Two Minister Approval).<sup>29</sup>

1.30 Finance further advised the ANAO that its involvement<sup>30</sup> in individual capability project submissions commences at officer level with meetings which allow it to understand proposals, assess Defence cost models, assess proposed costs against provisions, raise and, where possible, resolve issues before they progress to Defence's Investment Committee.<sup>31</sup> Finance provides a cost and risk statement which is included in Defence capability submissions to government.<sup>32</sup>

## Rationale for undertaking the audit

1.31 This audit was undertaken to provide independent assurance to the Parliament on Defence's processes for managing its Integrated Investment Program since 2016, and to provide transparency in relation to Defence program/project costs reported in the two public editions of the Program released since 2016.

1.32 The audit was identified as an audit priority of the Parliament by the Joint Committee of Public Accounts and Audit (JCPAA) in response to the ANAO's proposed 2021–22 Annual Audit Work Program.

## Audit approach

### Audit objective, criteria and scope

1.33 The audit objective was to examine the effectiveness of Defence's administration of the Integrated Investment Program since 2016.

1.34 To form a conclusion against the audit objective, the following high-level criteria were adopted:

- Has Defence established an effective governance, control and approval framework for the management of the Integrated Investment Program?
- Has Defence established an effective framework to guide its public reporting on the Integrated Investment Program?

1.35 The ANAO considered the arrangements used to manage and report publicly on the Integrated Investment Program, particularly public reporting of the costs of the projects that comprise the Program. In this context, the audit focused on two major projects, the former Future Submarine (Attack class) program and the ongoing Future Frigate (Hunter class) program, being two

29 Finance advised the ANAO in December 2021 that government agreed to alter the default approval authority and pathway for certain lower-risk projects, including mid-term refresh and redevelopment Estate projects, projects in the Estate Medium Works or PFAS [Perfluoroalkyl and Polyfluoroalkyl Substances] Remediation provisions, and projects in the Minors Program.

30 To support Finance's involvement, Defence provides it with a copy of the broadsheet. Finance advised the ANAO in December 2021 that: 'Defence provides Finance a 'Broadsheet' on a monthly basis, which provides a snapshot of the financial position of all IIP projects at the previous month end (i.e, a Broadsheet sent in August 2021 will include a snapshot of the IIP at July 2021 month end). The Broadsheet includes acquisition and sustainment provisions by financial year.'

31 The Defence Investment Committee is discussed further in Chapter 2 of this audit report.

32 The cost and risk statement is intended to provide government with arm's length advice on the cost estimates, risks, affordability and value for money associated with an IIP project.

of the most expensive projects Defence has embarked upon.<sup>33</sup> The costings for these projects have also been the subject of ongoing parliamentary interest.<sup>34</sup>

1.36 The ANAO sought to understand the relationship between the two public documents setting out the Integrated Investment Program in 2016 and 2020 and the contemporaneous underlying confidential IIP broadsheet maintained by Defence. That is, how the two public documents were derived from the relevant iteration of the confidential broadsheet and how the public documents correspond to or map to the relevant broadsheet.

1.37 The ANAO did not examine how Defence calculated and assured its costings for the individual projects comprising the Integrated Investment Program. Further, the audit did not encompass Defence's processes for identifying its capability needs and proposing programs/projects to address them.

### **Audit methodology**

1.38 The audit involved the departments of Defence and Finance, with a primary focus on Defence.

1.39 The methodology involved:

- examining relevant records and documents, including the IIP broadsheet;
- the use of data analytics and systems assurance work;
- discussions with relevant Defence and Finance personnel; and
- discussions with representatives of the defence industry.

1.40 The audit was conducted in accordance with ANAO Auditing Standards at a cost to the ANAO of approximately \$783,000.

1.41 Team members for this audit were David Rowlands, Fraser McEachan, Corné Labuschagne, Qing Xue and Sally Ramsey.

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33 The programs are discussed in the body of the audit report.

34 See for example correspondence requesting that the Auditor-General examine the Future Submarine and Future Frigate program costings [Internet], available at: <https://www.anao.gov.au/work/request/future-submarine-and-future-frigate-programs> [accessed 10 June 2022].

## 2. Governance, control and approval framework

### Areas examined

This chapter examines whether the Department of Defence (Defence) has established an effective governance, control and approval framework for the management of the Integrated Investment Program (IIP or Program).

### Conclusion

Defence's management of the Program is occurring within a defined structure and at a level commensurate with its cost, importance and program risk. There is an established governance structure, an identified senior responsible officer, and a biannual process for government consideration supported by central agency guidance and review. Defence also has an appropriate process for authorising the entry of projects into the Program, requiring government agreement through the biannual process, and an appropriate process for ensuring updates and changes to the Program are approved. However, Defence cannot provide assurance over IIP broadsheet controls or content before 2021 because the broadsheets were updated manually. In 2021, Defence commenced a progressive rollout of a systemised broadsheet to automate updates, mitigate the risk of error or unauthorised change, and improve the level of assurance it can provide over the broadsheet's control framework and contents.

### Areas for improvement

The ANAO has made three recommendations. These are aimed at Defence: recording the date on which entry of each project was authorised, and by whom; establishing arrangements to support data consistency and accuracy; and developing a risk management plan for the Program.

There are also opportunities for Defence to improve its performance monitoring and reporting on the Program.

2.1 This chapter assesses whether Defence has established an effective governance, control and approval framework for the management of the Integrated Investment Program (IIP or Program). An effective governance, control and approval framework establishes appropriate:

- structures and processes to guide the management of the IIP and provide for its oversight at a level commensurate with its importance and program risk; and
- processes for controlling amendments to the IIP, as the reliability of the IIP broadsheet — as an artefact to inform Defence and government decision-makers — is underpinned by the effectiveness of the controls framework that stops unauthorised projects from entering the IIP and stops unauthorised amendments being made to the IIP.

## Are there appropriate structures and processes within Defence to manage the Integrated Investment Program?

Management of the Integrated Investment Program is occurring within a defined structure and at a level commensurate with its cost, importance and program risk. The structures include a high-level defence committee, the Investment Committee, chaired by the senior responsible officer (the Vice Chief of the Defence Force) who is accountable for the Program. The processes for managing the Program are set out in Defence's budget and capability development policies and in specific estimates memoranda and Budget Process Operational Rules (BPORs) issued by the Department of Finance (Finance). Project proposals are scrutinised by Defence's Contestability Division and central agencies (Finance and the Department of the Prime Minister and Cabinet), before going to government for consideration. Biannual updates are provided to and considered by government.

Effective management of the Program was weakened when figures in the IIP broadsheet did not consistently encompass whole-of-life costs and the rules regarding the identification of offsets for nominally unaffordable projects were not observed. Over time, Defence has sought to improve and streamline the structure that supports the operation of the Program.

2.2 The Integrated Investment Program accounts for around two-thirds of the Defence budget, for which the Secretary of Defence is the accountable authority under the *Public Governance, Performance and Accountability Act 2013* (PGPA Act). In addition to the Secretary's Accountable Authority Instructions made under the PGPA Act, Defence has developed an internal budget policy manual to outline the framework for budgeting within Defence. The manual states that funding is provided under the government-approved 10-year funding model (with a planning horizon for the subsequent 10 years), with annual appropriations determined through the budget process.

2.3 Defence's internal funding structure comprises five major categories — acquisition, sustainment, workforce, operations and operating — with most of the budget being allocated to the first three (see paragraph 1.3). The Defence Management and Financial Plan (which is provided to government with the department's portfolio budget submission each year) outlines the Defence budget allocations over these categories across 20 years.<sup>35</sup>

2.4 Defence's Internal Budget Policy Manual identifies five senior Defence committees involved in setting the Defence budget. Of these, the committees with key responsibilities for the IIP are the Defence Committee and the Investment Committee. The Investment Committee, chaired by the Vice Chief of the Defence Force (VCDF), is responsible for supporting the Defence Committee (Defence's most senior committee) by overseeing the implementation and integrity of the IIP.

### The Investment Committee

2.5 In September 2015, in line with a First Principles Review recommendation, Defence established its Investment Committee.<sup>36</sup> Under its charter, the committee has primary

35 As required by the Budget Process Operational Rules (BPORs), discussed in paragraphs 1.25–1.30.

36 Department of Defence, *First Principles Review: Creating One Defence* [Internet], p. 27, Recommendation 1.13, available at <https://www.defence.gov.au/sites/default/files/2022-01/FirstPrinciplesReviewB.pdf> [accessed 1 November 2022]. The Investment Committee has fourteen members, including the Defence Chiefs, Defence's Associate Secretary and representatives of the Department of Finance and the Department of the Prime Minister and Cabinet.

responsibility for overseeing the ‘One Defence Capability System’ (the system of internal guidance for developing and managing capability proposals<sup>37</sup>) and for managing the IIP, both within Defence and in relation to central agencies and government. Its role includes exercising strategic control over the investment portfolio, and bringing the future joint force and supporting enablers into being. This means that the committee is required to consider strategic, estate, infrastructure, and information and communications technology capital investments. The committee also monitors Defence’s performance in delivering the IIP.

2.6 The Investment Committee is responsible for ensuring that each capability proposal is aligned with capability policy and the BPORs, that each is affordable within IIP provisions and that it includes whole-of-life costs and appropriate contingency amounts. The committee’s work incorporates a formal contestability function, to provide critical internal review of proposals put to it.<sup>38</sup> This function is supported by Defence’s Contestability Division. The current Interim BPORs (which took effect from 17 June 2022) recognise the key responsibility of the committee in providing advice to government and the National Security Committee of Cabinet (NSC).

2.7 As chair of the Investment Committee, the VCDF’s decision rights as Joint Force Authority have been strengthened and accountability for requirements setting have been transferred to the VCDF in accordance with First Principles Review recommendations. VCDF is also responsible for the future force design function.<sup>39</sup>

2.8 At the Investment Committee’s inaugural meeting, the chair (VCDF) presented a discussion paper setting out governance principles, member responsibilities and business rules. ANAO review indicates that the committee worked under these arrangements for several years. The first edition of the current terms of reference for the Investment Committee became available in 2019, having been approved by the VCDF. They have been updated regularly since then and are now in their fourth edition.

2.9 Defence has arranged for senior Department of Finance (Finance) representation on the Investment Committee from the committee’s commencement, and senior representation from the

37 Defence has issued guidance under the ‘One Defence Capability System’ to Defence personnel that informs them of the IIP. The Product Life Cycle Guidance document explains the IIP and sets out roles and responsibilities for all parties involved in initiating, progressing and approving projects. It provides detailed guidance on the processes that projects in the IIP must pass through and approvals they must gain. Defence has updated this document to reflect changes such as policy updates following government decisions.

38 The First Principles Review recommended that Defence introduce a strong and credible contestability function. The Review envisaged that this function would analyse and test investment proposals as independently as practicable within Defence and provide its advice to the Investment Committee when the proposal was under review. This includes review of force design outputs, business case, cost and schedule estimates and assumptions. An earlier performance audit examined this development and observed it then to be operating well. See Auditor-General Report No.34 2017–18 *Defence’s Implementation of the First Principles Review* [Internet], p. 7, available from [https://www.anao.gov.au/sites/default/files/ANAO\\_Report\\_2017-2018\\_34.pdf](https://www.anao.gov.au/sites/default/files/ANAO_Report_2017-2018_34.pdf) [accessed 1 November 2022]

39 The Secretary and Chief of the Defence Force (CDF) have delegated to the VCDF ‘the authority for strategic-level development and generation of Joint Forces including platform and systems, essential enablers and integrating elements.’ VCDF is supported by the Force Design Division, which includes: Force Options and Plans Branch; Force Exploration Branch; and Investment Portfolio Management Branch.

Department of the Prime Minister and Cabinet (PM&C) from mid-2016.<sup>40</sup> The Investment Committee charter does not specify the expectations or roles of these external members. Nevertheless, contributions from these members are regularly noted in the committee's meeting record.

2.10 Finance has previously advised the ANAO that its involvement in the Defence Investment Committee has helped to remediate issues, reduce risks, maximise compliance with government processes and reduce delays to projects progressing through government approval.<sup>41</sup> Finance does not have a mechanism to measure and quantify any improved timeliness of the approval process which would support this conclusion.<sup>42</sup>

### *The work of the Investment Committee*

2.11 The ANAO examined records of the Investment Committee's meetings spanning 10 September 2015 to 20 April 2022. The minutes reviewed by the ANAO showed that the committee had met at least monthly since its inception.

2.12 The minutes indicate that Investment Committee meetings are generally full-day sessions, largely taken up with consideration of submissions intended to be put forward to government.<sup>43</sup> Defence's records indicate that the committee critically reviewed project proposals and frequently identified further work to be done by the managers of those proposals.

2.13 A number of the contestability briefs provided to the Investment Committee and examined by the ANAO indicated that insufficient time was provided to the contestability function to perform a robust analysis to its satisfaction, before government consideration of submissions on major acquisitions, including the Future Submarine. Given the importance of the contestability function, this can introduce risk and potentially impact the quality of decision-making.

2.14 In April 2021, Defence advised the Minister for Defence that the Investment Committee typically considers 12 to 24 proposals per meeting. There has been a frequent need for additional

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40 Among the concerns of the First Principles Review was that Defence should establish better relationships with central agencies, to whom Defence had previously appeared not to be transparent. The Review recommended that a senior official from Finance be invited to participate in the new Defence Investment Committee as a means of building stronger partnerships with key central agencies. In its *Annual Report 2020–21*, PM&C stated that it has been 'working closely with the Department of Defence (Defence) to support implementation of the *2020 Defence Strategic Update* and delivering the associated Integrated Investment Program, which outlines and manages Defence's future investment in Australian Defence Force capability.' Department of the Prime Minister and Cabinet, *Annual Report 2020–21* [Internet], p. 94, available from <https://www.pmc.gov.au/sites/default/files/publications/pmc-annual-report-2020-21.pdf> [accessed 1 November 2022].

41 Auditor-General Report No.34 2017–18 *Defence's Implementation of the First Principles Review* [Internet], pp. 41–42, available from <https://www.anao.gov.au/work/performance-audit/defence-implementation-first-principles-review> [accessed 1 November 2022]. More recently, an internal Defence review stated that it had 'observed excellent examples of where improved outcomes were being achieved through stronger collaboration particularly with the Central Agencies'.

42 Performance monitoring and reporting of the government approval process is discussed further in this audit report at paragraph 2.35 forward.

43 The Investment Committee seeks to ensure that project updates and projects to be put to government for approval have received appropriate consideration at departmental level. The committee aligns its forward work plan with that of the relevant government committees, to enable streamlined consideration of project proposals and updates.

meetings (with typically three or more extraordinary meetings a year) and occasional out-of-session consideration of project proposals.

2.15 In relation to the Investment Committee's consideration of the Integrated Investment Program as a whole, Defence advised the ANAO (August 2022) that:

The broadsheet itself is not considered by the Investment Committee as it is a planning tool. Rather, the Investment Committee considers a suite of individual project and program proposals (including whole of life costs) and updates, and portfolio level updates such as the Bi-Annual update, Force Design products, Chief Finance Officer performance reports and delivery agency performance reporting. These products provide the Investment Committee with an overall view of portfolio planning and performance.

2.16 Defence further advised the ANAO that the Investment Committee 'does consider the full portfolio of projects as part of the DCAP and Force Structure Plan processes'.

2.17 The record of the Investment Committee's work indicates that, on several occasions since March 2016, the committee has identified benefits in taking a more 'programmatic' approach (grouping related projects which, considered together, form a program or have other common features). The 2017 estimates memorandum on costing Defence proposals (Estimates Memorandum 2017/55, discussed at paragraphs 1.21–1.24) stated that a programmatic approach could reduce the number of approaches to government and improve government's visibility of the strategic capability picture by identifying interdependencies among projects, and in doing so, outline the overall capability effect of multiple investment activities. A programmatic focus is one of the 'key capability principles' in Defence's capability administrative policy.<sup>44</sup>

2.18 By way of example, a programmatic approach was taken for four Maritime Domain programs. In this instance, the interdependent naval shipbuilding projects were grouped into the one submission to improve the strategic capability investment picture, including in respect to risk and performance. Defence advised the ANAO (August 2022) that:

Since 2020 Defence has been progressively implementing Capability Program management under the CPA [Capability Program Architecture] construct. This allows for an improved reporting framework by grouping together related capabilities for the presentation of information to government. An increasing number of capability programs across all Domains are preparing future programmatic submissions for IC [Investment Committee] and Government consideration.

Additionally, a review of internal Defence capability development and committee processes is being conducted to identify opportunities to optimise the development and progression of submissions through the internal Defence committee process and to government. There is also a body of work in progress to provide guidance to Capability Managers on how to better draft a program capability submission.

2.19 Defence further advised the ANAO (September 2022) that this review had 'a reporting date of no later than 30 November to VCDF'.

Biannual updates of the Integrated Investment Program

2.20 A major responsibility of the Investment Committee is to provide biannual IIP updates to government, as required by the BPORs. Biannual updates are reviewed by Defence's contestability

44 Department of Defence, 'Defence Capability Administrative Policy', January 2021, Key Capability Principle Seven.



division and central agencies before going to government. These updates have included project-specific commentary for the capability streams (before 2020) and domains (from 2020). Defence records show that such updates have been provided twice a year since 15 August 2017.

## Management of the Integrated Investment Program

2.21 The ANAO's review indicates that since its inception in 2015, the development, consideration and progress of IIP projects through to final project approval by government has occurred within a defined structure. Since 2015, the structure and associated processes have been refined with a view to improving and streamlining the operation.

2.22 The ANAO identified the following issues in Defence's management of the Integrated Investment Program:

- figures in the IIP broadsheet do not consistently encompass whole-of-life costs;
- the rules regarding the identification of offsets for nominally unaffordable projects are not consistently observed; and
- there are opportunities to improve performance monitoring and reporting.

### *Whole-of-life costs*

2.23 The 2015 First Principles Review envisaged that the Defence investment plan would consider whole-of-life costs of its constituent projects, in other words, their 'total cost of ownership'.<sup>45</sup> The public *2016 Integrated Investment Program* document stated that establishing the Program would facilitate a whole-of-life approach to investment reflected in the implementation plan for the First Principles Review. This would include costs expected to be incurred over the longer-term, workforce costs and full sustainment costs.

2.24 The Investment Committee decided in late 2015 that the Integrated Investment Program should include whole-of-life costs, including sustainment. Further, the committee noted in 2016 that Defence was moving away from the use of a traditional concept of 'NPOC' — Net Personnel

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45 Department of Defence, *First Principles Review: Creating One Defence* [Internet], pp. 13–14 and p. 27, available from <https://www.defence.gov.au/about/reviews-inquiries/first-principles-review-creating-one-defence> [accessed 1 November 2022]. Note that this point refers to investment plans, not the later stage when Defence brings forward a project identified in the Integrated Investment Program to government for approval (when whole-of-life costs are required to be included). The requirement for whole-of-life costs to be provided in proposals for government consideration is set out in Estimates Memorandum 2017/55, issued on 22 November 2017. Estimates Memorandum 2017/55 (discussed in the introduction of this audit report) states that the Total Cost of Ownership (TCO) Model is to be used to estimate costs for all new Defence IIP projects to be considered by government.

The TCO Model includes, but is not limited to, the following cost components relevant to the particular stage of the project (A+B+C+D+E+F):

- A = acquisition costs which reflect the cost of Defence acquiring an asset;
- B = (if applicable) the cost to finance the asset;
- C = the cost of bringing equipment into service;
- D = the cost of operating the asset over its life;
- E = the cost of sustaining the asset over its life; and
- F = the cost of disposing of the asset at the end of its useful life.



and Operating Costs.<sup>46</sup> This would be consistent with a 2015 First Principles Review finding agreed to in principle by government:

Net Personnel and Operating Cost is Defence's current estimate of the personnel, operating and sustainment cost of a proposed capability. It is an estimate of the differential cost above that of the current capability and is included in submissions to Government for approval. This approach is problematic as it does not inform Government of the total cost of the project across the life of the capability. Net Personnel and Operating Cost is also hard to estimate and often inaccurate. **We recommend this process cease immediately** [*emphasis in original*].

2.25 An earlier ANAO performance audit of Defence's implementation of the First Principles Review noted that an implementation Oversight Board for the First Principles Review, reporting to the Minister for Defence, had concluded that by September 2016, the use of NPOC had ceased.<sup>47</sup> Defence advised the ANAO at the time of that audit (which was tabled in April 2018) that 'Projects being submitted for Government approval now provide transparency of the total cost of ownership of the asset, rather than just the net additional costs'.<sup>48</sup> In the context of the current audit, ANAO review of the IIP broadsheet shows that, generally, the broadsheet includes acquisition and some sustainment costs for each project.<sup>49</sup> The 2016 and 2017 editions of the broadsheet include sustainment figures labelled 'NPOC'. The expression 'future sustainment' is used thereafter, at a similar value to the NPOC figures.<sup>50</sup>

2.26 An example of this continued use of NPOC is Defence's proposal for second pass approval of the Future Frigate (Hunter class) project in mid-2018. Defence's whole-of-life cost estimate included an amount for sustainment comprising a provision in the IIP broadsheet for Hunter class sustainment plus the value of the existing sustainment cost for the current Australian fleet of ANZAC class frigates.

2.27 The contemporaneous IIP broadsheet included only net sustainment costs for the Hunter class, being the additional funding expected to be needed when the new frigates replace the

46 NPOC was discussed in Auditor-General Report No.6 2013–14 *Capability Development Reform* [Internet], Appendix 5, Defence Costing Terminology, available from [https://www.anao.gov.au/sites/default/files/AuditReport\\_2013-2014\\_06.pdf](https://www.anao.gov.au/sites/default/files/AuditReport_2013-2014_06.pdf) [accessed 1 November 2022].

47 Auditor-General Report No.34 2017–18 *Defence's Implementation of the First Principles Review* [Internet], pp. 54–55, available from <https://www.anao.gov.au/work/performance-audit/defence-implementation-first-principles-review> [accessed 1 November 2011].

48 *ibid.*

49 Defence defines sustainment activity as work undertaken to maintain existing physical and intangible assets in an operable condition. This includes the costs of sustaining existing capability in service and the estimated costs of planned future capability yet to be introduced into service. Defence has given testimony at Senate Estimates hearings that sustainment is included in the IIP. Commonwealth, *Senate Budget Estimates*, Foreign Affairs, Defence and Trade Legislation Committee, 20 February 2019, p. 27, Vice Admiral David Johnston AO, RAN, Acting Chief of the Defence Force, available from [https://parlinfo.aph.gov.au/parlInfo/download/committees/estimate/c8ae66cc-37da-4c79-a94b-6ab2906174ff/toc\\_pdf/Foreign%20Affairs,%20Defence%20and%20Trade%20Legislation%20Committee\\_2019\\_02\\_20\\_6950\\_Official.pdf;fileType=application%2Fpdf#search=%22committees/estimate/c8ae66cc-37da-4c79-a94b-6ab2906174ff/0000%22](https://parlinfo.aph.gov.au/parlInfo/download/committees/estimate/c8ae66cc-37da-4c79-a94b-6ab2906174ff/toc_pdf/Foreign%20Affairs,%20Defence%20and%20Trade%20Legislation%20Committee_2019_02_20_6950_Official.pdf;fileType=application%2Fpdf#search=%22committees/estimate/c8ae66cc-37da-4c79-a94b-6ab2906174ff/0000%22) [accessed 1 November 2022]. Defence advised the ANAO in November 2022 that it has revised and updated its definition of sustainment. This will be reflected in a future version of the Internal Budget Policy Manual. It has not provided the ANAO with this revised definition.

Any investment to operate, replace, enhance, dispose of, or decommission an asset is not a sustainment cost. Costs relating to Defence employees are not sustainment activities — they are classified as workforce costs, although they may support sustainment. See Defence Internal Budget Policy Manual, Version 1.0, July 2021.

50 Defence confirmed to the ANAO in November 2022 that 'Net Personnel & Operating Costs (NPOC) was renamed to Future Sustainment, however [this] reflects funding for the same purpose'.

existing ANZAC capability. The data in the broadsheet represented the ‘new money’ — the additional funding required for sustainment of the new capability — and therefore did not reflect the full cost of sustainment.<sup>51</sup> While the IIP broadsheet continues to include only ‘net sustainment costs’ in relation to future sustainment provisions, it does not reflect whole-of-life costs as intended when the government agreed to the recommendations of the First Principles Review.<sup>52</sup> Defence did not advise the ANAO why this approach is still being taken.

2.28 The April 2022 edition of the Defence Capability Manual states that the IIP ‘includes the workforce costs and operating costs’.<sup>53</sup> It also identifies the IIP as a plan ‘which includes major capital equipment, facilities and ICT and associated sustainment funding’.<sup>54</sup> Whereas the IIP broadsheet includes capital costs and future sustainment, the ANAO identified no Defence plans or documents at the level of the IIP that include all of these items; that is, that include the whole of the expected sustainment costs and workforce costs. Defence advised the ANAO in November 2022 that:

Cabinet Submissions will disclose the total sustainment requirement, including the offset being provided by an existing in service capability being replaced. Cabinet Submissions also include details on Workforce costs, though funded separately to IIP.

2.29 The ANAO found that in June 2020, Defence had been considering how to include whole-of-life costs in the IIP. An internal minute showed that Defence’s rationale for this work was that:

A fully-costed IIP better supports the ongoing Defence Capability Assessment Program in providing a baseline for assessing future capability requirements and planned capability replacements.

Further, it enables Defence to better situate Government in understanding projected total cost of ownership for capability options, enabling value-for-money assessments and options comparisons.

2.30 Defence advised the ANAO in August 2022 that no further information was available on this work.

### *Managing offsets*

2.31 Under the estimates memorandum<sup>55</sup> on costing Defence capability projects, when Defence brings a project forward to government for approval, if the available funding provisions (both overall and in-year) are not sufficient for the required expenditure, the project is considered unaffordable in the respective years. In such a case, Defence is expected to identify offsets from other projects within the IIP submission to government (see paragraph 1.24 of this audit report). That is, Defence is expected to manage this excess cost within its overall funding envelope by finding offsetting savings elsewhere in the IIP. Otherwise, under the BPORs, major capital investments that are coming forward for final government consideration with no identified offsets are required to be treated as New Policy Proposals (which have additional requirements to meet).

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51 Defence subsequently advised the government of its whole-of-life cost estimates, in the submission prepared for the Hunter class second-pass approval.

52 Department of Defence, ‘Defence Internal Budget Policy Manual’, July 2021, p. 74, defines the IIP as encompassing ‘all capital investment (excluding Group Managed capital) and future sustainment costs.’

53 Department of Defence, ‘Defence Capability Manual’, version 1.2, 4 April 2022, p. 32.

54 *ibid.*, p. 29.

55 Discussed in paragraphs 1.18–1.24 of this audit report.

2.32 In respect of the Future Submarine and Future Frigate projects, the ANAO identified two occasions where Defence had not met the offsets requirement.

- *Future Submarine*: in September 2016, Defence sought funding for 2016–17 to 2018–19 to progress the Future Submarine project. This was substantially more than existing provisions in the IIP. Defence offered no specific offsets and undertook to manage the shortfall in an unspecified way across the IIP.
- *Future Frigate*: when Defence sought and gained second pass approval for SEA 5000 Phase 1 in June 2018, the project as a whole was unaffordable without offsets. No offsets against other IIP project provisions were recommended to government at this time to meet the shortfall. Defence stated that affordability would be managed within the provisions of the future naval construction program (a narrower scope than the IIP as a whole).<sup>56</sup> Defence informed the Parliament a few months later that:

We've advised what we think the total envelope for the acquisition is to government. We've advised how that fits inside the Integrated Investment Program, and the government has agreed to that funding envelope, noting that that goes well out.<sup>57</sup>

2.33 For the Future Frigates, ANAO review of subsequent iterations of the IIP broadsheet showed that some two years elapsed between Defence advising government of the expected costs of the frigates and the updating of the broadsheet to reflect the full acquisition cost in the provisions of the IIP.

2.34 Proceeding with substantial unmet offsets undocumented in the IIP broadsheet introduces uncertainty into the ongoing management of the Integrated Investment Program. If offsets to meet unaffordability can be identified by Defence when it is taking a proposal forward, as required under the BPORs, government agreement would allow the IIP to balance immediately where the projected future force remains affordable and is within the project's funding envelope.

### *Performance monitoring and reporting*

2.35 In its past annual reporting, Defence has measured its own capability development performance in part by the number of its proposals to government which gained government

56 Auditor-General Report No.39 2017–18 *Naval Construction Programs—Mobilisation* (May 2018) included a recommendation that: 'Defence, in line with a 2015 undertaking to the Government, determine the affordability of its 2017 Naval Shipbuilding Plan and related programs and advise the Government of the additional funding required to deliver these programs, or the Australian Defence Force capability trade-offs that may need to be considered'. Defence disagreed with the recommendation, stating that: 'Defence takes an enterprise approach for Naval Construction Programs. The shipbuilding provisions identified in the Integrated Investment Program are consolidated for Government to consider the Naval Construction Program affordability as each project is presented to Government.' Defence went on to state that: 'Offsets are recommended to Government if there is a shortfall between the funding requirement and existing provision.' The report is available from <https://www.anao.gov.au/work/performance-audit/naval-construction-programs-mobilisation> [accessed 2 November 2011].

57 Commonwealth, *Inquiry into Defence First Principles Review, Naval construction—Inquiry based on Auditor-General's reports Nos 34 and 39 (2017–18)*, Joint Committee of Public Accounts and Audit, 17 August 2018, Dalton, Rear Admiral Anthony (Tony), General Manager, Ships, Department of Defence [Internet], available from [https://parlinfo.aph.gov.au/parlInfo/download/committees/commjnt/cec15408-a7af-4bf8-8657-ee14091dfcf8/toc\\_pdf/Joint%20Committee%20of%20Public%20Accounts%20and%20Audit\\_2018\\_08\\_17\\_6468\\_Official.pdf;fileType=application%2Fpdf#search=%22committees/commjnt/cec15408-a7af-4bf8-8657-ee14091dfcf8/0000%22](https://parlinfo.aph.gov.au/parlInfo/download/committees/commjnt/cec15408-a7af-4bf8-8657-ee14091dfcf8/toc_pdf/Joint%20Committee%20of%20Public%20Accounts%20and%20Audit_2018_08_17_6468_Official.pdf;fileType=application%2Fpdf#search=%22committees/commjnt/cec15408-a7af-4bf8-8657-ee14091dfcf8/0000%22) [accessed 2 November 2022].

approval.<sup>58</sup> Defence has been using a similar mechanism to assess performance of the Integrated Investment Program since its inception.

2.36 The numbers of government approvals of IIP projects brought forward for decision, by year, has increased since the 2016 Defence White Paper and the inception of changes to the capability development process recommended by the First Principles Review (see Table 2.1). Defence provides a similar table with each biannual update to government.

**Table 2.1: Proposals approved by government since the 2016 Defence White Paper**

Financial Year	Number of approvals <sup>a</sup>	Total capital and future sustainment (\$ billion)
2015–16 (part-year)	18	9.3
2016–17	74	10.9
2017–18	111	47.1 <sup>b</sup>
2018–19	115	12.4
2019–20 <sup>c</sup>	108	13.7
2020–21 <sup>c</sup>	125	13.4
2021–22	99	27.2
2022–23 (part-year <sup>d</sup> )	1	0.1
<b>Total</b>	<b>651</b>	<b>134.1</b>

Note a: These figures include Integrated Investment Program-related proposals approved by government. Approvals include first pass, second pass and early access to provisions approved by ministers or the Government. The numbers of approvals will have increased since the inception of the IIP, in part because ICT and estate-related projects are included with capability-related projects. Projects may vary in size (as measured by capital cost) and some projects are directed at sustainment.

Note b: Approval of a project proposal by government does not usually entail approval of the whole of the expected expenditure for the project, which may take place over years or even decades. A smaller amount is often sought and approved for expenditure over the forward estimates period.

ANAO analysis of the classified Defence spreadsheet provided by Defence and from which this table was derived (the 'IPMB Approvals Database') shows that an amount of \$35 billion was originally recorded by Defence as an approved amount for the Future Frigate project, which had achieved second pass government approval late in that financial year (2017–18). ANAO analysis also shows that an amount of \$6.7 billion was actually approved for expenditure against a total estimated out-turned project acquisition cost of \$44.3 billion noted by government at that time. The contemporaneous draft press release prepared by Defence for the minister in late June 2018 specifies a figure of '\$35 billion plus' for the project. The ministerial press release that was issued publicly on 29 June 2018 refers to a '\$35 billion program'.

For 2017–18, Defence erroneously recorded a figure of \$75.4 billion for total capital and future sustainment in the IPMB Approvals Database. The error of reporting government approval of \$75.4 billion in 2017–18 has been perpetuated in Defence's IIP biannual updates to government since then, including in its February 2022 update.

Note c: For 2019–20 and 2020–21, the numbers of approvals set out in this table differ from the numbers reported in the respective Defence Annual Reports, which are 105 (for 2019–20) and 114 (for 2020–21). The numbers are consistent between the table and annual reports for 2016–17 to 2018–19.

Note d: Defence's November 2022 advice to the ANAO.

Source: Defence documentation.

<sup>58</sup> See for example, *Defence Annual Report 2011–12*, p. 97, and *Defence Annual Report 2013–14*, pp. 68–69, where Defence reports numbers of approvals by government as a measure of performance. Available from <https://www.defence.gov.au/about/information-disclosures/annual-reports> [accessed 2 November 2022].

2.37 Another potential indicator of performance is the project approval process itself. The First Principles Review examined a number of process metrics and stated (based on Defence data) that:

Project approval processes are lengthy and expensive. The average government submission is 70 pages long, takes 16 weeks to move through the Cabinet preparation process and an average of 46 months to progress from first pass initiation through to second pass approval.

2.38 This is an area where Defence has implemented many changes. Monitoring the types of process metrics examined by the First Principles Review could inform Defence of progress in an area where the Review criticised the performance it found as 'lengthy and expensive'. In August 2022 Defence advised the ANAO that it had 'no further update' on this matter.<sup>59</sup>

2.39 The biannual IIP updates to government since 2017 have included systematic reporting of cost variance, project slippage, and the number of approvals a year since the *2016 Defence White Paper*. The ANAO's review indicates that there has been no advice in these updates that indicates performance trends over time for the IIP as a whole and capability stream/domain-specific approved and unapproved financial values. The number of projects in each domain is not stated and the form of the updates does not facilitate performance monitoring and comparison between the capability stream structure (in place from 2015 to July 2020) and the domain level (from July 2020 forward).

2.40 A 2021 internally commissioned Defence review found no complete external or internal performance reporting product relating to the total IIP. The reviewers considered that Defence is not publicly transparent on financial performance at the IIP or program level, and concluded that:

Noting security and commercial sensitivities, there remained insufficient internal and external reporting to provide confidence and transparency that the IIP as a whole was being suitably monitored and governed.

2.41 The review recommended that:

To improve internal and external governance confidence and transparency, Defence should develop and publish a financial performance table in the Annual Report that compares the budgets and actual outcome of the four programs within the IIP.

2.42 As of April 2022, this recommendation had neither been accepted nor rejected by Defence but was awaiting further consideration.

#### Opportunity for improvement

Opportunities for Defence to improve its performance monitoring and reporting on the Integrated Investment Program include giving advice to government that provides transparency about performance trends over time for the IIP as a whole and capability stream/domain-specific approved and unapproved financial values.

<sup>59</sup> ANAO comment: notwithstanding this advice, the *Defence Annual Report 2021–22*, which was signed off on 29 September 2022, included the following statement on IIP approval and process metrics: 'In 2021, the Government agreed to a range of enhancements to the Defence approval process and the Biannual Updates process for the Integrated Investment Program. This is accelerating delivery schedules by reducing approval timelines between Investment Committee consideration and Government consideration by four to six months.' See Department of Defence, *Defence Annual Report 2021–22* [Internet], 'Performance Criterion 6', p. 39, available from <https://www.defence.gov.au/sites/default/files/2022-11/2021-22-Defence-Annual-Report.pdf> [accessed 10 November 2022].

## Does Defence have appropriate processes for entry into and updating of the Integrated Investment Program?

Defence currently has an appropriate process for authorising the entry of projects into the Program; that is, projects can enter only with government agreement. This occurs through government endorsement of the biannual update to the Program. However, Defence cannot systematically evidence how projects that were not specifically identified in the published 2016 *Integrated Investment Program* originally gained authority for inclusion in the Program, as it did not maintain a log of when each project was approved for entry by the government.

Defence has appropriate processes for ensuring updates and changes to the Program are approved. Changes are recorded and logged in a budget change journal for Defence's financial system (BORIS) on a project basis. These changes are extensive.

From 2016 until recently, Defence's processes for the generation and maintenance of the IIP broadsheet have been largely manual. Controls for mitigating the risk of unauthorised changes have relied on access restrictions and Defence's management of changes has relied on project or capability managers checking for accuracy. Defence could not provide assurance over IIP broadsheet content or controls because the broadsheets were updated manually.

System changes which Defence commenced rolling out in 2021 are intended to automate updates to the IIP broadsheet that are traceable to the authority for the change. This is expected to further mitigate the risk of error or unauthorised change and improve the level of assurance that Defence can provide over the broadsheet's control framework and contents.

### Entry to the Integrated Investment Program

2.43 Defence advised the ANAO that project entry into the IIP requires government approval and that this typically occurs through the biannual update to the IIP. Defence cited various authorities, at the head of which is the BPORs.<sup>60</sup> The section of this document that is taken as requiring government approval for a project to enter the IIP reads as follows:

#### **Major Capital Investment Projects**

Major capital investments that are not included in the current DIIP [Defence Integrated Investment Program], but are related to emerging risks identified through biannual updates of the DIIP and have identified offsets, can seek Government agreement to be included in the DIIP. These major capital investment proposals will not be subject to new policy proposal (NPP) requirements.

2.44 This rule has been cast in these terms since the 2019 edition of the BPORs. Earlier editions were less clear about the process of including new projects in the IIP.<sup>61</sup>

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60 Defence cited the BPORs, Defence Capability Manual (Integrated force design processes), Product Life Cycle Guidance, and IIP biannual process guidance.

61 For example, the 2017 edition indicated that major capital investment projects coming forward for final government consideration that are not included in the current IIP are to be treated as new policy proposals (NPPs) and are subject to either NPP requirements, including the completion of a risk assessment and identification of whole-of-life costs, or agreement is to be sought from government for the NPP's inclusion in the IIP.

### *Approval at commencement of the Integrated Investment Program*

2.45 As noted in paragraph 1.12, Defence put the inaugural IIP to government for agreement in June 2015. The summary of 73 key elements presented as the future force structure comprised existing, approved and proposed capability projects and enabling facilities at that time, structured by capability stream.<sup>62</sup> It is not clear from the associated documents which other projects were considered by Defence to be part of the Program at that time.

2.46 When, in February 2016, the government considered the draft of the *2016 Integrated Investment Program* document, along with an addendum comprising a list of classified projects, it endorsed the Program. The published edition of the *2016 Integrated Investment Program* subsequently issued refers to the Program as a 'summary of key investments' by capability stream.

2.47 The March 2016 classified IIP broadsheet shows that many more Defence capability projects existed and were documented in the broadsheet than were put to government at this time.<sup>63</sup> Given that subsequent biannual IIP updates to government proposed only new projects and changes to the list approved in 2016, it is not clear whether or when the many other projects in the underlying broadsheet in March 2016 were approved for inclusion in the IIP by government.

### **How project entry into the Integrated Investment Program is recorded**

2.48 Following government approval at a biannual update of the IIP, new projects are recorded on the broadsheet. This has remained generally consistent in internal structure since 2016. There have been formatting improvements to align, consolidate and standardise the capability, estate and ICT programs into the one broadsheet. Previously they were separate tabs within the broadsheet.

2.49 In recent editions of the IIP broadsheet, projects appear in the format set out in Table 2.2. When Defence put the *2020 Force Structure Plan* document to government, it presented about 227 new investments, 74 of which were to commence in the Forward Estimates period. These included new projects or initiatives, additions to existing project scope, or amendments to existing unapproved or approved projects.

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62 Some of these elements comprised distinct capability development projects; others represented an aggregation of less specific infrastructure projects.

63 In the edition of the broadsheet titled 'Baseline 2016 IIP' Defence has a total project count of 816 projects of which 546 had a cost greater than zero dollars. A list of 208 projects was published in the *2016 Integrated Investment Program*, though some of these represented aggregations of projects listed individually in the underlying broadsheet.



**Table 2.2: Typical format of the Integrated Investment Program broadsheet<sup>a</sup>**

Project Title		Status	Current Year	Year 2	Year 3	Year 4 <sup>b</sup>	Contingency <sup>c</sup>	10 Year Total	20 Year Total
Project A Phase 1									
Capital	Approved	Proposed	\$	\$	\$	-	\$	\$	\$
	Unapproved	Proposed	-	\$	\$	\$	\$	\$	\$
Future Sustainment	Approved	Proposed	-	\$	-	-	-	\$	\$
	Unapproved	Proposed	-	-	\$	\$	-	\$	\$
Project A Phase 2									
Capital	Approved	Proposed	-	-	-	-	-	-	-
	Unapproved	Proposed	-	\$	\$	\$	\$	\$	\$
Future Sustainment	Approved	Proposed	-	-	-	-	-	-	-
	Unapproved	Proposed	-	-	\$	\$	-	\$	\$

Note a: The broadsheet is stored in Defence's records management system as a Microsoft Excel file. In this file it is one of multiple spreadsheet tabs.

Note b: In the broadsheet, columns are provided for twenty years or more.

Note c: Within the IIP, each capital project is allocated a contingency provision, based on cost risk. A project can draw on the contingency amount during acquisition should unforeseen events emerge. Defence's Investment Committee has set out a formal process for access to contingency funds. Contingency funding cannot be used to address scope changes.

Note d: The dollar symbol (\$) represents an out-turned amount of Australian dollars.

Source: ANAO analysis of Defence records.

2.50 The date of entry of projects into the Integrated Investment Program is not stated in the published editions of the IIP nor in the classified IIP broadsheet. Defence advised the ANAO (August 2022) that decisions of the Government and reasons for approving adjustments to programs in the IIP are held in the relevant government record keeping systems.

2.51 While records of approval by government exist, reliance on these records alone does not support efficient quality checking that there was an approval for the entry of each item in the IIP. Further, the quality checking of historical IIP data is hampered as access to approvals made by prior governments is limited by convention.<sup>64</sup> Reliance on these government records alone would make it difficult to trace and verify when entry of a particular project into the IIP occurred, and whether it occurred with proper authority.

2.52 Maintaining a log of each project's authorisation to enter the IIP — for example by including this data in the broadsheet — would help provide certainty as to the origin, scope and authority of each IIP project. As discussed below, during 2021 Defence began automating production of the IIP broadsheet, however it remains unclear whether it will provide this function. It would be of particular value where, as is often the case with Defence capability projects, the span of time for development and full implementation may extend over a decade or more. Such a log of key information would also support capability managers and Investment Committee members over

64 Department of the Prime Minister and Cabinet, *Cabinet Handbook - 14th edition* [Internet], paragraphs 141–144, available from <https://www.pmc.gov.au/resource-centre/government/cabinet-handbook> [accessed 27 July 2022].



time to obtain assurance as to the accuracy of fundamental data in the broadsheet. Noting that the source of the approval is a government decision, appropriate consideration of the information to be logged and the handling of that information is necessary.

2.53 Defence advised the ANAO (August 2022) that:

CapabilityOne [Defence's project management software for capability development] does note major milestones but does not provide specific details of the exact decision Government made. Integration of an approvals register into CapabilityOne is on the forward work program for improvements. However, there would be benefit in recording in CapabilityOne the original approving authority ... where a project officially entered (or was cancelled) in the IIP.

### Recommendation no. 1

2.54 That the Department of Defence maintain a log of the date on which each project in the Integrated Investment Program was authorised, and by whom it was authorised.

**Defence response:** *Agreed.*

2.55 *Defence currently maintains a manual log but improvements can be made including further detail in a log and potential integration with other systems.*

### Updates and changes to the IIP broadsheet

2.56 Each year, the Defence minister seeks agreement to the annual Defence Management and Financial Plan as part of the Defence portfolio budget submission. As part of this process, the government approves changes and updates to the Integrated Investment Program.<sup>65</sup>

2.57 All changes and updates are within a 10-year funding envelope and relate to cost provisions, estimates and scheduled timing for approval and expenditure. This includes factoring-in out-turning adjustments flowing from inflation forecasts and project-specific foreign currency exchange rate forecasts. The latter reflect each project's exposure to an overseas supply chain.

2.58 From 2016–17 to 2019–20 Defence recorded 106 IIP projects affected by successive re-prioritisation, to deal with capability gaps and portfolio pressures. The consequences for these projects included a delayed decision, re-phasing of funding, reduction to funding or scope, deferral beyond the decade or, in five cases, removal.<sup>66</sup> Within six months of the 2020 Force Structure Plan's release (1 July 2020) some 240 changes were recorded.

2.59 During 2021, Defence began automating production of the IIP broadsheet as an output of its BORIS financial system (discussed further at paragraph 2.69).<sup>67</sup> As part of this process a baseline reconciliation exercise identified 95 project anomalies, being differences between budget data held in the broadsheet and that held in BORIS. Input from various areas within Defence was required to

65 The DMFP updates the internal program budget view of Defence and includes total Defence expenses over 20 years from the Budget year, including: the IIP provisions (acquisition and sustainment), Defence's departmental workforce costs (military and civilian), operating expenses, and costs associated with Defence operations. The BPORs require Defence to provide the 20-year financial data underpinning the DMFP to Finance to support government consideration of the DMFP.

66 'Removal' includes circumstances where the project scope is to be addressed through other projects.

67 The Budget and Output Reporting Information System (BORIS) is Defence's corporate budget development and reporting system. BORIS is regarded within Defence as the authoritative system for budget data.

obtain an agreed understanding of the correct provision, and to identify the correct change authority.

2.60 When government approves the biannual IIP update or agrees to individual project submissions, Defence is able to update the following information in its BORIS financial system:<sup>68</sup>

- the approved funding of projects' capital and future sustainment; and
- the unapproved provisions for future capital and sustainment.<sup>69</sup>

2.61 During this audit Defence automated this process and advised the ANAO that this has improved the acquitting of data entered into the IIP broadsheet against government approvals.

### Processes for ensuring accuracy of IIP data

2.62 Capability managers<sup>70</sup> are responsible for ensuring the accuracy of changes to the IIP — with appropriate approval authority — such as project reclassifications, apportioning of a project into approved and unapproved phases, creation and removal of sub-projects and financial figures.

2.63 In preparing the biannual update submission, capability managers are reminded of their obligations as 'accountable officers', including their responsibility for the quality of data provided under the Defence Capability Policy Framework, and the need for information entered into CapabilityOne (Defence's project management software for capability development) to be kept up to date. Where an inaccuracy is identified:

- For financial figures within 20 years, a corrective journal is to be raised in accordance with the Internal Budget Journal Policy. Each journal is logged.
- For all other information, including financial figures beyond 20 years, the capability manager is to request the managers of the IIP broadsheet within Defence to update the information.

2.64 From November 2020, the IIP broadsheet has had a 'known issues' tab that provides free text fields to record identified issues. The tab indicates that Defence is working to identify known issues.<sup>71</sup> The ANAO's review of Defence guidance material indicates that Defence does not have a standard process for detecting and reporting inaccuracies.

2.65 Defence and Finance advised the ANAO that in providing a copy of the IIP broadsheet to Finance each month, Defence includes an explanatory tab which documents changes that have

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68 According to the Defence Internal Budget Policy Manual (July 2021): 'The Defence budget is managed within BORIS, which is regarded as the single source of truth for budget numbers. Where other systems are being utilised and contradict BORIS, BORIS will take precedence' (paragraph 37, p. 11).

69 Defence also undertakes a review of approved programs through budget estimates and the additional estimates processes. These processes consider the acquisition and future sustainment costs of approved projects.

70 According to the Defence Internal Budget Policy Manual (July 2021), a Capability Manager is: 'a senior Defence officer (typically 3-star or SES Band 3) accountable for management of subordinate Capability Programs and oversight of any assigned Multi-Domain Programs, including the development, delivery, introduction, preparedness, withdrawal and disposal of capabilities, in accordance with Defence policy and directions.'

71 As an example of the issues that have arisen, a 2019–20 edition of the broadsheet was accompanied by notes which stated, for some 10 separate projects, that: 'The funding for this project is currently being held against [name of another project] until DFG [Defence Finance Group] generates a new WBS [Work Breakdown Structure] and splits the funding out'. Another example is a note that reads: 'The funding for this project does not reflect the changes agreed as part of the 2019–20 PBS Bi-annual update'.

occurred from the previous iteration of the broadsheet. Finance scrutiny of the broadsheet provides an additional opportunity for errors to be identified and corrected.<sup>72</sup>

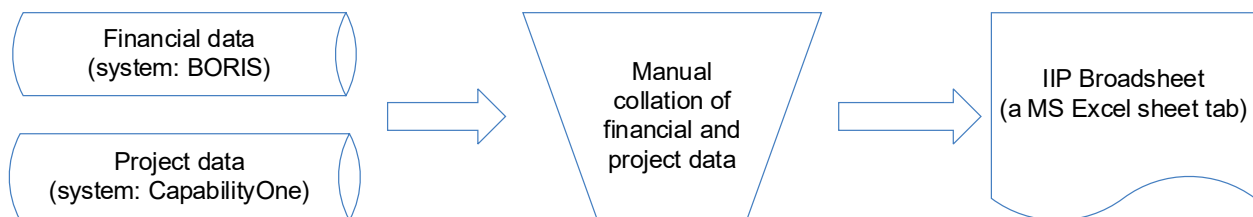
## Systems controls to manage data entry and data updates to the IIP broadsheet

2.66 Given the important role of the IIP as a tool for planning Defence investments and informing decision-makers and their advisers of the affordability of proposed projects, accurate and traceable processing of changes and updates to the IIP broadsheet is essential.

### *IIP broadsheet production*

2.67 Defence's guidance material for broadsheet production describes a process involving extracting data from its financial and project management systems in the protected environment and transferring the data into Defence's secret environment for further manual manipulation and collation. This process comprises at least 57 manual steps. The final step involves compressing seven files for migration into the Defence secret environment. Once in the secret environment, further manual steps are applied before an updated broadsheet record of the IIP is created and stored in Defence's records management system (see Figure 2.1).

**Figure 2.1: Production of the Integrated Investment Program broadsheet 2016–2021**



Note a: The broadsheet is stored in Defence's records management system as a Microsoft (MS) Excel file with multiple tabs.

Note b: See Table 2.2 for typical format of an IIP Broadsheet.

Source: ANAO analysis of Defence documents.

2.68 Defence commenced progressive rollout of a 'systematised' broadsheet during 2021. This initiative had the aim of eliminating the manual steps discussed above, to ensure a consistent and reusable structure with a minimum risk of errors. The system, known as TM1, is described by Defence as a solution for standardised financial reporting that obtains data directly from source systems for reporting purposes.

2.69 CapabilityOne is Defence's system to support and manage capability development across the portfolio.<sup>73</sup> It is designed to provide a centralised and single source of capability information to inform advice within Defence, and to advise the central agencies and government. It is the means

72 Finance provides comments on Cabinet submissions at each stage of the drafting process and prepares a 'Cost and Risk Statement', informed by the Cost Model Review, as part of the Coordination Comment process. The Cost and Risk Statement provided by Finance addresses the quality of estimates underpinning the Project's cost estimates, the Project's affordability, and associated risks. Finance also advises the Minister for Finance and/or the Cabinet (through ministerial briefs and/or Finance Green Briefs) on the affordability of IIP projects. Finance advised the ANAO in December 2021 that it works closely with Defence to resolve any questions regarding the cost estimates, including underlying assumptions where tender quality estimates are not available, particularly at a project's first and second pass.

73 Defence describes CapabilityOne, which came into initial operation in 2017, as a Defence Secret Environment web-based application comprising specialised modules, among which is a module that specifically supports capability development.

for capability managers to provide information that is entered into the IIP to help produce the biannual reports to government. Defence advised the ANAO that there are approximately 1300 active CapabilityOne users.

### *Broadsheet controls*

2.70 The ANAO's review of the various iterations of the IIP broadsheet revealed an evolving structure and level of detail. Each broadsheet comprised many hundreds of lines, dozens of columns, and multiple 'tabs'. Defence provided the ANAO with copies of instructions it has compiled for entry of new or amended data into the broadsheet. However, there is no documentation setting out the desired or optimum structure, content, and data definitions for the elements of the broadsheet.<sup>74</sup> The broadsheet has been maintained, used, and accessed by a small group of officials within Defence and Finance, which may have mitigated the risks of misinterpretation or error, notwithstanding the lack of documentation.

2.71 From 2016 to 2021, manual verification was the primary method of checking the accuracy of changes and updates to the IIP broadsheet. This is because once the data left the automated control environment of Defence's financial system, this data entered an environment that required a series of manual interventions to produce and update the broadsheet. Any errors that occurred during this process would be identified only through a manual check against the relevant approval authority. For example, when changes have been made, the relevant project or capability managers are expected to confirm that those changes are consistent with the approval authority.

2.72 Defence was not able to identify the exact changes made to the IIP broadsheet over time, with an explanation for those modifications, as the broadsheet does not have a system to trace changes to its source data.<sup>75</sup> Therefore Defence cannot provide assurance over content or the controls implemented for broadsheets generated in the past, as the data is captured in a document from reports generated from other systems and the identified key controls at this time were mostly manual. The ANAO did not test the controls that were in the process of being implemented as part of the recent automation process discussed in paragraph 2.68.

2.73 Defence's prototype automation solution, currently in development, is expected to automate broadsheet synchronisation with source data in BORIS and CapabilityOne. These changes are expected to include auditable controls that identify and log manual interventions and preserve broadsheet versions. Defence advised the ANAO in August 2022 that it is:

... developing a solution that is suitable for synchronisation between the Defence Financial Systems and CapabilityOne. The Broadsheet, however, now has system reconciliation to Defence's financial system of record (BORIS).

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74 For example, there is no embedded or other documentation to explain how columns in the broadsheet relate to each other or where the data has been sourced.

75 Similarly, the ANAO has observed, in successive editions of the annual Defence Major Projects Report (MPR), that Defence's use of spreadsheets as a primary form of record for risk management in the major acquisitions space is a high-risk approach, as spreadsheets lack formalised change/version control and reporting, thereby increasing the risk of error. This can make spreadsheets unreliable corporate data handling tools as accidental or deliberate changes can be made to formulae and data, without there being a record of when, by whom, and what change was made. A significant amount of quality assurance is necessary to obtain confidence that spreadsheets are complete and accurate. See Auditor-General Report No.13 2021–22, *2020–21 Major Projects Report*, paragraph 1.75.

2.74 Defence further advised the ANAO in August 2022 that:

- Responsibility of producing IIP Broadsheet has shifted from IPMB [Investment Portfolio Management Branch] to DFG [Defence Finance Group] CAAB [Capability Advice and Analytics Branch] within Defence [in] June 2021.
- The IIP Broadsheet is automatically updated in TM1 based on budget adjustments from the Defence Financial Systems.
- The IIP Broadsheet is reconciled each month to Defence Management Financial Plan (DMFP) to ensure internal reporting amounts are complete and accurate.
- Security controls have been introduced, i.e. password protection of the IIP Broadsheet to avoid changes after publishing and secure access for users through a Defence file management system (Objective).
- Adjustment to projects and products in the IIP Broadsheet/Defence Financial System are subject to internal controls that are linked to the internal budget policy document (each adjustment must have authority or authoritative supporting documentation).
- Projects that are approved ... [by the Government] ... and not yet processed in the system are listed in a log as an attachment to the IIP Broadsheet to outline projects that need to be updated to reflect real time.

## Recommendation no. 2

2.75 That the Department of Defence:

- (a) define all data elements in the broadsheet supporting the Integrated Investment Program;
- (b) prepare business rules for managing, maintaining and updating the broadsheet; and
- (c) keep systematic records of all changes and updates to the broadsheet in a manner that facilitates quality assurance and later review.

**Defence response:** *Agreed.*

2.76 *This is currently achieved through the production of the IIP Broadsheet using the Financial Management System (TM1) and the associated controls per the Internal Budget Journal Policy governing budget adjustments. The IIP Broadsheet goes through quality assurance reviews before it is distributed to stakeholders.*

2.77 The Defence Investment Committee outcomes reviewed by the ANAO did not indicate whether the Committee has assessed the adequacy of these improved broadsheet controls and treatments, in the context of the IIP broadsheet's identified risks or its role as a decision-making tool. While the ANAO found IIP risks identified in the business plans of relevant Defence Groups, there is no risk management plan or risk register for the Integrated Investment Program. There would be benefit in Defence adopting a risk management plan for the IIP that is consistent with the standard Defence risk management framework.<sup>76</sup>

<sup>76</sup> A recent Defence internal review also found that many of the extant IIP budget risk mitigation strategies being employed, such as over-programming program budgets and the inclusion of adequate contingency, would benefit from financial risk assessments and improved governance.

### Recommendation no. 3

2.78 That the Department of Defence develop an Integrated Investment Program risk management plan, to include risk management of IIP broadsheet risks and controls.

**Defence response:** *Agreed.*

2.79 *The scope of the Audit covered the public Integrated Investment Program documents related to the 2016 Defence White Paper, and the 2020 Force Structure Plan (FSP). Since the 2020 FSP, Defence has already implemented a range of improvements within its financial systems. Defence will continue to ensure key governance checkpoints and controls to the IIP broadsheet are fully implemented and monitored on a regular basis.*

### 3. Public reporting

#### Areas examined

This chapter examines whether the Department of Defence (Defence) has established an effective framework to guide its public reporting on the Integrated Investment Program (IIP or Program).

#### Conclusion

For the two public editions of the Program published to date, there was no guidance to officials on how to report publicly, and the transparency and usability of the public editions was reduced by: making it difficult to identify projects and track between public editions; omitting certain projects or aggregating projects without some explanation of the approach adopted; and using different approaches to report potential costs without explaining why. The reporting approach adopted for the Future Submarine and Future Frigate programs in the first public edition, particularly the inclusion of substantially lower minimum costs than those provisioned for in the underlying confidential IIP broadsheet, fell short of providing accurate, reliable and transparent information for users of the public document. Defence did not establish effective systems for reconciling information in the IIP broadsheet and the public editions of the Program, and did not seek arm's length verification that the costings included in the public editions accurately reflected the broadsheet costings.

#### Areas for improvement

The ANAO has made three recommendations. These are aimed at: facilitating the reconciliation of information between successive public editions of the Program; defining the purpose of public editions and developing guidance for their preparation; and documenting a clear line of sight between information in the classified IIP broadsheet and public editions of the Program.

3.1 Public reporting on the Integrated Investment Program (the Program or IIP) informs the Parliament and the public about Defence's expected expenditure on capability and facilitates accountability for public expenditure. In announcing the *2016 Integrated Investment Program* document, the Prime Minister and the Minister for Defence said that the IIP 'sets a new benchmark for transparency'.<sup>77</sup> The Minister for Defence added that the Program, together with the other papers released simultaneously:

transform the Defence-to-industry relationship that is at the heart of delivering capability to Defence.<sup>78</sup>

3.2 This chapter assesses whether Defence has established an effective framework to guide its public reporting on the Integrated Investment Program. To accurately inform parliament and the national conversation on Defence acquisitions, and guide defence industry investment as to Defence's longer terms plans to deliver capability, the public reports need to convey information

77 M Turnbull (Prime Minister) and M Payne (Minister for Defence), '2016 Defence White Paper', 24 February 2016, available from <https://www.minister.defence.gov.au/media-releases/2016-02-24/prime-minister-and-minister-defence-2016-defence-white-paper> [accessed 2 November 2011].

78 M Payne (Minister for Defence), 'Launch of the 2016 Defence White Paper', 25 February 2016, available from <https://www.minister.defence.gov.au/speeches/2016-02-25/minister-defence-launch-2016-defence-white-paper> [accessed 14 July 2022]. The three documents released by the government were the *2016 Integrated Investment Program*, the *2016 Defence White Paper* and the *2016 Defence Industry Policy Statement*.

that is otherwise classified, in a clear and meaningful way. The effectiveness of Defence's processes for preparing its two public reports on the IIP were assessed by the ANAO in terms of:

- the availability of guidance to inform officials about quality, consistency, readability and presentation, including the presentation of sensitive information; and
- the accuracy of public reporting on project costs.

### Is there guidance to officials on how to report publicly on information in the Integrated Investment Program?

For the two public editions of the Program published to date — the *2016 Integrated Investment Program* and the *2020 Force Structure Plan* — there was no guidance to officials on how to report publicly on the Program.

The *2016 Integrated Investment Program* included a commitment to produce an online edition of the IIP to ensure industry access to current information, with periodic updates to reflect changes in the Program, and Defence advised the Parliament in February 2017 that the online version would be available within months. Defence subsequently (May 2020) advised the Defence Minister against developing a website with more detailed IIP project and program data than was about to appear in the *2020 Force Structure Plan*, on the grounds of security and commercial risk. Defence records indicate that it received no response to this advice. Defence did not publish an online edition of the IIP.

The transparency and usability of the two public editions of the Program has been reduced by:

- each public edition providing limited data, being acquisition-focused and without forecast sustainment or workforce costs for individual projects or programs;
- making it difficult to identify projects and track between public editions;
- omitting certain projects or aggregating projects without some explanation of the approach adopted; and
- using different approaches to report potential costs without explaining why, particularly where the cost range is unbounded, with no upper limit, as in the case of the Future Submarine and Future Frigate programs.

While Defence needs to manage security and commercial issues in its public reporting on the Program, industry has advised the ANAO that the two public editions released to date do not provide the insight industry expects.

3.3 The *2016 Integrated Investment Program* document was released by the Australian Government in February 2016.<sup>79</sup> The document was considered as a whole and approved for publication. At the time the government approved the *2016 Integrated Investment Program*, it was envisaged that annual updates to that document would accompany the Defence Budget from

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79 M Turnbull (Prime Minister) and M Payne (Minister for Defence), '2016 Defence White Paper', 24 February 2016, available from <https://www.minister.defence.gov.au/media-releases/2016-02-24/prime-minister-and-minister-defence-2016-defence-white-paper> [accessed 2 November 2011].



2017–18. The government also made a commitment to produce an online edition of the IIP.<sup>80</sup> These initiatives were not implemented.

3.4 When the *2016 Integrated Investment Program* document was approved for release, the government agreed a communications strategy for the *2016 Defence White Paper* and the public IIP. There was no specific, documented guidance to Defence officials on the public release of any further IIP information thereafter, beyond the rules surrounding the handling of classified information and the giving of evidence to the Parliament.<sup>81</sup>

3.5 On this matter, Defence advised the ANAO in November 2021 that:

The public release of IIP information is a matter for the Government of the day and as such there is limited formal codified guidance available to the Department. Defence can provide advice to Government with reporting options and advice as to the expected commercial, strategic or security sensitivities associated with the public release of IIP information. This has changed over the years due to a significant shift in the strategic environment.

3.6 Defence further advised the ANAO (August 2022) that ‘In considering the Defence Strategic Review, Government may choose to provide further direction on the public IIP.’

### **Provision of public information about the Integrated Investment Program**

3.7 In April 2015, Defence’s First Principles Review, in recommending the development of a Defence investment plan, stated that:

A version of this plan should be made available to industry to enable appropriate planning for future capital projects.<sup>82</sup>

3.8 The *2016 Integrated Investment Program* document included a commitment to produce an online edition:

Since the status of projects will change as they move through the different stages of the approval cycle, it will be inefficient to maintain a current hard copy version of the Integrated Investment Program. To ensure that industry has access to current information, an online version will be periodically updated to reflect changes in the program.<sup>83</sup>

3.9 At the launch of the *2016 Defence White Paper*, senior Defence officials undertook that a supporting website would be available from about June–July 2016. A year later, in February 2017, Defence officials were asked by a parliamentary committee when the online version of the IIP would arrive. Defence testimony was that:

We anticipate in the next couple of months to go online, and it will evolve. ... Our aim is for it not to be fire and forget but for it to be probably updated twice a year, if we could do that. I think that

80 This commitment is stated on pp. 10–11 of the *2016 Integrated Investment Program*.

81 See for example the Department of the Prime Minister and Cabinet, *Government Guidelines for Official Witnesses before Parliamentary Committees and Related Matters - February 2015* [Internet], available from: <https://www.pmc.gov.au/resource-centre/government/government-guidelines-official-witnesses-parliamentary-committees-and-related-matters-february-2015> [accessed 19 September 2022]. See also Department of Industry, Science and Resources, *The Australian Public Service Framework for Engagement and Participation*, 2020, available from: <https://www.industry.gov.au/sites/default/files/2019-11/aps-framework-for-engagement-and-participation.pdf> [accessed 19 September 2022].

82 Defence, *First Principles Review: Creating One Defence*, p. 41.

83 *2016 Integrated Investment Program*, pp. 10–11.

would be very useful, and that would align with our biannual reporting to government on the state of the integrated investment plan.<sup>84</sup>

3.10 There is evidence from within Defence that in August 2017, work on the proposed public website was underway. In the same month, a report in *The Strategist*, a publication of the Australian Strategic Policy Institute (ASPI), reported that an updated version of the IIP had appeared online.<sup>85</sup> An addendum to the report stated that Defence had advised the report's author that the then current online version of the IIP was not the online edition promised in February 2016. According to this statement, the online edition was still under development and would be released when complete.<sup>86</sup>

3.11 The *Defence Industrial Capability Plan*, released by the government in April 2018, reaffirmed the commitment to an online edition, stating that:

More detailed project and program information will be available through the Integrated Investment Program web page to be launched in 2018.<sup>87</sup>

3.12 Defence advised the ANAO in November 2021 that it:

... has developed options for government consideration to publish and maintain a public online version of the IIP. These options require careful management of commercial and strategic risks and, as yet, Government has not agreed an online version of the IIP.

3.13 In May 2020 Defence had provided advice to the Minister for Defence recommending that Defence not develop a website with more detailed IIP project and program data than was about to appear in the public *2020 Force Structure Plan*. Defence's advice was that public online release of more detailed IIP data would present 'risk to the Government and Defence in terms of national security, loss of commercial leverage and reduced flexibility in responding to shifting strategic and national priorities.' Defence also sought the Minister's agreement that the *2020 Force Structure Plan* would provide an appropriate alternative to a public online version of the IIP. Defence indicated that if the Minister wished to continue with a detailed online IIP Defence would return with further advice. Defence records indicate that it received no response to this advice. Defence did not publish an online edition of the IIP.

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84 Commonwealth, *Inquiry into Department of Defence Annual Report 2015–16*, Joint Standing Committee on Foreign Affairs, Defence and Trade, 17 February 2017, p. 18, R Griggs, Vice Admiral, AO, CSC, Vice Chief of the Defence Force (VCDF), available from [https://parlinfo.aph.gov.au/parlInfo/download/committees/commjnt/8d78002b-9c0a-455a-88f7-dc6e06110630/toc\\_pdf/Joint%20Standing%20Committee%20on%20Foreign%20Affairs,%20Defence%20and%20Trade\\_2017\\_02\\_17\\_4749\\_Official.pdf;fileType=application%2Fpdf#search=%22committees/commjnt/8d78002b-9c0a-455a-88f7-dc6e06110630/0000%22](https://parlinfo.aph.gov.au/parlInfo/download/committees/commjnt/8d78002b-9c0a-455a-88f7-dc6e06110630/toc_pdf/Joint%20Standing%20Committee%20on%20Foreign%20Affairs,%20Defence%20and%20Trade_2017_02_17_4749_Official.pdf;fileType=application%2Fpdf#search=%22committees/commjnt/8d78002b-9c0a-455a-88f7-dc6e06110630/0000%22) [accessed 2 November 2022].

85 M Thomson, 'More of the same: Defence's online Integrated Investment Program', *The Strategist*, 4 August 2017, available from <https://www.aspistrategist.org.au/defences-online-integrated-investment-program/> [accessed 2 November 2022]. This analysis found that the online version contained numerous mistakes (including transposition errors), that some material was out-of-date, and that it contained broken links to other documents. The online edition of the IIP found by the analyst in 2017 is no longer available on the internet. Links published in 2017 in the critique of that online edition take the user to a general page for Defence's Strategy, Policy and Industry Group, a part of the department which is not responsible for the IIP.

86 During this audit the ANAO found no internet record of the online edition of the IIP discovered by the ASPI analyst in 2017. Defence has not provided advice to the ANAO on what occurred at that time.

87 Department of Defence, *2018 Defence Industrial Capability Plan* [Internet], p. 53, available from <https://www.defence.gov.au/business-industry/capability-plans/defence-industrial-capability-plan> [accessed 14 July 2022]. This was released by the Minister for Defence Industry.

### *Other public information about the Integrated Investment Program*

3.14 In addition to the two publicly released editions of the IIP, information about individual projects in the IIP has been presented in public in other ways. For example:

- Defence provides some related information in other publications, such as the *2017 Naval Shipbuilding Plan*, the *2018 Defence Industrial Capability Plan*, and on its website. None of these sources provides data across the whole of the Program in the style of the *2016 Integrated Investment Program* and the *2020 Force Structure Plan*.<sup>88</sup>
- Parliamentary scrutiny of Defence's capability development has required officials from Defence and Finance to respond to questions about specific projects in the IIP, most frequently about the costs of those projects.<sup>89</sup>
- Ministers have referred frequently in press releases and in public interviews to prominent capability projects in the IIP and the costs of those projects. For example, ministers have mentioned the former Future Submarine (Attack class) program and its cost in press statements at least two dozen times between the release of the *2016 Integrated Investment Program* and the publication of the *2020 Force Structure Plan*. Ministers have also mentioned the Future Frigate (Hunter class) at least half-a-dozen times in press statements over the same period.

### **Information reported in public editions of the Integrated Investment Program**

3.15 The two publicly released editions of the IIP — the *2016 Integrated Investment Program* and the *2020 Force Structure Plan* — provide a portion of the whole of the IIP data held by Defence (some of which is classified).<sup>90</sup>

3.16 The *2016 Integrated Investment Program* stated that:

The hard copy version of the Integrated Investment Program provides a consolidated overview of the elements of the plan for the future force; it does not provide an exhaustive list of projects.<sup>91</sup>

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88 Defence advised the ANAO (August 2022) that it also provides information to industry and the public through a number of forums and publications such as: the 2016 Defence Industry Policy Statement; the 2017 Defence Industry and Innovation Program Update; the 2018 Defence Export Strategy; the 2020 Defence Transformation Strategy: Lead the Way; Sovereign Industrial Capability Plans; the Defence Science and Technology Plan 2030; the Next Generation Technologies Fund and Innovation Hub; various industry engagements via industry briefings; individual environmental working groups run by each of the armed Services; and Defence conferences.

89 For example, a catalogue compiled by Defence of some of these statements in relation to Defence's Future Submarine (Attack class) project is set out in a document tabled in Parliament by the Minister for Defence on 26 October 2020: see L Reynolds CSC (Minister for Defence), 'Future Submarine Program – Estimated Acquisition Cost – Timeline', available from [https://www.aph.gov.au/-/media/Estimates/fadt/bud2021/tabled\\_docs/Defence\\_tabled\\_doc\\_-\\_FSP\\_-\\_estimated\\_acquisition\\_cost\\_timeline.pdf?la=en&hash=C032F19EE6929B2B63EB8BE314EB56EE743E6247](https://www.aph.gov.au/-/media/Estimates/fadt/bud2021/tabled_docs/Defence_tabled_doc_-_FSP_-_estimated_acquisition_cost_timeline.pdf?la=en&hash=C032F19EE6929B2B63EB8BE314EB56EE743E6247) [accessed 14 July 2022].

90 Defence's Investment Committee noted in late 2015 that there were over a thousand 'elements' in the IIP.

91 Defence, *2016 Integrated Investment Program*, p. 10.

3.17 The 2016 public document presents a list of ‘key’ projects and forecasts of total acquisition costs for each.<sup>92</sup> A footnote to each table of projects in the document states that:

The figures in the table cover the acquisition element of the programs. There will be additional investment in whole-of-life sustainment and operating costs for each program. All figures are calculated on an out-turned price basis.

3.18 In a similar way to the 2016 document, charts listing individual projects in the *2020 Force Structure Plan* provide acquisition costs. Sustainment costs are stated in summary form, aggregated by domain.<sup>93</sup> Defence has stated elsewhere that whole-of-life costs for capability are typically 30 per cent in acquisition and 70 per cent in sustainment.<sup>94</sup> In its engagement with the ANAO, industry observed that sustainment is an area where local industry participates, but this is a topic for which detailed information is largely absent from the publicly released IIP documents.

3.19 In the two publicly released IIP documents, the cost figures provided for individual items do not represent the total cost of acquiring, maintaining and operating the respective capabilities over the working life of the equipment involved (this is the ‘total cost of ownership’ or ‘whole-of-life’ cost). Whole-of-life costs include, but are not limited to: (i) acquisition costs; (ii) sustainment costs, including any costs flowing from the disposal of equipment; and (iii) workforce costs.<sup>95</sup> Operating costs for the individual capabilities were not included in either of the two public documents. The public documents do not make clear whether costs include expenditure already made for projects that are underway or how long the project has been in existence. A further consideration in assessing costs is that for major platforms like the Future Submarine, weapons, infrastructure and related systems to equip and maintain the platform may comprise separate projects. For example, ‘Weapons and Systems’ for the Future Submarine was a separate project in the *2016 Integrated Investment Program* document, with a reported out-turned cost of \$5 billion to \$6 billion.<sup>96</sup>

#### *Identification of projects and tracking between documents*

3.20 The information identifying projects in the two public editions of the IIP is limited when compared to other Defence documentation. Neither public document mentions projects by their usual Defence identification number, as has been done elsewhere in Defence’s public literature. Defence divides most major projects into multiple phases and, in some cases, sub-phases; but project phases are not identified in either public IIP document. This information might also have

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92 The *2020 Force Structure Plan* changes this practice in that it includes sustainment costs for certain projects.

93 More specifically, the *2020 Force Structure Plan* (p. 21) states that 2020–30 planned investment figures provided for the five capability domains (totals across all projects within the domain) comprise acquisition and sustainment funding. On the other hand, costs stated in the Plan’s charts for individual projects comprise acquisition costs only.

94 Department of Defence, *2017 Naval Shipbuilding Plan*, Figure 5.1, p. 80, available from [https://www.defence.gov.au/sites/default/files/2020-05/NavalShipbuildingPlan\\_1.pdf](https://www.defence.gov.au/sites/default/files/2020-05/NavalShipbuildingPlan_1.pdf) [accessed 4 November 2011]. Earlier work within Defence following the First Principles Review found that sustainment tended to be overlooked in comparison with acquisition. See Auditor-General Report No.34 2017–18 *Defence’s Implementation of the First Principles Review*, p. 52 and Auditor-General Report No.2 2017–18 *Defence’s Management of Materiel Sustainment*, p. 26.

95 See the earlier discussion of the requirements of Estimates Memorandum 2017/55 at paragraph 2.24 of this audit report. Defence advised the ANAO in November 2022 that ‘The risk with disclosing workforce cost is that the perception may be that this is an additional cost to Defence, when in fact workforce is already funded within the Defence budget’.

96 Defence, *2016 Integrated Investment Program*, p. 89.

helped identify the scope of the projects included in the public IIP documents, which do not otherwise specify project scope.<sup>97</sup>

3.21 There has been no public reconciliation against the two published editions of the IIP. While there has been ad hoc reporting and disclosure of progress at parliamentary estimates hearings and other inquiries<sup>98</sup>, there has been no consolidated public report on progress against the *2016 Integrated Investment Program* document, showing what became of each project. The subsequent *2020 Force Structure Plan* cannot be reconciled with the 2016 document, so as to provide the Parliament and other users of the documents with insight into progress and changes between 2016 and 2020.

3.22 The new material in the 2020 document was presented without a guide to help the reader comprehend how changes in priorities and scheduling affected individual projects identified in the 2016 document. The lack of explanatory information means that users of the documents cannot readily identify the relationship between projects from one document to the other and from tracking progress and understanding the changes between 2016 and 2020. Further, the *2020 Force Structure Plan* does not refer to or mention the *2016 Integrated Investment Program*, even though it can reasonably be viewed as a successor to that document or an updated edition.<sup>99</sup>

### *Omission/aggregation of projects*

3.23 Defence omitted some projects appearing in the classified Integrated Investment Program from the two public editions of the IIP, reporting only what it considered to be key projects.

3.24 The public *2016 Integrated Investment Program* document includes 200 identified projects, which is 37 per cent of the number recorded in the March 2016 classified IIP broadsheet (a total of 546 items).<sup>100</sup>

3.25 The public *2020 Force Structure Plan* includes 106 identified projects. The ‘fact sheet’ published at the same time stated that Defence has over 200 large scale acquisition programs

97 These codes and identifiable phases are used in public Defence material such as the Department of Defence, *2017 Naval Shipbuilding Plan* [https://www.defence.gov.au/sites/default/files/2020-05/NavalShipbuildingPlan\\_1.pdf](https://www.defence.gov.au/sites/default/files/2020-05/NavalShipbuildingPlan_1.pdf) [accessed 14 July 2022] and in the ‘Defence Projects’ section of the Defence website <https://www.defence.gov.au/projects> [accessed 14 July 2022]. For example, this site describes projects with clear identification, such as: ‘SEA 1439 Phase 5B2 will acquire a Modernised Submarine Communications System (MSMSC) for the Collins Class submarines’; SEA 1439 Phase 6 will deliver a sonar capability assurance program for the Collins Class submarines; and ‘SEA 4000 Phase 3.3, ... facilitates a key component of Operational Test and Evaluation of the three Hobart Class Destroyers (DDG) through the United States Navy (USN) Combat System Sea Qualification Trials (CSSQT) packages’. Defence project identification numbers and phases are also referred to in Defence’s ‘Australian Industry Capability Public Plans’ available from <https://www.defence.gov.au/business-industry/capability-plans/australian-industry-capability-public-plans> [accessed 14 July 2022] and numerous other places on the Defence website.

98 Department of Defence, ‘Answer to question on notice, Topic: SSFADT – BE 26/27 October 2020 – Q155 – 216 Integrated Investment Program (IIP) – Senator KITCHING’ [Internet], available from <https://www.aph.gov.au/api/qon/downloadestimatesquestions/EstimatesQuestion-Committeeld5-EstimatesRoundld9-Portfoliold7-QuestionNumber155> [accessed 7 November 2022].

99 Department of Defence, ‘Answer to question on notice, Topic: SSFADT – BE – 26/27 October 2020 – Q162 – 2020 Force Structure Plan and relation to the 2016 Integrated Investment Program (IIP) – Senator KITCHING’ [Internet], available from <https://www.aph.gov.au/api/qon/downloadestimatesquestions/EstimatesQuestion-Committeeld5-EstimatesRoundld9-Portfoliold7-QuestionNumber162> [accessed 7 November 2022].

100 As noted in paragraph 1.7 of this audit report, the March 2016 edition of the IIP broadsheet is the earliest that Defence could locate in its records.

underway at any one time. Data supplied by Defence shows that some 590 projects were in the classified IIP broadsheet immediately before approval of the *2020 Force Structure Plan*.

3.26 It is to be expected that Defence may exclude some items that refer to highly classified projects where national security sensitivities preclude publication. Other projects are obscured by aggregation into combined projects. The two public editions of the IIP do not identify the basis for omission or the factors driving the inclusion of projects in those publications.

### *Use of cost bands or ranges*

3.27 Each public edition of the IIP presents a succession of tables and/or charts with a list of projects, an estimated out-turned acquisition cost (or range of costs) for each, and an 'indicative acquisition window'.<sup>101</sup> For projects that had been approved for acquisition before publication, a specific figure is generally provided for the total acquisition cost.

3.28 The use of cost bands reflects that the IIP is a planning tool, and that most of its projects remain in planning. In these cases, the two public documents provide a range or band of possible costs. For example, the project 'Destroyer Program — Area Air Defence Weapons' in the 2016 public document is given a timeframe of 2018 to 2028 and an 'approximate investment value' of \$2 billion to \$3 billion. By providing a range, Defence reduces the risk of disclosing its own estimate of acquisition costs so as not to lose for the Commonwealth the commercial advantage conferred by any competitive acquisition process that may follow.

3.29 In a small number of cases, the costs published in the 2016 public document are not described as a band as set out above. For this small number of cases, the descriptors used were:

- 'Less than \$100 million' (nine cases);
- 'Less than \$260 million' (one case);
- 'Future Submarine Program — Design and Construction, 2018–2057, >\$50bn' (that is, an unbounded range, with a minimum value of \$50 billion and no upper limit); and
- 'Future Frigate Program — Design and Construction, 2017–2040, >\$30bn' (that is, an unbounded range, with a minimum value of \$30 billion and no upper limit).

3.30 There are no similar cases in the 2020 public document.

### *Transparency and usability of Defence reporting in public editions of the IIP*

3.31 In summary, the transparency and usability of Defence's public reporting of the Integrated Investment Program, in the two public editions released to date, has been reduced by:

- each public edition of the IIP providing limited data, being acquisition-focused and without forecast sustainment or workforce costs for individual projects or programs;
- making it difficult to identify projects and track between public editions of the IIP;
- omitting certain projects or aggregating projects without some explanation of the approach adopted; and

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<sup>101</sup> The project timeframe is presented as a clear span of years in tables provided in the 2016 public document. The 2020 public document is less precise in that the dates of the acquisition window must be derived by the reader interpreting from the axes of a Gantt (timeline) chart.



- using different approaches to report potential costs without explaining why, particularly where the cost range is unbounded as in the case of the Future Submarine and Future Frigate programs.

3.32 Industry representatives advised the ANAO that the two public editions of the IIP, in the form in which they have been published to date, are pitched at too high a level for industry to use as planning documents, with too little detail, particularly about smaller projects. While Defence needs to manage security and commercial issues in its public reporting, these comments indicate that the public editions of the IIP have not provided the intended planning information for industry.

3.33 Public reporting on progress against the plans set out in public editions of the IIP, such as the *2016 Integrated Investment Program* and the *2020 Force Structure Plan*, would provide improved transparency and accountability to the Parliament, and would assist users of the documents. Progress reporting could be implemented without disclosing highly sensitive or classified information. To enable the reconciliation of information, public reporting should document projects cancelled, amalgamated, slipped in timing, changed in title, scope or cost.

#### Recommendation no. 4

3.34 That the Department of Defence state, in its public reports on the Integrated Investment Program, progress against its plans:

- showing projects cancelled, amalgamated, slipped in timing, changed in title, scope or cost; and
- publish sufficient information as to enable reconciliation of the public edition with the previous public edition.

**Defence response:** *Not agreed.*

3.35 *Defence disagrees to the recommendation.*

3.36 *The content of any public report on the Integrated Investment Program is a Decision of Government.*

3.37 *Defence recognises the importance of providing project progress reports to Government and provides comprehensive, classified bi-annual Integrated Investment Program updates. Defence notes that the public reporting of project performance is achieved through the Major Projects Report published by the ANAO.*<sup>102</sup>

102 ANAO comment: the purpose of the annual Major Projects Report (MPR) is to report on the performance of selected Defence major capital equipment acquisition projects since Second Pass Approval, and associated sustainment activities (where applicable), managed by Defence. Approximately 20–30 major projects have been included in the MPR each year since its inception. As discussed in paragraphs 3.24–3.25 above, the public *2016 Integrated Investment Program* document included 200 identified projects, while the public *2020 Force Structure Plan* included 106 identified projects.

## Is Defence reporting accurately on the costs in the Integrated Investment Program?

Defence's systems could not provide clear line-of-sight traceability or complete and accurate evidence — for the purposes of internal quality assurance or independent review — regarding the basis for, and accuracy of, public reporting in the *2016 Integrated Investment Program* document.

Defence has not retained records about how it developed the public *2016 Integrated Investment Program* and populated it with cost data from the contemporaneous broadsheet and could provide no means to map between the two. Therefore, Defence systems do not enable itself or an independent reviewer to trace systematically, and with confidence, the source of the data in the public document nor to assess whether there is systematic variance in the financial information contained in the broadsheet and public reporting in 2016 on its content. Through comparative analysis, the ANAO was able to identify 67 per cent of the projects in the public document by names in the Defence broadsheet with broadly consistent acquisition cost data.

The majority of the cost figures in the public *2016 Integrated Investment Program* accurately reflect those provided to government by Defence in the draft version of the document. Nevertheless, some anomalies exist.

The reporting approach adopted for the Future Submarine and Future Frigate programs in the *2016 Integrated Investment Program* — particularly the inclusion of substantially lower minimum costs than those provisioned for in the confidential IIP broadsheet — fell short of providing accurate, reliable and transparent information for users of the public document. For the Future Submarine, the capital cost advised to government in February 2016 (\$78 billion) was 56 per cent higher than the minimum capital cost of \$50 billion reported publicly at that time. For the Future Frigate, the figure appearing at that time in the IIP broadsheet (\$36 billion) was 20 per cent higher than the minimum cost of \$30 billion reported publicly.

On the basis of information available and advice from Defence, the ANAO did not identify any substantial differences between the second public edition of the Program (the *2020 Force Structure Plan*) and the underlying IIP broadsheet. Defence was able to provide the ANAO with a spreadsheet-based working document that helped to map between the *2020 Force Structure Plan* and the contemporaneous classified IIP broadsheet.

### Defence's reporting on costs in the public editions of the IIP

3.38 The ANAO sought to compare the costs reported in the two public editions of the IIP with those in the relevant iteration of the classified IIP broadsheet, to assess whether Defence's public reporting on costs was accurate. The ANAO's comparative analysis was performed between each of the two public editions of the IIP and the respective copy of the classified broadsheet nominated by Defence as the contemporaneous basis of each public edition.

3.39 As discussed in paragraph 2.72, the IIP broadsheet does not record changes and updates automatically with a transaction history, authority for the change or the identity of each user.<sup>103</sup>

103 Spreadsheet documents may have a facility to record the identity of the last user to have modified the spreadsheet and the time of that modification. However, they do not record the nature of the change or retain a record of earlier changes.



This means that, to identify all changes to the broadsheet, Defence would have had to maintain a log using a manual process. Defence has not kept such a log. Defence advised the ANAO that the number of users of the broadsheet was limited and controlled, and that this mitigated risks to its management and accuracy.<sup>104</sup> Nonetheless, the lack of records relating to changes to the broadsheet is an impediment to internal quality assurance and independent analysis.<sup>105</sup>

3.40 A further impediment to review and analysis flows from the lack of records retained by Defence about the production of the *2016 Integrated Investment Program* document. Defence was not able to provide the ANAO with any documented specification as to what was required, business rules, tasking statements, or other guidance or formal documentation associated with Defence's creation and preparation of the first public edition of the IIP. Further, there is no record of deliberations over the compilation of the lists of projects, dates and costs in that document or of quality checking processes to provide assurance over the accuracy of the publicly reported information. Defence advised the ANAO in August 2022 that 'no subsequent evidence has been identified'.

3.41 In contrast, Defence was able to provide the ANAO with a spreadsheet-based working document that helps to map between the second public edition of the IIP (the *2020 Force Structure Plan*) and the contemporaneous classified IIP broadsheet. This was used for the relevant part of the ANAO's comparative analysis set out below.

3.42 The ANAO also identified a number of unexplained differences in approach between the costings in the *2016 Integrated Investment Program* and the *2020 Force Structure Plan*. Although neither document specifically mentions contingency amounts, the 2016 document includes contingency amounts in project costings whereas the 2020 document generally excludes contingency amounts, even though these amounts form provisions within the broadsheet.<sup>106</sup> Defence advised the ANAO in August 2022 that 'while contingency is included in government approvals and tracked by Defence, it is unfunded and is not triggered except by a contingent event occurring, and so providing information on provisions without contingency included is a logical

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104 ANAO analysis of the copies of the broadsheet provided by Defence indicates that around 30 people had edit/update access. Defence advised the ANAO in November 2022 that it would 'update current permissions as soon as we can'.

105 As discussed in footnote 75, the ANAO has similarly observed, in the annual Defence Major Projects Report (MPR), the risks relating to spreadsheets. Their lack of formalised change/version control and reporting can increase the risk of error, making them unreliable corporate data handling tools. Accidental or deliberate changes can be made to formulae and data, without there being a record of when, by whom, and what change was made. Therefore, a significant amount of quality assurance is necessary to obtain confidence that spreadsheets are complete and accurate.

106 Department of Defence, 'Defence Internal Budget Policy Manual' Version 1.0, July 2021, p. 56. Contingency amounts can be substantial. For example, the out-turned contingency amounts recorded in the broadsheet for the Future Submarine program were \$13.7 billion (2016) and \$15.2 billion (2020). The ANAO observed that contingency amounts were included in some maritime projects in the *2020 Force Structure Plan*, but were not included in most entries in that document. Consistency in approach would be a benefit of developing guidance for officials when providing IIP information in public material.

approach’.<sup>107</sup> However Defence also advised that it ‘has not been able to identify evidence behind the change in position for calculations’ between the two public documents.<sup>108</sup>

3.43 Available evidence does not show that the individual project costs listed in the public editions of the IIP were checked and verified at arm’s length of the original authors before publication, to give Defence and the government assurance as to their accuracy. Because the information involved is sensitive, such assurance would need to be provided by a party with appropriate qualifications and security clearance.

3.44 Arm’s length checking has been adopted for other documents issued by ministers that include cost information. For example, cost figures used in Budget-related press releases by Defence ministers have been ‘fact-checked’ independently of Defence.<sup>109</sup> There is no evidence that the individual project cost figures set out in the public *2016 Integrated Investment Program* or the *2020 Force Structure Plan* were verified in this way.<sup>110</sup>

### ***2016 Integrated Investment Program costings and variances from broadsheet***

3.45 Defence advised the ANAO (March 2022) that:

There may be variances between the classified IIP Broadsheet and public reporting contained in the Government’s 2016 Integrated Investment Program publication. This is due to the need for Defence to balance providing sufficient transparency to the public, and enough detail for industry to conduct planning and preparations to support capability delivery, with a need to preserve national security and commercial leverage (to achieve value-for-money outcomes for Government).

3.46 Defence has not advised the ANAO of specific variances between the classified broadsheet and public reporting contained in the *2016 Integrated Investment Program* publication.

#### ***Data source for the 2016 Integrated Investment Program document***

3.47 To provide a basis for comparative analysis by the ANAO, Defence identified the broadsheet version which it believes the first public edition of the IIP was based on. That broadsheet is dated March 2016 and its embedded properties indicate that it was last modified in October 2017. The *2016 Integrated Investment Program* was published in February 2016.

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107 ANAO comment: Department of Defence, ‘Management of Contingency Budgets in Defence Acquisition Projects’, 15 May 2019, states that contingency provisions are approved by government as part of the total project budget, though are not programmed or funded in cash terms and projects are encouraged to meet contingency funding requirements from within their currently programmed cash funding. If this cannot be achieved, a project may propose to access contingency funding from the relevant capital program — the Approved Major Capital Investment Program (AMCIP), Facilities and Infrastructure Program (FIP) and ICT Capital Program. If this cannot be achieved, the contingency call will be presented to the Defence Investment Committee, which if agreed will potentially be met by budget offsets across the whole Integrated Investment Program .

108 Defence advice to the ANAO, August 2022.

109 The Department of Finance advised the ANAO (December 2021) that, at budget updates since the publication of the *2016 Defence White Paper* and *2020 Force Structure Plan*, it ‘fact checked’ Defence’s budget media releases to ensure consistency with relevant government decisions and the budget papers. However, it did not perform a similar check of the costs stated in the *2016 Integrated Investment Program* or the *2020 Force Structure Plan*.

110 Defence advised the ANAO (August 2022) that its Finance Group verified the ‘whole-of-domain’ and other aggregate figures contained in the *2020 Force Structure Plan*.

3.48 However, Defence advised the ANAO that it cannot confirm that the *2016 Integrated Investment Program* document was based on this version of the broadsheet. Defence has not retained adequate records of the spreadsheet underpinning the development of the *2016 Integrated Investment Program* and could provide no information to help with mapping cost data between the broadsheet and the public document.

3.49 There is also uncertainty that the version of the broadsheet identified by Defence is the version on which the public document is based. The doubt arises from differences between a key cost figure in the relevant government decision and the corresponding figure in this version of the broadsheet. Specifically, the value recorded in the March 2016 broadsheet for the Future Submarine (Design and Construction phase) was some \$1.62 billion greater than the value agreed by government in February 2016.

3.50 In summary, Defence's systems and processes could not provide a clear line of sight, or complete and accurate evidence, for the purposes of the ANAO's review of the basis for, and accuracy of, public reporting in the *2016 Integrated Investment Program* document.

#### *Comparing the draft and final versions of the 2016 Integrated Investment Program document*

3.51 Defence provided the ANAO with the proposed '2016 Integrated Investment Program' document, dated 9 February 2016. The draft was submitted to government for approval shortly thereafter. The ANAO's comparative analysis of this draft with the published document, released on 25 February 2016, identified a number of differences. The notable differences, which relate to changes in the cost bands for certain projects, are set out in Table 3.1.

3.52 The circumstances under which the cost bands in the draft document put to government were amended to the bands shown in the final public document are not documented. The government gave authority to certain ministers to finalise the text of the document to be published. It is not documented whether this authority extended to varying the cost figures in the document. The ANAO has not identified any documentary source or authority for these changes among Defence's records. Defence has not been able to explain these differences.

**Table 3.1: Major items exhibiting differences in costs between the draft and final versions of the 2016 Integrated Investment Program document**

Project	Cost band in draft document considered by government	Cost band in final (published) document
Future Submarine — weapons and systems	\$4 billion–\$5 billion	\$5 billion–\$6 billion
Future Frigate Program — weapons	\$2 billion–\$3 billion	\$3 billion–\$4 billion
Growler Electronic Attack Enhancements	\$4 billion–\$5 billion	\$5 billion–\$6 billion
Airborne Early Warning and Control (AEW&C) Capability Upgrade Program	\$2 billion–\$3 billion	\$3 billion–\$4 billion
Joint Counter Improvised Explosive Device Program	\$2 billion–\$3 billion	\$3 billion–\$4 billion

Source: Draft and final versions of the 2016 Integrated Investment Program document, ANAO analysis.

### *Comparing the 2016 Integrated Investment Program document with the confidential broadsheet*

3.53 As discussed in paragraph 3.47, Defence advised the ANAO that it believes the 2016 public edition of the IIP was based on a classified IIP broadsheet dated March 2016.

3.54 The ANAO compared the public document and the broadsheet.<sup>111</sup> With no further explanatory material available from Defence to assist mapping from one to the other (discussed in paragraphs 3.38–3.41), this comparison was performed by inspection. There are no unique identifiers for projects listed in the public document to aid the inspection, nor information about scope. This makes comparison possible only by reference to the project names and timeframes used in the two documents. This is an inherently uncertain process, as names of projects are not consistent over time and project scope may change.<sup>112</sup> The ANAO was able to identify 67 per cent of the published projects with confidence in the broadsheet. In 19 per cent of cases, the corresponding projects could not be identified in the broadsheet by these means. In the remaining 11 per cent of cases, although project names were similar, there remained uncertainty about scope.

3.55 In some cases, the total acquisition cost in the broadsheet was outside the range of costs provided in the public document. This is because the projects in the public document were presented as an investment plan over a specific period, and the additional costs in these cases were expected to be incurred later, or as part of an additional phase to the project in question. However, the public document is ambiguous as to how far its forecasts extend except in these general terms:

The Integrated Investment Program focuses on the first ten years of investment, with broad guidance on the second decade to FY 2035–36 where feasible, to allow for longer-term investment portfolio planning.<sup>113</sup>

3.56 The public document does not make clear what is encompassed by ‘broad guidance on the second decade’. The public document does nominate two specific cases — the Future Submarine and Future Frigate projects — where the costs it provides encompass a period well beyond the decade.

3.57 Setting these two projects aside, among the 67 per cent of projects in the public document that could be identified with confidence in the broadsheet, the ANAO identified five projects whose cost in the broadsheet lay outside the range in the published document. None of these exceeded the cost in the published document by more than three per cent of the top of the band. The projects were: Deployable Force Infrastructure; Maritime Communications Modernisation; Maritime Combat Helicopter Assurance Program; Collins — Satellite Communications; Torpedo Self Defence and Air Combat Capability Facilities and Enablers.

3.58 In the case of the Future Submarine and Future Frigate programs, their documented cost in the broadsheet was substantially higher than the bottom of the range reported in the published

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111 The ANAO identified some 265 projects in the broadsheet.

112 The ANAO’s inspection process took account of the limited information available, including the project names (as set out in each document), costs/cost ranges and any other contextual information (such as whether a project had been approved or was scheduled for approval, or whether multiple phases with distinct start times were identified). The different editions of the broadsheet over the years from 2016 show variability in the precise formulation of project names and phases for IIP projects. The ANAO inspection involved a judgement as to whether a match could be made with confidence between items in the two documents or whether uncertainty or ambiguity prohibited this.

113 Defence, *2016 Integrated Investment Program*, p. 9.

document. Further, and as discussed in paragraph 3.31, the presentation of these two programs did not conform to the practice elsewhere in the *2016 Integrated Investment Program* document. Defence did not employ a cost band and instead provided a minimum figure with an unbounded upper range.

### *Reported costs for the Future Submarine and Future Frigate programs*

3.59 The ANAO's comparison of costings for the Future Submarine and Future Frigate programs in the public document of February 2016 and the classified broadsheet of March 2016 is set out in Table 3.2 and discussed further below.

**Table 3.2: Future Submarine and Future Frigate projects: costs recorded in the 2016 Integrated Investment Program and broadsheet**

Project name	Acquisition cost in 2016 IIP (public document)	Acquisition cost in classified broadsheet	Percentage difference <sup>a</sup>	Value of difference
Future Submarine Program — Design and Construction	>\$50bn	\$79,798.6m	59.60%	\$29,798.6m
Future Frigate Program — Design and Construction	>\$30bn	\$36,406.2m	21.35%	\$6,406.2m

Note a: The percentage difference is calculated on the basis of the reported minimum cost — \$50bn for the Future Submarine program and \$30bn for the Future Frigate program.

Sources: *2016 Integrated Investment Program* and March 2016 Defence IIP broadsheet.

3.60 The ANAO's review of Future Submarine (Attack class) costs indicates that:

- The cost of the 'Future Submarine Program — Evaluation, Design and Construction' over the period 2018–2057, as stated in the February 2016 published edition of the IIP following government approval of that document, was 'greater than \$50 billion' (out-turned).<sup>114</sup>
- The cost advised to government in February 2016 was \$78.18 billion (out-turned). Both Finance and Defence have stated publicly that a figure of \$78.9 billion appeared in the classified IIP at that time.<sup>115</sup> A figure of \$79.80 billion appeared in the classified broadsheet viewed by the ANAO, dated March 2016. This was the earliest edition of the broadsheet that Defence identified for ANAO review.
- The cost advised to government in February 2016 (\$78.18 billion) was 56 per cent higher than the minimum cost of \$50 billion reported publicly in the *2016 Integrated Investment Program*. The \$78.18 billion figure was not just a Defence forecast, but a funding

114 *ibid.*, chart, p. 77, and Table 6, p. 89. A footnote to Table 6 (p. 90) states that 'All figures are calculated on an out-turned basis.'

115 Testimony given by Defence to Senate Estimates (20 October 2020) was that 'The 2016 Defence white paper was released in February that year. In that document the government committed to the acquisition of a fleet of 12 regionally superior submarines. The Integrated Investment Program released at that time stated an approximate investment in submarines of greater than \$50 billion out-turned over the time period 2018 to 2057. The provision within the classified IIP at that time was \$78.9 billion'. Finance advised the ANAO that 'Finance records from that time reflect that it became aware of the \$78.9 billion funding provision for the Future Submarine Program when the Defence Integrated Investment Program (Defence IIP) broadsheet was provided to Finance by Defence on 23 February 2016'.

provision — an aggregate of a series of out-turned funding amounts noted for future budgets and agreed as such by government in February 2016.<sup>116</sup>

- While the presentation of the indicative acquisition cost of the ‘Future Submarine Program — Evaluation Design and Construction’ in the *2016 Integrated Investment Program* document was not incorrect, the minimum publicly reported cost was 37 per cent lower than the provision in the broadsheet.

3.61 The ANAO’s review of Future Frigate (Hunter class) costs indicates that:

- For the ‘Future Frigate Program — Evaluation, Design and Construction’, the February 2016 public edition of the IIP reported an out-turned figure of ‘greater than \$30 billion’ (out-turned).<sup>117</sup>
- The total capital funding provision over the future years of the project recorded in the confidential IIP broadsheet dated March 2016, was \$36 billion (out-turned).
- The figure appearing in the IIP broadsheet (\$36 billion) was 20 per cent higher than the minimum cost of \$30 billion reported publicly.
- While the presentation of the indicative acquisition cost of the ‘Future Frigate Program — Evaluation, Design and Construction’ in the *2016 Integrated Investment Program* document was not incorrect, the minimum publicly reported cost was 18 per cent lower than the provision in the broadsheet.

3.62 The ANAO sought to establish the basis for Defence’s approach of providing minimum figures with unbounded upper ranges in these two cases (that is, ‘greater than \$50 billion’ for the Future Submarine and ‘greater than \$30 billion’ for the Future Frigate). Defence records do not document the decision or rationale to adopt a public reporting approach, for these particular programs, with a substantially lower possible cost than the provision in the broadsheet or for the top of the band to be unbounded. Defence advised the ANAO in August 2022 that:

The banding was set in place by the 2016 White Paper leads and Defence has been unable to identify any official record of the decision.

3.63 Defence also advised the ANAO in February 2022 that:

At the time of the 2016 IIP development and publication, both projects were in the process of completing Competitive Evaluation Processes (CEPs) and were awaiting Government approval of the preferred tender and designs. As such a more conservative banding was published to mitigate commercial and foreign affairs sensitivities for those active tenderers engaging with the Commonwealth.

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116 It should be noted that this did not represent approval for Defence to spend but the ‘earmarking’ of the expected call on successive future budgets for the life of the project. Appendix 3 of this audit explains the effects of out-turning on the stream of costs over the years of the acquisition. The first occasion when Defence made it known in public that the out-turned acquisition cost was ‘in the order of \$80 billion out-turned’ was the testimony of Rear Admiral Sammut to a Senate estimates hearing, 29 November 2019.

117 Defence, *2016 Integrated Investment Program*, chart, p. 77, and Table 6, p. 89. A footnote to Table 6 (p. 90) states that ‘All figures are calculated on an out-turned basis.’

3.64 This information does not explain why Defence did not:

- place the cost within a bounded range, to more accurately and transparently reflect the cost known to government and shown as provisioning in the confidential IIP broadsheet; or
- hold the figure as confidential until a later time.

3.65 The Parliament and community rely on the release of accurate and meaningful cost information by Defence, as a basis for informed scrutiny and discussion on its acquisition activity. In addition, industry relies on Defence's public reporting for planning purposes, and the public editions of the IIP were intended to assist industry. These transparency, accountability and informational considerations could have been reconciled with the commercial and other sensitivities relating to the Future Submarine and Future Frigate programs at that time. The reporting approach adopted for these programs in the *2016 Integrated Investment Program* document fell short of providing accurate, reliable and transparent information for users of the document. For these programs, Defence included substantially lower minimum costs in the public document as compared to the actual provisions in the confidential IIP broadsheet, which were 56 per cent higher for the Future Submarine program and 20 per cent higher for the Future Frigate program.

### Recommendation no. 5

3.66 That the Department of Defence define the purpose of any future public editions of the Integrated Investment Program and develop guidance for officials on the preparation and public release of IIP information to achieve the defined purpose. This guidance should also include a reporting structure that provides confidence that public reporting is accurate and transparent. Where there is a need to balance commercial or other sensitivities, public reporting should document the approach adopted.

**Defence response:** *Agreed.*

3.67 *Defence agrees to the recommendation.*

### **2020 Force Structure Plan costings and variances from the contemporaneous broadsheet**

3.68 The ANAO's comparative analysis of the *2020 Force Structure Plan* against the contemporaneous classified IIP broadsheet showed that it was possible, with some effort, to identify in the broadsheet the source for each item in the public edition. The analysis was facilitated by a further spreadsheet 'working document' that Defence had maintained showing the calculations involved. This spreadsheet performed the function of calculating the spread of costs to be used as a cost band in the public document, drawing on the data in the underlying classified IIP broadsheet.

3.69 Among the 106 projects appearing in the *2020 Force Structure Plan*, in about ten cases, most often in the Maritime Domain, preparation of the cost figures for the public document required manual insertion of an updated cost figure by Defence (that is, a different amount from that in the broadsheet). In discussions with the ANAO, Defence explained these adjustments as follows:

- The need to reflect the full acquisition cost of certain projects. The 20 years of the *2020 Force Structure Plan* encompasses the acquisition period for the great majority of IIP projects. Certain projects' acquisition periods extended beyond the horizon of the Plan, in particular, the Future Submarine and Future Frigate programs.
- Updates to reflect a government decision or announcement. These were decisions made or announced since the underlying classified IIP was last agreed by government (as in the case of the Future Frigate and Cape Class Patrol Boat projects). As noted in paragraph 2.33, some of these updates took two years to be reflected in the IIP broadsheet.
- Changes to include earlier expenditure on some projects. As most of the costs reflected the full acquisition costs of a forthcoming acquisition, it may have looked anomalous in a public document not to have included the full costs of the program where substantial expenditure had already occurred.

3.70 As discussed in paragraph 3.41, even with the benefit of Defence's 'working document' spreadsheet, identifying a clear line of sight between the individual project costs reported in the public document and the source material in the classified broadsheet is an intricate task. It requires close familiarity with the mechanics and techniques of the IIP broadsheet's administration and a capacity to follow the embedded formulae to their source. In this case, the broadsheet included a calculation of the proposed range for use in the public document.

3.71 After allowing for the manual adjustments referred to in paragraph 3.69, the ANAO identified no variance between the figures published in the *2020 Force Structure Plan* and those in the contemporaneous broadsheet.

3.72 If Defence updates the *2020 Force Structure Plan* in 2024 as expected<sup>118</sup>, or produces another substantial public extract from the classified IIP, it should also prepare a detailed mapping document for internal use that provides a clear line of sight to the classified broadsheet and documents any decisions made to include different information in the public report. This approach would: assist in demonstrating to its ministers, the central agencies and the government how the numbers to be reported publicly have been determined; contribute to Defence's own quality assurance and internal review activities; and facilitate external scrutiny.

## Recommendation no. 6

3.73 That, for future public editions of the Integrated Investment Program, the Department of Defence maintain sufficient internal documentation to provide clear line-of-sight traceability to the classified IIP broadsheet.

**Defence response:** *Agreed.*

3.74 *Defence will continue to maintain sufficient internal documentation to provide clear line-of-sight traceability to the classified edition of the Integrated Investment Program on which the public edition is based.*

<sup>118</sup> See paragraph 1.17 of this audit report.



3.75 Defence advised the ANAO in August 2022 that:

Both the DMFP and IIP Broadsheet are now sourced from the same data cube in TM1. Additional checks are performed to ensure that in the presentation of the data, there are no inconsistencies. Internal controls are also maintained in line with the internal budget policy.

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Grant Hehir  
Auditor-General

Canberra ACT  
29 November 2022



## **Appendices**

## Appendix 1 Entity responses



Australian Government

Defence

PO Box 7900 CANBERRA BC ACT 2610

EC22-004081

**Mr Grant Hehir**  
Auditor-General  
PO BOX 707  
CANBERRA ACT 2601

Dear Mr Hehir

*Dear Grant*

**Australian National Audit Office (ANAO) Section 19 Proposed Report – Defence's Administration of the Integrated Investment Program.**

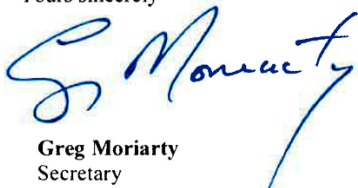
Thank you for the opportunity to comment on the Proposed Report for the ANAO performance audit *Defence's Administration of the Integrated Investment Program*.

Defence is committed to strengthening its governance, control and the approval framework for the management of the Integrated Investment Program. Defence will continue to review and amend current processes, as required. Defence is also committed to providing project progress reports to the Government, in appropriate formats and forums as requested by Government, taking into account national security requirements and the protection of necessary Defence capability information, as well as managing commercial sensitivities.

Attached to this letter are Defence's Proposed Amendments, Editorials and Comments (**Annex A**), Defence's Response to Requests for Information (**Annex B**), Defence's Response to the Proposed Recommendation (**Annex C**) and Defence's Summary Response (**Annex D**). These constitute Defence's formal response to the Section 19 proposed report.

Our point of contact is the ANAO Liaison Officer who can be contacted via email at: [anao.lo@defence.gov.au](mailto:anao.lo@defence.gov.au).

Yours sincerely

  
**Greg Moriarty**  
Secretary

31

October 2022

  
**Angus J Campbell, AO, DSC**

General  
Chief of the Defence Force

31

October 2022



**Australian Government**  
**Department of Finance**

**Jenny Wilkinson PSM**  
**Secretary**

Our Ref: EC22-000563

Mr Grant Hehir  
Auditor-General  
Australian National Audit Office  
GPO Box 707  
CANBERRA ACT 2601

Dear Mr Hehir

Thank you for your correspondence of 7 October 2022, providing the proposed performance audit report regarding the Department of Defence's Administration of the Integrated Investment Program (the Report), and seeking a response from the Department of Finance (Finance).

Finance notes the recommendations and findings of the Report. Finance would be pleased to support the Department of Defence in its implementation of the recommendations of the Report.

Finance has directly provided a minor editorial comment to your staff.

I thank you and your staff for your close engagement with Finance throughout the audit process.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'J. Wilkinson'.

Jenny Wilkinson  
Secretary

3 November 2022

One Canberra Avenue, Forrest ACT 2603 • Telephone 02 6215 3445  
Internet [www.finance.gov.au](http://www.finance.gov.au)

## Appendix 2 Improvements observed by the ANAO

1. The existence of independent external audit, and the accompanying potential for scrutiny improves performance. Improvements in administrative and management practices usually occur: in anticipation of ANAO audit activity; during an audit engagement; as interim findings are made; and/or after the audit has been completed and formal findings are communicated.

2. The Joint Committee of Public Accounts and Audit (JCPAA) has encouraged the ANAO to consider ways in which the ANAO could capture and describe some of these impacts. The ANAO's 2021–22 Corporate Plan states that the ANAO's annual performance statements will provide a narrative that will consider, amongst other matters, analysis of key improvements made by entities during a performance audit process based on information included in tabled performance audit reports.

3. Performance audits involve close engagement between the ANAO and the audited entity as well as other stakeholders involved in the program or activity being audited. Throughout the audit engagement, the ANAO outlines to the entity the preliminary audit findings, conclusions and potential audit recommendations. This ensures that final recommendations are appropriately targeted and encourages entities to take early remedial action on any identified matters during the course of an audit. Remedial actions entities may take during the audit include:

- strengthening governance arrangements;
- introducing or revising policies, strategies, guidelines or administrative processes; and
- initiating reviews or investigations.

4. In this context, the below actions were observed by the ANAO during the course of the audit. It is not clear whether these actions and/or the timing of these actions were planned in response to proposed or actual audit activity. The ANAO has not sought to obtain assurance over the source of these actions or whether they have been appropriately implemented.

- Defence has moved from manually maintaining the Integrated Investment Program broadsheet on an Excel spreadsheet, to an automated system deriving data from BORIS (Defence's financial reporting system). Access to this file is to be limited to 'view only' and there is to be no ability for stakeholders to adjust data in the source document. Specifically, Defence advised the ANAO (November 2022) that 'Defence Finance Group (DFG) started pursuing the automation of standardised reporting before this audit of Defence's management of the Integrated Investment Program. DFG had transitioned its standardised management reporting production to TM1 in 2019 as a first step to improve quality assurance and internal controls of management reporting. A systematised Broadsheet began rollout in 2021'.
- Changes to streamline the process of government consideration of Integrated Investment Program proposals by amending approval authorities and pathways were agreed during the audit. Some of these changes required development before implementation.
- Defence has updated its capability life cycle documentation.

## Appendix 3 Out-turned dollars

### What are out-turned dollars?

1. Project costs in the public *2016 Integrated Investment Program* document and the *2020 Force Structure Plan* are expressed in 'out-turned' dollars. The alternative method used to state forecasts of total costs is in 'constant dollars'. Costs expressed in these two different forms for the same project can differ substantially, especially for those projects whose expenditure is spread over many years. Any lack of clarity about which approach is being used can cause confusion.

2. The Department of Finance has advised the Parliament that:

Cost estimates for Defence projects change due to the out-turning of costs and price basis updates, which occur three times a year. The out-turned value is a projected measure of expenditure at a future point in time in the dollars (or nominal value) estimated to apply in that year. This will depend on assumptions about inflation and foreign exchange year-on-year, over the length of a project. As a result of price basis updates, cost estimates of Defence projects may increase or decrease depending on expected underlying economic factors.<sup>119</sup>

3. Defence has advised the Parliament, in the context of the annual Defence Major Projects Report (MPR), that:

Defence establishes cost estimates using out-turned costs (i.e. inclusive of agreed or estimated contract price indexation) to ensure that estimates include allowances for future inflationary cost increases and foreign exchange.<sup>120</sup>

### Why express costs in out-turned dollars?

4. Using out-turned dollars recognises that the dollar is worth less over time. The reason for expressing future costs in out-turned dollars is that it allows the Commonwealth to identify as best it can the expected call on the budget from projects with expenditure in future years, for each of those years. This helps to ensure that sufficient funds are available in future years for the project.

5. The Department of Finance (Finance) issues guidance to Australian Public Service (APS) entities on matters relating to budget estimates in the form of estimates memoranda. In December 2015, Finance issued an estimates memorandum tailored to Defence's new Integrated Investment Program, entitled *Defence-specific costing requirements for projects in the Defence Integrated Investment Programme*. The purpose of the estimates memorandum was to 'update the requirements for estimating whole-of-life costs for Department of Defence (Defence) Integrated Investment Programme (DIIP) projects brought forward for Government consideration.'

6. Among other matters, the estimates memorandum required all Integrated Investment Program proposals to be brought forward to government with costs and provisions out-turned

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119 Senate Economics References Committee, Inquiry into Australia's sovereign naval shipbuilding capability, answer to a written question on notice. See <https://www.aph.gov.au/DocumentStore.ashx?id=db62cc71-dd9d-4262-9242-d35593d20c2a> [accessed 14 July 2022].

120 Glossary of Defence terms included in Auditor-General Report No.13 2021–22, *2020–21 Major Projects Report*, p. 109. See <https://www.anao.gov.au/work/major-projects-report/major-projects-report-2020-21> [accessed 2 August 2022].

using the most recently issued price and exchange parameters and reflected in the current price basis. An identical requirement appears in the subsequent updated estimates memorandum which covers the period in which the *2020 Force Structure Plan* was prepared.<sup>121</sup>

7. The Defence Internal Budget Policy Manual states a requirement consistent with the estimates memoranda:

Provisions are out turned as they include allowances for future inflationary cost increases. The provisions also include an initial estimate of foreign exchange impacts at that point in time. Foreign exchange rates and associated estimates are updated regularly in line with Commonwealth Budget processes on a No-win/no-loss basis.<sup>122</sup>

8. The *2020 Force Structure Plan* (pp. 21–22) briefly explains Defence’s use of out-turned dollar costs as compared with constant dollar costs, as follows:

The out-turned values within the *2020 Force Structure Plan* are projections of expenditure over time based on estimates of when expenditure is anticipated to occur into the future, adjusted for inflation and foreign exchange. These expenditure projections are calculated using economic parameters that are periodically updated by the Departments of Finance and Treasury. While this Plan reflects only out-turned dollars, Defence projects may sometimes also be expressed in constant dollar terms. This is where the cost of a project is described in ‘current day’ dollars as opposed to its cost into the future.

9. Finance has provided the ANAO with the following more detailed explanation of the process of out-turning:

Out-turning is the process of applying expected price effects (including price indexation and foreign exchange adjustments) to estimated project costs over the life of a project. It takes into account expected increases in costs due to inflation and the impact of foreign exchange movements. Before bringing forward a project for Government approval, Defence out-turns project cost estimates using the most recent parameters issued by the Department of the Treasury (the Treasury) and / or project-specific parameters. ... Where Treasury-issued parameters (which are provided over the forward estimates) are used to out-turn prices beyond the forward estimates, these parameters are assumed to remain at the forward year-three value over the medium to longer-term estimates.

10. Defence projects comprising the Integrated Investment Program generally run over several years and sometimes major projects take several decades. In the first instance, Defence calculates the costs it expects to incur in terms of current year prices. These costs are calculated for each year of the life of the project, according to when payments are expected to be made. Next, the costs are out-turned for each year by applying the relevant parameters.

11. It is important to calculate these figures because budget estimates for Defence, including the Integrated Investment Program, are provisioned for 10 years in Finance’s Central Budget

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121 Estimates Memorandum 2017/55, 22 November 2017. Successive estimates memoranda from at least October 2011 have included a requirement for out-turning of project costs. This was set out in Estimates Memorandum 2011/36, 18 October 2011, and Estimates Memorandum 2013/27, 23 August 2013.

122 Defence Internal Budget Policy Manual, July 2021, Chapter 4, paragraph 100(a), p. 27.



Management System and presented there on an out-turned basis.<sup>123</sup> The Integrated Investment Program provision is used to fund the costs of Defence capability acquisition projects.

12. An added complexity is that as parameters change (that is, for example, exchange rates vary) the out-turned estimates must be recalculated each time and may rise or fall. This means that a project's total out-turned cost may change even where there is no change of substance to the project itself or to the project cost expressed in constant dollars. Consistent with this, the *2020 Force Structure Plan*, which presents costs in out-turned dollars, states (p. 21) that 'Figures provided in this publication are point-in-time estimates and will be regularly adjusted in line with Commonwealth Budget processes.'

### An example

13. Finance provided the ANAO (December 2021) with the following simple example to show how out-turning is done and its effects on future cost estimates:

A simple example is provided below for a project with a total cost estimate of \$170 in current dollars over eight years. If inflation is estimated to be five per cent per annum from Year 2 onwards, this would produce an out-turned project cost estimate of \$201 [Table A.1]:

**Table A.1: Illustration of out-turning of costs**

Year	1	2	3	4	5	6	7	8	Total
[A] Estimated cost (\$) (current year price)	10	19	27	35	33	24	15	7	170
[B] Indexation rate (%)	–	5	5	5	5	5	5	5	–
[C] Out-turned cost (\$) (C = A * (1 + B) ^ (Year no. – 1))	10	20	30	41	40	31	20	10	201

Source: Department of Finance.

14. Although the difference between the current year price and the out-turned price over just a few years may not be very great, the cumulative effect of compounding inflation will be more significant for projects which stretch over many years. Finance has pointed out that, in addition, variations to IIP project provisions due to changes in foreign exchange parameters may be significant at a whole-of-Defence level.<sup>124</sup>

15. The *2020 Force Structure Plan* (p. 22) points out that 'For projects that run for many years, or even decades, and that have higher exposure to foreign currencies, the differences between out-turned and constant dollars can be substantial for the same project value'. It illustrates this discussion by reference to the example of the former Attack class submarine program:

For example, the *Attack* class submarine acquisition cost is currently \$89.7 billion in 2019–20 MYEFO out-turned dollars, which adjusts for inflation and projected foreign exchange variations; when isolated from these factors, the cost remains \$50 billion in 2016 constant dollars. The out-

123 The Central Budget Management System manages the flow of financial information between Finance and Commonwealth Government entities to facilitate cash and appropriation management, preparation of budget documentation and financial reporting. See <https://www.finance.gov.au/government/federal-budget/central-budget-management-system-cbms> [accessed 28 July 2020].

124 Finance advice to the ANAO, August 2022.

turning of project estimates enables the purchasing power of a project budget to remain current in the year expenditure and capability delivery is planned to occur.

16. Expressing costs on some occasions in constant and, on other occasions, in out-turned prices can cause confusion, including in Defence publications. For example, the *2017 Naval Shipbuilding Plan* presents the costs of a range of naval projects expressed in out-turned dollars and one (the Future Submarine) in constant dollars.