

Department of Defence's Sustainment of Canberra Class Amphibious Assault Ships (Landing Helicopter Dock)

Department of Defence

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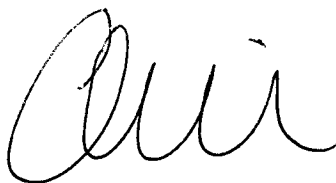
27 June 2025

Dear President
Dear Mr Speaker

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 *Department of Defence's Sustainment of Canberra Class Amphibious Assault Ships (Landing Helicopter Dock)*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, 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



Dr Caralee McLiesh PSM
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

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Audit team

Mark Rodrigues
Megan Beven
Ciorsdan Daws
Steven Meyer
Lorraine Watson
Shane Madden
Ethan Carey
Amy Willmott

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Audit snapshot

Auditor-General Report No.50 2024–25

Department of Defence's Sustainment of Canberra Class Amphibious Assault Ships (Landing Helicopter Dock)



Why did we do this audit?

- ▶ The Royal Australian Navy's (Navy) amphibious warfare fleet includes two Canberra class amphibious assault ships, known as landing helicopter docks (LHDs).
- ▶ Since entry of the LHDs into service in 2014, Defence has contracted its core LHD sustainment delivery activities to industry.
- ▶ This audit provides assurance to Parliament on the effectiveness of Defence's sustainment arrangements for the LHD capability.



Key facts

- ▶ Arrangements for the sustainment of the LHDs have changed over time across three contractual phases or models: transition to sustainment; asset class prime contractor; and the Maritime Sustainment Model.
- ▶ LHD sustainment has the fourth highest expenditure across all sustainment products in the maritime domain, with funding of \$180 million in 2024–25.



What did we find?

- ▶ Defence's arrangements for the sustainment of Navy's LHDs have been partly effective.
- ▶ Defence did not plan effectively for the transition from acquisition to sustainment. Value for money was not clearly demonstrated and probity was not well managed in the three relevant procurement activities.
- ▶ Defence has not managed its LHD sustainment contracts effectively. The LHDs have operated with ongoing deficiencies and have experienced critical failures during operations.
- ▶ Monitoring and reporting in respect to LHD sustainment outcomes, the extent to which Navy's requirements have been met, and the implementation of the Maritime Sustainment Model arrangements has been partly effective.



What did we recommend?

- ▶ There were nine recommendations to the Department of Defence aimed at improving: the transition from acquisition to sustainment; effective management of sustainment; and contract management, including potential fraud concerns.
- ▶ Defence agreed to the recommendations.

\$1.9 bn

estimated cost of LHD sustainment for the decade to 2033–34

30 years

remaining on the LHDs' planned life-of-type, with withdrawal planned for 2055 and 2056

223

open urgent defects reported for the LHDs in June 2025

Summary and recommendations

Background

1. The Royal Australian Navy (Navy) amphibious warfare fleet includes two Canberra class amphibious assault ships, also known as landing helicopter docks (LHDs). These are HMAS *Canberra*, commissioned in November 2014, and HMAS *Adelaide*, commissioned in December 2015. The role of the LHDs is to provide capabilities in amphibious warfare, humanitarian assistance, disaster relief and sealift, and to contribute to broader naval activities. Effective sustainment of the LHDs, including maintenance and support, is essential for the effective delivery of these capabilities.
2. Defence's Naval Shipbuilding and Sustainment Group has been responsible for the sustainment of the LHDs on behalf of the Navy (the capability manager) since October 2022.¹ Since entry into service in 2014, Defence has contracted its core LHD sustainment delivery activities to industry. Defence's contracting model has changed from time to time, with each of the arrangements established at the commencement of the following three phases: the transition from acquisition to sustainment (from 2014 to 2019); the asset class prime contractor model (from 2019 to 2024); and the Maritime Sustainment Model (as of 1 July 2024).

Rationale for undertaking the audit

3. In 2024–25, Defence's sustainment activities for its fleet of two Canberra class amphibious assault ships, or LHDs, had a funding provision of \$180 million (estimated at \$1.9 billion to 2033–34). With service life-of-type until the mid-2050s, the LHDs provide Navy with amphibious capabilities which are to support the delivery of the Australian Government's strategic intent through joint Australian Defence Force (ADF) deployments. This audit provides assurance to the Parliament on Defence's sustainment of naval capability, building on Auditor-General Report No.30 2018–19 *ANZAC Class Frigates — Sustainment*.

Audit objective and criteria

4. The audit objective was to examine the effectiveness of Defence's sustainment arrangements for Navy's Canberra class fleet of amphibious assault ships (or LHDs).
5. To form a conclusion against the audit objective, the following high-level criteria were adopted.
 - Has Defence implemented fit-for-purpose planning and value for money procurement arrangements to support its sustainment activities?
 - Has Defence effectively managed its sustainment contracts?
 - Has Defence established appropriate performance monitoring and reporting arrangements?

1 Prior to October 2022, the acquisition and sustainment of the LHDs was managed by the Capability Acquisition and Sustainment Group (CASG). CASG assumed this role from the former Defence Materiel Organisation (DMO) on 1 July 2015 when the DMO was delisted, and those functions were transferred to the Department of Defence. References to Defence in this report include the Department of Defence and the DMO prior to 1 July 2015.

Conclusion

6. Defence's sustainment arrangements for Navy's LHDs have been partly effective. Risks arising from an accumulation of defects and maintenance backlogs over several years have materialised. The substandard condition of the vessels, and personnel workforce shortages, have resulted in instances of critical failure and impacts to the Navy's delivery of operational outcomes.
7. Defence did not implement fit-for-purpose planning and value for money procurement arrangements to support LHD sustainment. Defence's future sustainment requirements, including access to important intellectual property for the LHDs, were not sufficiently developed during the acquisition phase. Establishment of the sustainment arrangements was delayed, occurring during the transition to sustainment process and alongside remediation activities to address issues persisting from acquisition. Defence's remediation activities did not achieve the required outcomes, resulting in additional work being transferred to the sustainment phase or managed as part of capability improvement projects.
8. Value for money and the intended sustainment outcomes were not achieved through Defence's procurement processes. Early cost estimates for the sustainment of the LHDs were under developed and did not anticipate the impact of the protracted acquisition deficiencies extending into sustainment and continuing into 2025. Defence has regularly reviewed and adjusted its sustainment budget.
9. Sustainment of the LHDs was not managed effectively by Defence through its prime contractor arrangements. Governance arrangements, contract management guidance, and risk management practices were not implemented in a timely manner and contract-specific probity arrangements were not developed. Defence did not take reasonable steps, as required by the *Public Governance, Performance and Accountability Act 2013* (PGPA Act), to manage systemic poor procurement practices by the prime contractor or investigate claims of fraudulent activity in sub-contracting arrangements in accordance with its own policies. Defence did not use the full range of contractual levers available to manage its primary sustainment contract. This approach impacted the quality of service delivery and undermined the achievement of value for money through the contract.
10. Defence has established partly appropriate performance monitoring and reporting arrangements for the Canberra class LHDs. Sustainment outcomes have largely met Navy's requirements for the operational use of the platforms. The long-term availability and reliability of the LHDs is at risk primarily due to the accumulation of urgent defects, maintenance backlogs and shortfalls in personnel to undertake organic level maintenance. As a result, the LHDs have experienced critical failures, impacting on Navy operations.
11. Defence's transition to the new Maritime Sustainment Model lacked reliable and complete information on the expected performance of sustainment contractors. Value for money outcomes for the procurements under the new model were limited by poorly implemented probity arrangements and the procurements commencing later than planned, reducing the time available to resolve issues during contract negotiations.

Supporting findings

Planning and procurement

12. Defence accepted delivery of the ships from BAE in 2014 and 2015 later than planned and with defects and deficiencies in both vessels, many of which remain unresolved.

- In 2017, Defence established a Transition and Remediation Program (TARP) to manage the transition into sustainment and conduct the remediation work required to achieve the full capability expected from the LHDs. The remediation activities did not achieve all the intended outcomes, and in November 2019, Defence accepted the LHDs into full service with six 'significant residual deficiencies'.
- In 2021, Defence established a capability assurance program to address urgent operational and safety issues for the LHDs, including issues carried over from the TARP.
- In July 2024, one quarter of the way through the planned life of the ships, Defence closed the acquisition project with significant defects and deficiencies from acquisition remaining unresolved and to be managed during the sustainment phase (see paragraphs 2.2 to 2.21).

13. The integrity of Defence's procurement processes for the LHD sustainment prime contractors was undermined by poor controls over probity risks.

- In 2014, the Capability Support Coordinator contract was awarded following an open tender process. The effectiveness of this procurement was limited by issues in the planning and evaluation processes. There were also shortcomings in the subsequent extension of the services with the incumbent provider under the Major Service Provider Panel following an unsolicited proposal in 2022.
- In 2014, the Transition In-Service Support Contract was awarded following a 'collaborative' sole source procurement process involving protracted engagement by Defence to improve an under-developed tender response. The procurement outcome did not demonstrate value for money.
- In 2018, the Asset Class Prime Contractor was awarded following a two-stage selection process which involved assessments against fit-for-purpose evaluation criteria. The integrity of the process was compromised by the departure of a senior Defence official with early involvement in the procurement who was then employed by, and negotiated with Defence on behalf of, the winning tenderer (see paragraphs 2.22 to 2.77).

14. Defence's forecast and management of sustainment costs have been impacted by deficiencies from acquisition extending into sustainment. Since final operating capability was declared in 2019, the LHD sustainment funding provision per financial year has not met in-year requirements, with some sustainment work deferred and future costs increasing. In 2024 senior Defence officials considered options to address Navy sustainment funding pressures. Following consultation with the Minister for Defence in 2024, Navy sustainment funding was increased by an additional \$300 million over two years to June 2026, of which Defence allocated \$36 million towards LHD sustainment funding for 2024–25 (see paragraphs 2.78 to 2.88).

Sustainment management

15. Defence established governance arrangements to support its management of LHD sustainment contracts. These arrangements were either not implemented effectively or not maintained by Defence, resulting in a number of shortcomings.

- Since 2012, updates to the Materiel Sustainment Agreement (head agreement) between Navy and the Naval Shipbuilding and Sustainment Group have not been timely, occurring several years after key changes in responsibilities or organisational restructures had taken effect.
- A contract management plan was not established for the first 17 months of the ACPC contract. Contract risks, including those identified during the procurement process, were not revisited as planned or covered in the contract management plan.
- Contract-specific probity arrangements were not established for the ACPC contract. Defence relied solely on its broader departmental arrangements instead, which require Defence personnel to proactively identify and declare any actual, potential or perceived conflicts of interest as and when they arise.
- LHD sustainment risks at the strategic level are managed separately and in isolation from risks at the operational and technical levels. There is no hierarchy or clear line of sight between the risks identified in the Materiel Sustainment Agreement and those being managed day-to-day (see paragraphs 3.2 to 3.32).

16. Defence did not manage its primary LHD sustainment contracts as intended by its performance-based design. As a result, Defence cannot assure itself or ministers that sustainment services were delivered effectively and in accordance with the contracted requirements. Key deficiencies were that Defence did not:

- ensure that all mandatory reports were submitted in a timely manner by the contractor;
- undertake full or timely assessments of the contractor's performance;
- ensure that all key sustainment deliverables had been completed in full prior to making payments to the contractor; or
- use the full range of levers available in the contract to drive satisfactory performance.

17. Between 2021 and 2023 there were at least three separate allegations of fraudulent activities or instances of poor sub-contracting practices related to the ACPC contract. Defence did not seek further information from the contractor on the 2023 allegations and did not change its approach to managing the contract after being notified of the various issues (see paragraphs 3.33 to 3.79).

Performance monitoring and reporting

18. Defence has established a sustainment performance framework for the LHDs, with performance measures set out in a written agreement and reporting provided to senior Defence leadership. The performance measures adopted are relevant to the LHDs but are not fully reliable and do not provide a complete and clear picture of sustainment performance as some important areas of sustainment are not covered. For some performance measures, the nature of the targets selected has led to reporting that does not provide a fair presentation of performance results for the LHDs (see paragraphs 4.2 to 4.18).

19. Navy's operational requirements have been impacted by shortcomings in the management of LHD sustainment. Sustainment outcomes have included an accumulation of urgent defects, persistent maintenance backlogs, and the degradation of the condition of the platforms. The LHDs have fallen short of meeting availability targets since 2020–21 and sustainment-related deficiencies and workforce shortfalls have given rise to risks involving critical failures in the vessels, possible damage to Navy's reputation and concerns for the sustainability of the LHDs over the long-term. Some of these risks have materialised, including:

- total power failures in 2022 and 2023, making the LHDs temporarily unavailable while providing humanitarian assistance and disaster relief support in Tonga and Vanuatu; and
- a reduction from three ships to two available for deployment in the amphibious force during 2025 (see paragraphs 4.19 to 4.53).

20. In July 2024, Defence transitioned LHD sustainment to the 'Maritime Sustainment Model', which involved the procurement and contracting of new commercial arrangements. Defence started the procurements later than planned, which limited the options available to Defence to manage issues and strengthen value for money outcomes during negotiations. Arrangements to manage probity were not robust and, in respect to the LHD Capability Life Cycle Manager procurement, probity was poorly managed. Defence has not benchmarked or established expected sustainment performance levels for the Maritime Sustainment Model (see paragraphs 4.54 to 4.83).

Recommendations

Recommendation no. 1 The Department of Defence ensures that appropriate arrangements are in place for its transition and remediation programs to improve the rigour with which these activities are managed, and provide assurance that the relevant objectives have been achieved.
Paragraph 2.18

Department of Defence response: *Agreed.*

Recommendation no. 2 To support the future requirements for the LHDs, the Department of Defence develops and maintains class-specific life cycle sustainment plans for the Navy fleet, including funding requirements for the planned life of type, to ensure that the required capability is maintained across the classes' whole of life, at a rate of agreed availability.
Paragraph 2.87

Department of Defence response: *Agreed.*

Recommendation no. 3 The Department of Defence promptly reviews and updates, Navy's Materiel Sustainment Agreements with the Capability Acquisition and Sustainment Group and Naval Shipbuilding and Sustainment Group, following significant changes in organisational structures, or at least every three years.
Paragraph 3.6

Department of Defence response: *Agreed.*

Recommendation no. 4
Paragraph 3.31

The Department of Defence reviews and documents its LHD risk management arrangements, including the use of various ICT systems and oversight forums, with a view to identifying efficiencies, where possible, and ensuring that risks are appropriately identified, and actively managed with clear line of sight.

Department of Defence response: *Agreed.*

Recommendation no. 5
Paragraph 3.69

Where the Department of Defence is notified of incidents such as suspected fraud or unethical conduct, the Department of Defence ensures that its response is fully documented and conforms to Defence policies and the *Commonwealth Fraud and Corruption Control Framework*.

Department of Defence response: *Agreed.*

Recommendation no. 6
Paragraph 3.78

Where the Department of Defence's contracts with industry include mechanisms to obtain assurance over the completion of activities under the contract and the performance of suppliers, the Department of Defence ensures that contractual mechanisms are implemented.

Department of Defence response: *Agreed.*

Recommendation no. 7
Paragraph 4.13

The Department of Defence review the performance measures for the sustainment of the LHDs to support a more reliable and complete assessment of sustainment performance.

Department of Defence response: *Agreed.*

Recommendation no. 8
Paragraph 4.63

The Department of Defence establishes arrangements to ensure that its internal policies for the establishment of appropriate probity processes commensurate with the size, scale and risk of its procurement activities are complied with.

Department of Defence response: *Agreed.*

Recommendation no. 9
Paragraph 4.82

The Department of Defence benchmarks and monitors sustainment performance under the Maritime Sustainment Model to enable an assessment of the achievement of its strategic objectives.

Department of Defence response: *Agreed.*

Summary of entity response

21. The proposed audit report was provided to the Department of Defence. Extracts of the proposed audit report were provided to BAE Systems Australia Pty Ltd, Babcock Pty Ltd, and Kellogg Brown and Root Pty Ltd. The Defence summary response is provided below and its full

response is provided at Appendix 1. Responses from BAE Systems Australia Pty Ltd, Babcock Pty Ltd, and Kellogg Brown and Root Pty Ltd are provided at Appendix 1.

The Department of Defence acknowledges the findings contained in the Auditor General's report on the sustainment of the Canberra Class amphibious assault ships.

Defence acknowledges that planning and procurement processes, sustainment management arrangements and performance monitoring and reporting were assessed as partly effective.

Defence supports the recommendations. Defence is committed to ensuring the through-life sustainment of the Canberra Class amphibious assault ships deliver the best possible capability outcomes for the Australian Government and the Australian Public.

Key messages from this audit for all Australian Government entities

22. 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.

Policy and program design

To appropriately manage assets throughout the asset life cycle, entities should prepare long-term plans that consider whole-of-life costs and strategies and that are updated to reflect changes in the operating environment and then act in accordance with the plans.

Audit findings

1. Background

Introduction

1.1 The Royal Australian Navy (Navy) amphibious warfare fleet includes two Canberra class amphibious assault ships, also known as landing helicopter docks (LHDs).² These are HMAS *Canberra*, commissioned in November 2014, and HMAS *Adelaide*, commissioned in December 2015. The role of the LHDs is to provide Australian Defence Force (ADF) capabilities in amphibious warfare, humanitarian assistance, disaster relief and sea-lift and to contribute to broader naval activities.³ Effective sustainment of the LHDs, including maintenance and support, is essential for the effective delivery of these capabilities.

Key features of the capability

1.2 At 27,000 tonnes, the LHDs are the largest vessels in the Navy and are each intended to carry and embark over 1,000 personnel by helicopter and watercraft, with weapons, ammunition, vehicles and stores. The flight deck enables landing and transportation of helicopters, with vehicle decks able to accommodate up to 110 vehicles and 12 Abrams tanks. The LHDs also have medical facilities that include operating theatres, wards, x-ray, and dental facilities.

1.3 Each LHD is designed to carry and deploy four purpose-built LHD landing craft to transport personnel and equipment from the LHD ships to the shore without fixed port facilities.⁴ At a length of 23.3 metres, each landing craft has a displacement of 56.6 tonnes (light) and 110 tonnes (at full load).⁵ An image of equipment loaded on a Canberra class LHD is at Figure 1.1.

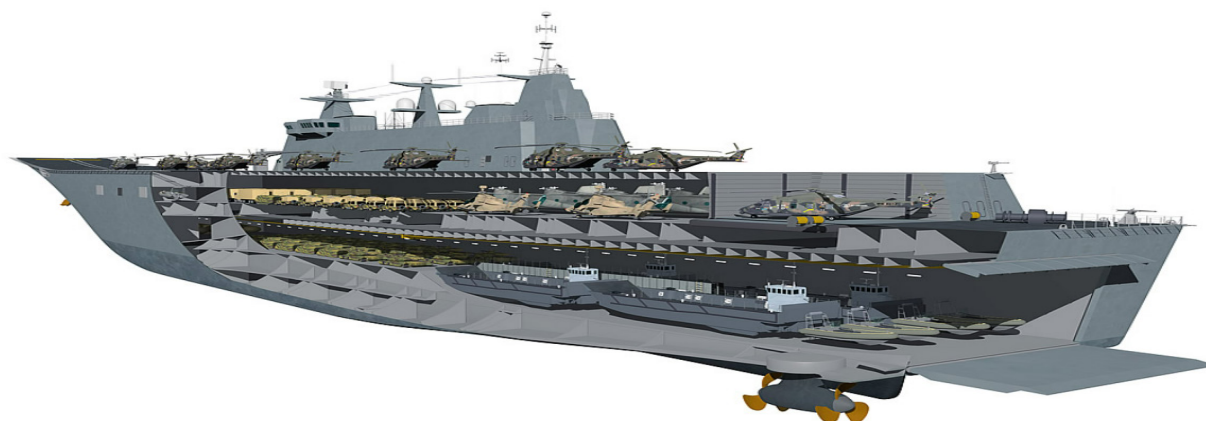
2 In addition to the two Canberra class LHDs, the other vessels comprising the amphibious warfare force consist of one modified Bay class Landing Ship Dock, HMAS *Choules*, and 12 landing craft.

3 The Defence Capability Manual 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'.

4 Navy has a total of 12 landing craft. Landing craft are assigned to the LHDs on a rotational basis with their usage reflecting the operational tasking of the LHDs at that time.

5 Trials conducted to carry the M1A1 Main Battle Tank (Abrams tank) on the LLCs in May 2016 were unsuccessful, as it required the operation of the landing craft in an overload state. Auditor-General Report No.40 2016–17, *2015–16 Major Projects Report*, ANAO, Canberra, 2017, p. 53, para 2.48, available from <https://www.anao.gov.au/work/major-projects-report/2015-16-major-projects-report> [accessed 17 June 2025].

Figure 1.1: Image of equipment loaded onto a Canberra class Landing Helicopter Dock



Source: Department of Defence.

Acquisition

1.4 Following a two-pass government approval process and limited tender involving two vendors, in 2007 the Department of Defence (Defence) contracted BAE Systems Australia Limited (BAE Systems) to build the two Navantia-designed LHD vessels and support systems.⁶ The LHD design was based on an existing Spanish ship (*Juan Carlos*) and incorporates the Australian Navy Combat System supplied by SAAB Australia Proprietary Limited. The total project budget for the LHD acquisition, including the 12 landing craft, was reported by Defence at \$3.09 billion in June 2019.⁷

Sustainment arrangements

1.5 Since October 2022, Defence's Naval Shipbuilding and Sustainment Group (NSSG) has been responsible for the sustainment of the LHDs and landing craft on behalf of the Navy in accordance with a Materiel Sustainment Agreement (MSA).⁸

1.6 Within the Maritime Sustainment Division of NSSG, the Amphibious Combat and Sealift Systems Program Office (ACSSPO) within NSSG is responsible for the delivery of materiel sustainment of Navy's amphibious combat and support capabilities comprising of the LHDs, the

6 The acquisition contract was signed with Tenix Pty Ltd on 9 October 2007 with an effective date of 23 November 2007. In 2008, BAE Systems acquired Tenix. Tenix/BAE Systems and Navantia Australia Pty Ltd were parties to a subcontract for the acquisition.

7 The government's second pass approval for the 12 landing craft was obtained in 2011 for \$235.7 million. The LHD acquisition project was last included in Auditor-General Report No. 19 2019–20, *2018–19 Major Projects Report*, ANAO, Canberra, 2019, p. 47, Table 9, available from <https://www.anao.gov.au/work/major-projects-report/major-projects-report-2018-19> [accessed 17 June 2025].

8 Prior to October 2022, CASG was responsible for naval sustainment. Under the MSA, Product Delivery Schedule CN34 sets out Navy's requirements for the sustainment of the Canberra class LHDs.

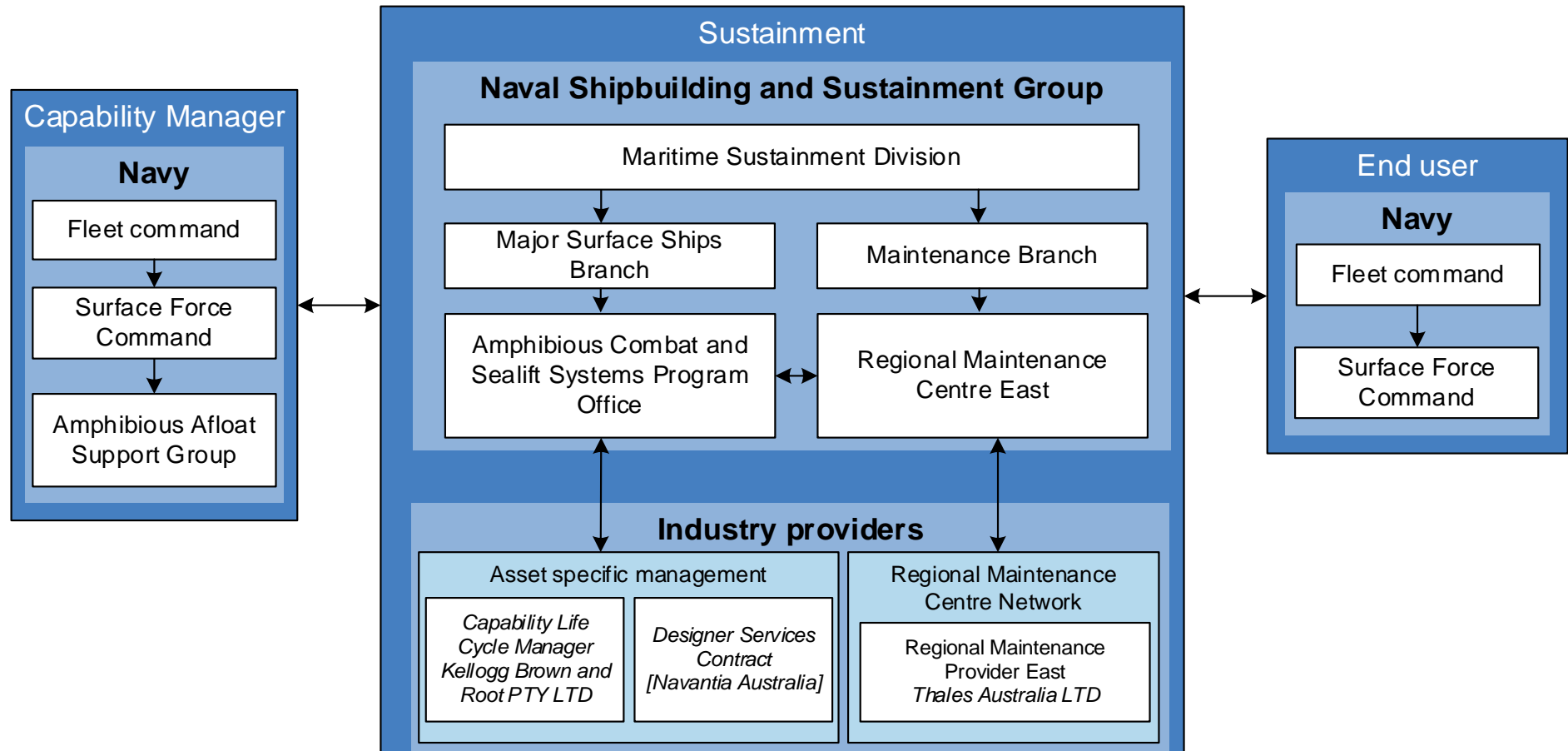
12 LHD Landing Craft, the Landing Ship Dock HMAS *Choules* and related shore-based facilities,⁹ principally at Fleet Base East, Garden Island, Sydney.

1.7 From July 2024, accountability for the execution of LHD maintenance activities transitioned from the ACSSPO to the newly established 'Regional Maintenance Centre East' under new organisational arrangements. ACSSPO retained accountability to 'direct, govern and assure through life asset stewardship and seaworthiness' of the LHDs (supported by industry providers), with the ACSSPO Director responsible under the MSA for the 'design and delivery of effective sustainment services to enable the achievement of Navy's outcomes'.

1.8 Figure 1.2 provides an overview of Defence's sustainment arrangements for the LHDs, as of July 2024.

9 ACSSPO was known as the LHD Systems Program Office (LHDSPO) until late 2018. This report uses both names depending on which was in use at the time. Defence's framework for the management of materiel sustainment under the Systems Program Office model was examined in Auditor-General Report No.2 2017–18, *Defence's Management of Materiel Sustainment*, ANAO, Canberra, 2017, available from <https://www.anao.gov.au/work/performance-audit/defence-management-materiel-sustainment> [accessed 17 June 2025].

Figure 1.2: Defence's sustainment arrangements for the LHDs from July 2024



Source: ANAO analysis of Defence documentation.

1.9 Under the MSA, sustainment activities, including maintenance and engineering changes, are to be conducted in accordance with a continuous maintenance philosophy and a 60-month (five year) usage upkeep cycle. Planned and corrective maintenance is undertaken:

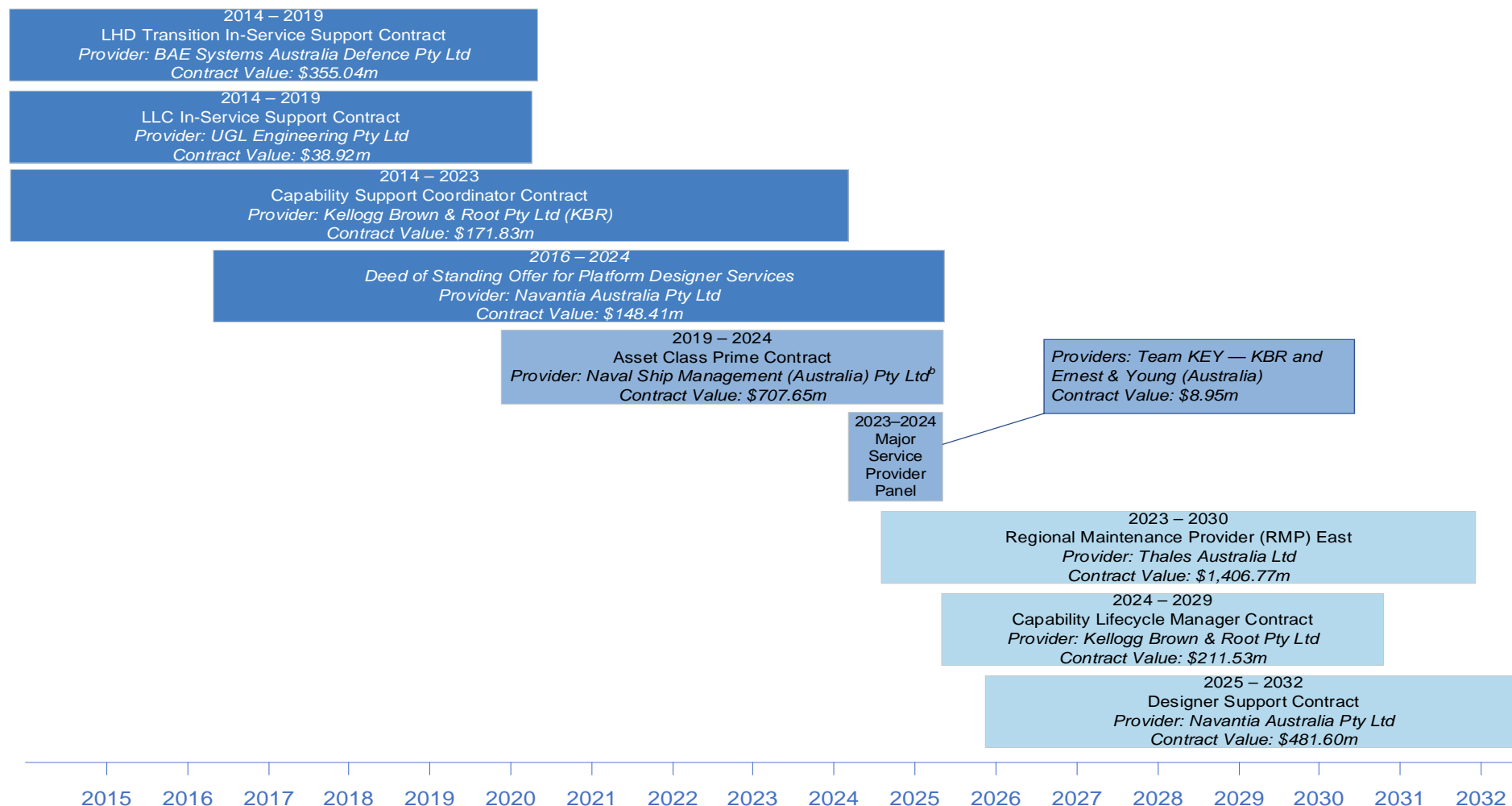
- during programmed external maintenance periods (6 to 8 weeks in duration, twice a year per ship), outside sea days; and
- through ‘organic level’ maintenance, typically performed on-board by Navy personnel, during sea days.

1.10 At the end of each five-year cycle, a docking for around 12 weeks is scheduled for the completion of major work, which may include work on the propulsion pods and propellers, bow thrusters, fin stabilisers, hull work and major engineering changes.

Sustainment contracting

1.11 Since entry into service in 2014, Defence has contracted with industry for its core LHD sustainment delivery activities. Defence’s contracting model has changed from time to time, with each of the arrangements established at the commencement of the following three phases: the transition from acquisition to sustainment (from 2014 to 2019); the asset class prime contractor model (from 2019 to 2024); and the Maritime Sustainment Model (from 1 July 2024).

Figure 1.3: Key LHD sustainment contracts^a



Key: ■ Phase 1: transition to sustainment — operational from November 2014 to June 2019 ■ Phase 2: asset class prime contractor sustainment contracting — operational from July 2019 to June 2024 ■ Phase 3: Maritime Sustainment Model — operational from July 2024

Note a: Contract value as at end of contract or at March 2025 (GST inclusive).

Note b: At the time of the procurement, NSM was a joint venture between UGL Engineering Pty Ltd (UGL) and Babcock International Group PLC (Babcock). On 18 February 2022, Babcock acquired the remaining 50 per cent shareholding in NSM.

Source: ANAO analysis of Defence documentation.

1.12 The LHDs are a 'Top 30' capability sustainment product for Defence.¹⁰ LHD sustainment has the fourth highest expenditure across all sustainment products in the maritime domain, with a funding provision of \$180 million in 2024–25 (estimated at \$1.9 billion to 2033–34).

Defence Strategic Review and other reviews

1.13 The Australian Government released a public version of the *Defence Strategic Review* (DSR) on 24 April 2023. Of relevance to the LHDs, the review stated that a 'fully enabled, integrated amphibious-capable combined-arms land system' is a key factor in the 'ADF's operational success'.¹¹ The DSR recommended that an 'analysis of Navy's surface combatant fleet capability should be conducted in Q3 [Quarter Three] 2023 to ensure its size, structure and composition complement the capabilities provided by the forthcoming conventionally-armed, nuclear-powered submarines'.¹² The DSR also recommended options be developed to change, streamline and accelerate the capability acquisition process for projects designated as strategically urgent or of low complexity.¹³

1.14 The *Surface Combatant Fleet Review* was provided to the government on 29 September 2023 and a public version of the review was released on 20 February 2024.¹⁴ This review outlined a future surface combatant fleet design to provide enhanced lethality and complement the planned introduction of conventionally armed, nuclear-powered submarines.¹⁵

1.15 The government's response to the DSR included the establishment of a new biennial *National Defence Strategy* (NDS), the first of which was released on 17 April 2024. The NDS stated that '[a]cross the coming decade, investment in the integrated, focused force will be extended to deliver increases in combat and enabling abilities' in a number of capability priorities, including the:

amphibious capable combined-arms land system, enabled by Navy and Air Force combat capabilities and supported by Navy's amphibious capability, to optimise the Army for littoral manoeuvre and control of strategic land positions, and to enable the ADF to undertake rapid stabilisation and humanitarian assistance and disaster relief operations.¹⁶

10 The 'Top 30' are the 30 most costly Defence sustainment projects. More information can be found at: Australian Government, *Portfolio Budget Statements 2023–24 Budget Related Paper No.1.4A, Defence Portfolio*, Commonwealth of Australia, Canberra, 2023, pp. 127–33, available from <https://www.defence.gov.au/about/accessing-information/budgets/budget-2023-24> [accessed 17 June 2025].

11 Australian Government, *National Defence: Defence Strategic Review 2023*, Canberra, 23 April 2023, p. 19, available from <https://www.defence.gov.au/about/reviews-inquiries/defence-strategic-review> [accessed 17 June 2025].

12 *ibid.*, pp. 58 and 104. The government agreed or agreed in principle to the recommendations of the review.

13 Since the release of the DSR, Defence's Capability Acquisition and Sustainment Group (CASG) has commenced a program of initiatives called 'CASG 2.0'. In a November 2023 update to Defence's Enterprise Business Committee, procurement reform was described as 'the highest priority initiative in the CASG 2.0 strategy' and with a focus on 'streamlined processes' and 'accelerated delivery outcomes'.

14 Australian Government, *Enhanced Lethality Surface Combatant Fleet 2024*, ANAO, Canberra, February 2024, p. 17, available from <https://www.defence.gov.au/about/reviews-inquiries/independent-analysis-navy-surface-combatant-fleet> [accessed 17 June 2025].

15 The Surface Combatant Force consists of three Hobart class air warfare destroyers and eight Anzac class frigates. As part of its response to the review, the government committed to increasing the total size of the fleet to 26. Australian Government, *Enhanced Lethality Surface Combatant Fleet 2024*, pp. 7–8. The review did not make findings or recommendations directly related to the LHDs.

16 Australian Government, *National Defence Strategy 2024*, Canberra, April 2024, p. 38, available from: <https://www.defence.gov.au/about/strategic-planning/2024-national-defence-strategy-2024-integrated-investment-program> [accessed 17 June 2025].

1.16 Further, in response to the DSR and the NDS, an updated *Naval Shipbuilding and Sustainment Plan* was released in December 2024.¹⁷ The plan stated that the LHDs:

will continue to provide the ADF with one of the most sophisticated amphibious operations capabilities in the world. In addition to deploying embarked forces, they can also conduct large-scale humanitarian and disaster relief missions.¹⁸

Previous audit coverage

1.17 Previous Auditor-General reports relating to naval procurement and sustainment, and of relevance to this audit include:

- Auditor-General *Major Projects Reports* 2008–09 to 2017–18¹⁹;
- Auditor-General Report No.30 2018–19 *ANZAC Class Frigates — Sustainment*²⁰;
- Auditor-General Report No.44 2017–18 *Defence’s Management of Sustainment Products — Health Materiel and Combat Rations*²¹;
- Auditor-General Report No.2 2017–18 *Defence’s Management of Materiel Sustainment*²²;
- Auditor-General Report No.9 2015–16 *Test and Evaluation of Major Defence Equipment Acquisitions*²³; and
- Auditor-General Report No.30 2014–15 *Materiel Sustainment Agreements*.²⁴

Rationale for undertaking the audit

1.18 In 2024–25, Defence’s sustainment activities for its fleet of two Canberra class amphibious assault ships, or LHDs, had a funding provision of \$180 million (estimated at \$1.9 billion to 2033–34). With service life-of-type until the mid-2050s, the LHDs provide Navy with amphibious capabilities which are to support the delivery of the Australian Government’s strategic intent through joint Australian Defence Force (ADF) deployments. This audit provides assurance to

17 Australian Government, *2024 Naval Shipbuilding and Sustainment Plan: Evolving the Enterprise*, Canberra 2024, December 2024, p. iv, available from: <https://www.defence.gov.au/about/strategic-planning/2024-naval-shipbuilding-sustainment-plan> [accessed 17 June 2025].

18 *ibid.*, p. 23.

19 Auditor-General reports for 2008–09 to 2017–18 Major Projects Reports, available from <https://www.anao.gov.au/pubs/major-projects-report?page=1> [accessed 5 June 2024].

20 Auditor-General Report No.30 2018–19, *ANZAC Class Frigates — Sustainment*, ANAO, Canberra, 2019 available from <https://www.anao.gov.au/work/performance-audit/anzac-class-frigates-sustainment>. [accessed 17 June 2025]

21 Auditor-General Report No.44 2017–18, *Defence’s Management of Sustainment Products — Health Materiel and Combat Rations*, ANAO, Canberra, 2018, available from <https://www.anao.gov.au/work/performance-audit/defence-management-sustainment-products-health-materiel-and-combat-rations> [accessed 17 June 2025].

22 Auditor-General Report No.2 2017–18, *Defence’s Management of Materiel Sustainment*, ANAO, Canberra, 2017, available from <https://www.anao.gov.au/work/performance-audit/defence-management-materiel-sustainment> [accessed 17 June 2025].

23 Auditor-General Report No.9 2015–16, *Test and Evaluation of Major Defence Equipment Acquisitions*, ANAO, Canberra, 2015, available from <https://www.anao.gov.au/work/performance-audit/test-and-evaluation-major-defence-equipment-acquisitions-0> [accessed 17 June 2025].

24 Auditor-General Report No.30 2014–15, *Materiel Sustainment Agreements*, ANAO, Canberra, 2015, available from <https://www.anao.gov.au/work/performance-audit/materiel-sustainment-agreements> [accessed 17 June 2025].

Audit approach

Audit objective, criteria and scope

1.19 The audit objective was to examine the effectiveness of Defence's sustainment arrangements for Navy's Canberra class fleet of amphibious assault ships (or LHDs).

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

- Has Defence implemented fit-for-purpose planning and value for money procurement arrangements to support its sustainment activities?
- Has Defence effectively managed its sustainment contracts?
- Has Defence established appropriate performance monitoring and reporting arrangements?

1.21 The audit scope included examining the procurement of LHD sustainment services, the governance of procurement and sustainment activities, the management of sustainment contracts (primarily the Asset Class Prime Contractor contract), and performance monitoring and reporting.

1.22 The scope of the audit did not include Defence's activities to procure the LHDs and landing craft, whether Defence appropriately managed outstanding build deficiencies, projects to enhance LHD capability (such as the SEA 2048 Capability Assurance Program, SEA 1442 Phase 5 Maritime Communications Modernisation, or SEA 1778 Phase 1 Deployable Mine Countermeasures Capability), or Defence's management of 'fundamental inputs to capability' (such as the recruitment and retention of marine technicians and other specialists).

Audit methodology

1.23 The audit procedures included:

- reviewing Defence records, including procurement planning, tender assessments, advice to decision-makers, and contract management documentation;
- meetings with Defence personnel and Defence contractors;
- walkthroughs of Defence systems; and
- on-site fieldwork at Defence premises in Canberra and Fleet Base East within the Garden Island Defence Precinct in Sydney, where the LHDs are home ported.

1.24 The ANAO has co-operative evidence gathering arrangements in operation with entities. Defence advised the ANAO that it was unable to voluntarily provide certain information to the ANAO due to legislative restrictions on the disclosure of the information. In November 2023, ANAO officials exercised their delegation pursuant to section 33 of the *Auditor-General Act 1997* to access information and be provided with documents. Defence provided the information and access to the required documents within the requested timeframe.

1.25 The audit was open to contributions from the public. The ANAO received and considered one submission.

1.26 The audit was conducted in accordance with ANAO Auditing Standards at a cost to the ANAO of approximately \$1,274,000.

1.27 The team members for this audit were Mark Rodrigues, Megan Beven, Ciorsdan Daws, Steven Meyer, Lorraine Watson, Shane Madden, Ethan Carey and Amy Willmott.

2. Planning and procurement

Areas examined

This chapter examines whether the Department of Defence (Defence) implemented fit-for-purpose planning and value for money procurement arrangements to support its sustainment activities for the Landing Helicopter Docks (LHDs).

Conclusion

Defence did not implement fit-for-purpose planning and value for money procurement arrangements to support LHD sustainment. Defence's future sustainment requirements, including access to important intellectual property for the LHDs, were not sufficiently developed during the acquisition phase. Establishment of the sustainment arrangements was delayed, occurring during the transition to sustainment process and alongside remediation activities to address issues persisting from acquisition. Defence's remediation activities did not achieve the required outcomes, resulting in additional work being transferred to the sustainment phase or managed as part of capability improvement projects.

Value for money and the intended sustainment outcomes were not achieved through Defence's procurement processes. Early cost estimates for the sustainment of the LHDs were under developed and did not anticipate the impact of the protracted acquisition deficiencies extending into sustainment and continuing into 2025. Defence has regularly reviewed and adjusted its sustainment budget.

Areas for improvement

The ANAO made two recommendations aimed at improving Defence's management of its remediation programs and ensuring class-specific funding requirements for military capabilities are developed and maintained on a whole of life basis.

2.1 The *Defence Capability Manual*²⁵ applies to all major expenditure decisions taken by Defence, including major military equipment.²⁶ The manual outlines four phases in the Defence capability life cycle, comprising the: strategy and concepts; risk mitigation and requirement setting; acquisition; and in-service (sustainment) and disposal phases. Defence's 2007 *Acquisition and Sustainment Manual*, in place at the time of the acquisition of the LHDs, advised that planning for the transition of a platform into sustainment should commence early, in the requirement setting phase, and mature during the acquisition phase.

25 The *Defence Capability Manual* is Defence's keystone guidance document for its capability development and product life cycle and has been revised on a number of occasions over the past 20 years. It is part of a broader Defence capability framework, including Defence Instructions, templates and additional guidance documents.

26 The 2006 *Defence Capability Development Manual* was in place at the commencement of the LHD acquisition contract.

Did Defence appropriately manage the transition from acquisition to sustainment?

Defence accepted delivery of the ships from BAE in 2014 and 2015 later than planned and with defects and deficiencies in both vessels, many of which remain unresolved.

- In 2017, Defence established a Transition and Remediation Program (TARP) to manage the transition into sustainment and conduct the remediation work required to achieve the full capability expected from the LHDs. The remediation activities did not achieve all the intended outcomes and, in November 2019, Defence accepted the LHDs into full service with six 'significant residual deficiencies'.
- In 2021, Defence established a capability assurance program to address urgent operational and safety issues for the LHDs, including issues carried over from the TARP.
- In July 2024, one quarter of the way through the planned life of the ships, Defence closed the acquisition project with significant defects and deficiencies from acquisition remaining unresolved and to be managed during the sustainment phase.

2.2 The acquisition phase for the two LHDs commenced when the Australian Government provided second pass approval on 19 June 2007 for \$3,182 million (Budget 2007–08 out-turned). Defence's advice to government stated that the total operating cost of the LHDs, including sustainment, was estimated at \$1,349 million over the life of the ships.²⁷ Details on the future sustainment arrangements for the LHDs were not provided to government in the 2007 advice.

2.3 Defence's planning activities between 2010 and 2012 included developing the contracting arrangements for LHD sustainment services and establishing the LHD Systems Program Office (LHDSPO) in January 2011. Final operational capability was to be achieved in November 2016. The acquisition contract with BAE Systems was expected to end in 2015.²⁸

Acceptance of the LHDs into service

2.4 The acceptance of HMAS *Canberra* and HMAS *Adelaide* from BAE to Defence was originally scheduled for January 2014 and August 2015, respectively. HMAS *Canberra* was delivered in October 2014 (a delay of eight months) with 6,640 defects and deficiencies, and HMAS *Adelaide* was delivered in October 2015 (a two-month delay) with 2,240 defects and deficiencies. As a result of the delay for the first LHD, Defence assessed that BAE owed the Commonwealth liquidated damages under the acquisition contract. In January 2015, a settlement was reached between Defence and BAE for in-kind services to be provided by BAE to Defence.²⁹

27 The effectiveness of Defence's forecasting and management of sustainment costs is discussed in paragraphs 2.78 to 2.88.

28 Defence's 2007 advice to government stated that the production and design risks for the LHDs represented a low to medium risk of schedule slippage.

29 In addition to the claim for liquidated damages, Defence entered into two commercial settlements involving BAE Systems in 2019 and 2021. The first commercial settlement in 2019 related to the propulsion pods (outlined in footnote 44). The second settlement took effect in 2021 and is discussed in paragraph 2.21.

2.5 The Chief of Navy approved the acquisition milestone of initial operational capability (IOC) for HMAS *Canberra* on 24 November 2015.³⁰ Advice to the Chief of Navy included that, '[n]otwithstanding the success of IOC, issues remain that will require resolution as the capability progresses to FOC [final operational capability]'. These issues comprised 'over 1000 residual defects and deficiencies' identified within the ship's communications system, radar system, combat management system, sewage system and integrated logistic support system.³¹ Following IOC, further issues were identified during Navy operational test and evaluation.³²

Impact of acquisition issues on sustainment

2.6 The 'Navy Capability Transition into Service' guidance states that residual risks, 'including known defects, deficiencies and shortcomings, plus as yet undiscovered latent defects'³³ are to be managed as part of the transition into service. Impacts from these issues on LHD sustainment activities were documented in routine senior Defence internal reviews including Navy Fleet Screening reviews and Independent Assurance Reviews of LHD acquisition and sustainment.³⁴ In March 2017, LHD sustainment was listed as an underperforming program on the Defence Product of Interest list 'due to ongoing propulsion pod reliability and vibration concerns at delivery, as well as the concerns over maturity of the overall sustainment system'.³⁵

2.7 A Seaworthiness Review Board meeting described as the defects and issues as, 'in aggregate a critical seaworthiness risk', for which 'progress on remediation must be accelerated'.³⁶ The board observed that Defence lacked 'sufficiently defined policies, systems and processes needed to translate transition theory or aspirations into practice' and called for a new framework in CASG maritime transition policy. The board also observed Defence's 'acquisition centric management focus' and stated that the 'LHD project is an example where a lack of planning for sustainment and transition has generated chronic and systemic deficiencies'.

30 Key milestones, such as initial operational capability (IOC) and final operational capability (FOC), are achieved incrementally during the transition from the acquisition phase into sustainment. IOC indicates that the capability has reached a baseline level of maturity and, having achieved the minimum specifications approved by government at second pass approval, can begin operational deployment.

31 Of these defects and deficiencies, 637 were specific to the integrated logistic support (ILS). ILS is a whole-of-life management discipline that addresses the provision of support and services to a capability, at the lowest possible life cycle cost. Logistic support includes the identification and sourcing of parts, and determining provisioning lists for spares, tools and equipment.

32 The LHDSP Business Plan was not updated to note the extent of defects identified and related consequences for the transition of the LHDs to sustainment.

33 Latent defects are defects that are not discoverable by reasonable or customary inspection. The acquisition contract required BAE Systems to rectify any latent defects within the contract price or at its own expense within five years from date of acceptance.

34 Independent Assurance Reviews are management-initiated reviews to provide the Defence Senior Executive with assurance that projects and products will deliver approved objectives and are prepared to progress to the next stage of activity.

35 LHD sustainment was removed from the list in July 2022, on the recommendation of an Independent Assurance Reviews. Defence's Projects and Products of Concern and Interest regime was established to manage the remediation of underperforming materiel acquisition projects and sustainment products. See: Auditor-General Report No. 31 2018–19, *Defence's Management of its Projects of Concern*, ANAO, Canberra, 2019, available from: <https://www.anao.gov.au/work/performance-audit/defence> [accessed 17 June 2025].

36 The board was advised that Navy had 'lost confidence in the Seaworthy state of the vessels and had recalled them alongside for technical investigations and consequent mechanical repairs'.

Revised transition into service plans

Transition and Remediation Program, 2017–2020

2.8 In April 2017 Defence established a Transition and Remediation Program (TARP)³⁷ to remediate the LHDs and close the acquisition project. Issues covered by the TARP included warranty claims, engineering changes, condition of class issues, and latent defects relating to the propulsion pods, vibration, propeller corrosion and cavitation, anaesthetic gas, shore power and the integrated logistic support system.³⁸

2.9 The cost of the TARP was estimated at \$128 million in acquisition funding. A total of 755 defects and deficiencies were grouped into 31 TARP funded sub-projects across two remediation plans.³⁹ Project activities were aligned to the high-level objectives of the TARP but not clearly defined in project documentation. This reduced the clarity over roles and responsibilities and created ambiguity as to which tasks were regular sustainment work and which were TARP activities.

2.10 Final materiel release, a key acquisition milestone, was approved on 18 October 2019 by the Head of Navy Capability, with Defence advising that work would continue on outstanding integrated logistic support system and materiel deficiencies.⁴⁰ The approval documentation included a list of the 64 defects and delivery issues that remained unresolved⁴¹, an unsigned and undated TARP closure plan, and the summary-level achievements of the TARP.⁴² The documentation did not detail the extent to which its objectives were achieved, or the actual costs of the program to date.

Achievement of final operational capability

2.11 The Chief of Navy approved final operational capability for the LHDs on 5 November 2019, with the following six 'significant residual deficiencies' to be managed during the in-service phase.⁴³

- Propulsion pod vibration.⁴⁴
- Insufficient physical space in the medical facility to enable the compliant configuration of the contractually required 34 beds.

37 The TARP was led by a retired senior Navy officer from the United Kingdom (Rear Admiral).

38 Oversight for the program was provided by a three-star steering group led by the Chief of Navy and a one-star remediation working group led by the Director-General Major Surface Ships. These working groups monitored reporting on the progress of TARP projects and the resolution of outstanding defects and deficiencies. Defence provided briefings to its Minister on the remediation activities under the TARP including propulsion pod defects, and delays to the achievement of final operational capability between 2017 and 2019.

39 Sub-projects were listed in either the Materiel Remediation Plan or the Integrated Logistic Support Remediation Plan.

40 Final materiel release marks the completion and release of the capability by the acquisition authority (then CASG, now NSSG) to the support organisation (the LHDSPPO). FMR is the key precursor to achieving FOC.

41 This list included five class certification issues, five integrated logistic system issues, six safety issues, 28 other defects and deficiencies, 13 performance limitations and seven verification and validation tests that were not completed.

42 Reported TARP achievements included the '[i]mmediate remediation of issues preventing LHDs from going to sea' and '[s]ignificant root cause analysis of all major LHD fragility or major issues'.

43 Final operational capability marks the point at which the capability manager (for example, the Chief of Navy) agrees that all the other prerequisites to a functional capability have been delivered and that the final, or full, capability can be operationally employed.

44 On 29 November 2019, Defence entered into a commercial settlement with Siemens Australia, Siemens AG (Germany), BAE Systems Australia, Navantia SA (Spain) and Navantia Australia due to issues with the propulsion pods. The contractors agreed to discount future related work. The parties agreed to the settlement without any admission or acceptance of liability.

- Noise in accommodation and compartments.
- Ongoing issues with the integrated logistic support system.
- Insufficient explosive ordnance magazine capacity.
- Issues with the sewage treatment plants.

2.12 Defence notified the Minister for Defence on 5 November 2019 that final operational capability had been achieved but with significant deficiencies that would remain ongoing. Defence advised that '[t]hese deficiencies, their impacts on capability and sustainability, and their ongoing remediation strategies have been addressed and are being managed.'

2.13 Updates on Defence's management of these deficiencies have been provided by the ANAO in the Defence Major Projects Reports (MPRs). Of those six deficiencies:

- two — propulsion pods and integrated logistic support system — were reported by Defence in December 2021 as 'being rectified'⁴⁵;
- two — hospital bed configuration and noise in accommodation compartments — were transferred to the 'LHD acquisition upgrade project' (Capability Assurance Program); and
- two — sewage treatment plants and magazine capacity — were transferred to sustainment.⁴⁶

Capability Assurance Program, 2021 to 2024

2.14 In March 2021, government provided first pass approval for \$60.4 million (MYEFO 2020–21 out-turned) for the first tranche of work under the Capability Assurance Program (or SEA2048 Phase 6) for the LHDs.⁴⁷ The program's activities comprised of 41 tasks in total, some of which had been transferred from the predecessor program, the TARP (which closed in September 2020). The first tranche of work was to cover urgent operational and safety issues as priority tasks and the initial planning work for the capability assurance activities.

2.15 The scope and schedule of the Capability Assurance Program was reset by Defence in 2022 to include additional issues.⁴⁸ In August 2023 an Independent Assurance Review into the Capability Assurance Program concluded that the first tranche of work, as approved in March 2021, would not be delivered as the priority tasks had not progressed beyond the design stage. The Independent Assurance Review also stated that:

45 Statement by the Secretary of Defence, Auditor-General Report No.13 2021–22, *2020–21 Major Projects Report*, ANAO, Canberra, 2021 p. 119, available from: <https://www.anao.gov.au/work/major-projects-report/2020-21-major-projects-report> [accessed 17 June 2025].

46 See: Auditor-General Report No.14 2023–24, *2022–23 Major Projects Report*, ANAO, Canberra, 2024, p. 127, available from <https://www.anao.gov.au/work/performance-audit/defence-management-materiel-sustainment> [accessed on 17 June 2025]

47 The total unapproved Integrated Investment Program capital provision for the program was \$370.7 million (\$97.1 million contingency).

48 Approval for this change was provided by the Band 2/two-star Joint Amphibious Council, which was responsible for endorsing a prioritised scope of work to be recommended for second pass government approval. Defence did not seek government approval for these changes in scope.

[t]he complete list of capability assurance tasks has been de-scoped and re-prioritised, and there is insufficient schedule and budget remaining from the \$60m approved at First Pass to complete the designs for all tasks, with some designs now needing to be funded at Second Pass.⁴⁹

2.16 In November 2023, Defence's Investment Committee delayed a number of capability assurance activities by two years due to the reprioritisation of Defence funding following the Defence Strategic Review. Navy was tasked with reporting back to the Investment Committee on how LHD sustainment funding could be prioritised for assurance program activities. In April 2024, government approved a further \$65 million to progress the project.

2.17 Case study 1 provides an example of how Defence has managed a group of issues related to the LHD medical facility (Primary Casualty Reception Facility).

Case study 1. Remediation of the medical facility

The delivery of health support services through the medical facility is a key capability provided by the LHDs and is of high mission criticality for evacuation and humanitarian assistance and disaster relief activities. In January 2015, Defence evaluated the operational condition of HMAS *Canberra's* medical facility. As a result, a number of issues were identified, with short-term (within six months) and longer term (greater than six months) remediations recommended to address the issues.

In 2016, work was undertaken to better understand and remediate the ongoing deficiencies — some of which had resulted in limitations being imposed on LHD activities. In April 2017, this work became part of the Transition and Remediation Program (TARP, see paragraphs 2.8–2.10). The scope of the TARP included the following issues:

- excessive vibration and insufficient physical space to accommodate the required number of beds;
- sterilisers not meeting standards and X-Ray monitors being inadequate;
- anaesthetic gas scavenging system not meeting Australian standards and an unacceptable medical air system;
- compartment door coamings preventing safe transportation of patients and equipment;
- insufficient stretcher storage and tie down points in theatres; and
- insufficient power outlets and refrigeration not on uninterruptible power supply.

When final operational capability was achieved in November 2019, the medical facility was included as one of six 'significant residual deficiencies' due to the limited physical space available between the beds. The number of beds in the facility was reduced from eight to five to provide 1,600 millimetres between each intensive care bed and 1,000 millimetres between each high dependency bed. The revised configuration resulted in facility not meeting the original requirements for patient capacity in the critical care wards.

When the TARP was closed in September 2020, and after a vibration reducing system (approved for use on critical care beds) had been installed, the medical facility remained impacted by excessive vibration. This vibration was addressed in all but two areas of the ship once new four-

49 The report found the 'lack of progress' was a result of 'ineffective and inefficient commercial arrangements, prime and sub-contractor resource constraints, dysfunctional industry relationships, and a failure to progress requirements definition with the Sponsor'.

bladed propellers were installed in 2021.^a This TARP medical facility work was among those transitioned to the Capability Assurance Program (see paragraph 2.14 to 2.16). Other detailed costing and design work was also to be completed under the program.

The first phase of the Capability Assurance Program did not progress as planned, and adjustments were made to Defence's requirements between 2021 and 2023. In April 2024, government approved a further \$65 million to address critical safety issues and bring the LHDs up to a 'minimum viable capability'. This approval did not include the work required to remediate the facility, which had an estimated cost of \$5 million. At October 2024, a number of issues remain unresolved and the medical facility continues to operate with limitations (refer to paragraphs 4.26 to 4.29 for further discussion of operational limitations).

Note a: Defence advised the ANAO in June 2025 that the new propeller could only be installed when the LHDs were in dry dock, which occurred after the TARP was closed.

Recommendation no. 1

2.18 The Department of Defence ensures that appropriate arrangements are in place for its transition and remediation programs to improve the rigour with which these activities are managed, and provide assurance that the relevant objectives have been achieved.

Department of Defence response: *Agreed.*

2.19 *Defence agrees to the recommendation.*

Project closure

2.20 A second deed of settlement was negotiated with BAE Systems and Navantia, releasing the parties from all claims and actions.⁵⁰ The acquisition project was then closed in July 2024, five years after final operational capability was declared in 2019.

2.21 Under the settlement deed: BAE Systems agreed to provide in-kind labour support and outstanding work, to be conducted within five years; and Navantia undertook to provide discounts on LHD support and outstanding work.

Did Defence conduct compliant and effective procurement for sustainment activities?

The integrity of Defence's procurement processes for the LHD sustainment prime contractors was undermined by poor controls over probity risks.

- In 2014, the Capability Support Coordinator contract was awarded following an open tender process. The effectiveness of this procurement was limited by issues in the planning and evaluation processes. There were also shortcomings in the subsequent extension of the services with the incumbent provider under the Major Service Provider Panel following an unsolicited proposal in 2022.
- In 2014, the Transition In-Service Support Contract was awarded following a 'collaborative' sole source procurement process involving protracted engagement by Defence to improve

50 Defence decided to settle rather than escalate a dispute under the acquisition contract based on legal advice from Defence's external legal provider Ashurst.

an under-developed tender response. The procurement outcome did not demonstrate value for money.

- In 2018, the Asset Class Prime Contractor was awarded following a two-stage selection process which involved assessments against fit-for-purpose evaluation criteria. The integrity of the process was compromised by the departure of a senior Defence official with early involvement in the procurement who was then employed by, and negotiated with Defence on behalf of, the winning tenderer.

2.22 Defence's procurements for its LHD sustainment activities were informed by a number of strategic reviews undertaken progressively between 2009 and 2017. These reviews led to a series of reforms to Defence's Systems Program Offices (or 'SPOs'), largely stemming from the Rizzo Review in July 2011 and the First Principles Review in April 2015.⁵¹

Phase 1: Interim arrangements for the transition to sustainment

2.23 By late 2011, Defence's proposed strategy for contracting LHD sustainment services involved open tender processes and establishing performance-based arrangements, with multiple contractors. One of those contractors — the in-service support contractor — was to be primarily responsible for the implementation of sustainment activities. Another prime contractor — the Capability Support Coordinator (CSC) — was intended to be a 'key partner' to Defence, providing asset management expertise and overseeing the work of Defence's other contractors.

2.24 Since at least 2011, Defence was aware through its industry engagement activities that the acquisition prime contractor, BAE, was planning to tender for the LHD sustainment procurements. In this context, where a potential service provider holds an existing relationship with Defence, attention to probity is particularly important to ensure the integrity and effectiveness of the procurement. An LHDSPO probity plan was approved in May 2011 and procurement-specific probity plans were approved on 8 June 2012 for the CSC and 26 July 2013 for the TISSC (as discussed at paragraph 2.57).

Reviews and revisions of the contracting model

2.25 Reviews of Defence's major programs, capital projects, and sustainment products known as Gate Reviews and Independent Assurance Reviews, have been undertaken since 2009.⁵² At least 13 gate/assurance reviews examining aspects of the LHDs were conducted between 2011 and 2023. Six of those reviews addressed Defence's sustainment arrangements.⁵³

2.26 In 2011 a gate review found that the development of the tender documentation for LHD sustainment contracts had started later than necessary and it was unlikely that services providers would be in place in time for acceptance of the first LHD. A further gate review of LHD sustainment

51 Defence, *Plan to Reform Support Ship Repair and Management Practices*, [Rizzo Review] July 2011, p. 38.

52 The Gate Review process for major Defence capital acquisition projects was broadened to include sustainment in 2013–14. In 2016, Defence replaced the Gate Review Process with Independent Assurance Reviews. Defence policy in effect at the time of the LHDSPO procurements stated that the board was to be chaired by senior Defence personnel and comprise at least two external members. The board was to 'provide direction to the project and make a recommendation ... regarding the readiness of the project for progression to the next stage in the project life cycle.'

53 This includes reviews for the SEA2048 Phase 6 Capability Assurance Program. Gate reviews for the LHD landing craft (LLC) have been excluded.

was conducted on 30 April 2012.⁵⁴ This review was compromised because Defence did not implement its arrangements to manage probity risks. On 16 April 2012, two external members of the review board met with BAE and heard of BAE's interest in LHD sustainment contracts.⁵⁵ On 23 April 2012, BAE provided Defence a 'discussion paper' as 'an industry input for the gate review process' following its offer to a third board member (the Deputy Chief Executive Officer of the Defence Materiel Organisation). The discussion paper was considered within Defence to be an unsolicited proposal and was circulated to the review board members on 26 April 2012.

2.27 The BAE proposal highlighted the risks associated with a change of provider and recommended that Defence delay its planned procurements to adopt an interim strategy instead, where BAE would perform the functions of the CSC and maintenance contractors until the end of the LHD warranty period.⁵⁶ Defence did not handle the unsolicited proposal in accordance with its procurement guidance in place at that time.⁵⁷ The LHDSPO probity plan required Defence representatives to receive a probity briefing prior to any meetings with potential tenderers and to provide advance notice of any such meetings to the Chief Contracting Officer.⁵⁸ The LHDSPO officer responsible for the procurement was not notified in advance of the meeting with BAE and the review board members were not probity-briefed.

2.28 The gate review concluded that Defence's proposed procurement strategy was 'unachievable' and there were 'significant challenges' to overcome to establish the required LHD sustainment arrangements. The board did not endorse Defence's proposed approach and instead recommended adopting a 'fall back strategy' to ensure a minimum level of sustainment capability at handover of the first LHD. This involved procuring a CSC contractor with a reduced scope and placing responsibility for LHD sustainment and other support tasks with BAE as an interim arrangement. The BAE proposal was not referred to in the gate review report.

2.29 While the risks associated with the interim arrangements were not explored in depth, the review board considered it to be the 'only viable way forward'.⁵⁹ The LHDSPO examined and

54 The review board included the Defence Materiel Organisation Deputy Chief Executive Officer and was chaired by the General Manager Systems Division (Band 2/2 Star). One external member was a retired Navy Rear Admiral and the other an ex-senior public servant with experience in asset sales and IT outsourcing.

55 The meeting was with BAE System's LHD Sustainment Capture Manager and was held in Williamstown, Victoria, for a duration of 3.5 hours. The two external board members attended, along with a Defence official supporting the review.

56 The warranty period is one year after Defence accepted each individual ship.

57 Auditor-General Report No. 15 2021–22, *Department of Defence's Procurement of Six Evolved Cape class Patrol Boats* recommended that Defence 'develop and implement specific requirements for the management of probity when engaging with industry on unsolicited proposals including by identifying, assessing and managing probity risk at an early stage, when considering and assessing the feasibility of unsolicited proposals'. That recommendation was closed by the Defence Chief Audit Executive on 23 March 2023. Auditor-General Report No. 15 2021–22, *Department of Defence's Procurement of Six Evolved Cape class Patrol Boats*, ANAO, Canberra, 2021, p. 11, available from <https://www.anao.gov.au/work/performance-audit/departments-defence-procurement-six-evolved-cape-class-patrol-boats> [accessed 3 July 2024]. Unsolicited proposals are discussed further at paragraphs 2.52 to 2.54

58 The LHDSPO probity plan stated that where the Chief Contracting Officer 'feels the meeting may not be in the interest of maintaining probity they may notify PD ADAS [Program Director Amphibious Deployment and Sustainment] of this matter and request the meeting be cancelled.' The Chief Contracting Officer and the LHDSPO Director were primarily responsible for the management of probity under the plan.

59 One risk was documented in the gate review outcome documentation approved on 19 May 2012. This was that BAE 'could potentially disguise [integrated logistic system] shortfalls in the acquisition contract through ... control of the sustainment activities.'

documented the risks in more detail on 3 May 2012, after the gate review. A number of 'medium to high' risks were identified, including: a lack of competitive pressure on BAE in a sole source approach; and limited incentive for BAE as the acquisition contractor to adequately test the acquisition deliverables.

2.30 The sustainment strategy was updated and approved in September 2012 to reflect the interim arrangements. Consistent with BAE's unsolicited proposal, the strategy covered a five-year period incorporating the warranty periods of both vessels from 2014. Two key LHD sustainment contracts were to be established: the CSC contractor; and a Transition In-Service Support Contract (TISSC). The two procurements were conducted in parallel over a 24 month period in 2013 and 2014, alongside other LHDSP0 procurements.⁶⁰

Capability Support Coordinator (CSC) contract

2.31 The CSC was to provide Defence with independent assurance services over the work of the prime contractor for the period of the TISSC and the preliminary stages of the follow-on 'Asset Class Prime Contractor' contract. The CSC contract was for 'above the line' services, meaning CSC staff would be embedded within the LHDSP0 alongside Defence personnel.⁶¹ The independence of the CSC from other contractors was a key feature of the sustainment model selected by Defence.⁶²

Planning for the CSC procurement

2.32 Defence adopted a two-stage approach for the procurement, comprising an initial request for tender process followed by an 'Offer Definition Activity' phase. An open approach to market was approved by the delegate on 24 January 2013. Defence opened the CSC RFT to the market on 25 February 2013, the same day that its legal advisor (Ashurst Australia) provided comments on an incomplete draft. As a consequence, the tender was not fully developed at the time it was issued, compromising the effectiveness of the process. Unresolved risks identified by Ashurst included: the significant risk arising from third party intellectual property arrangements for disclosure restricted entities⁶³ and the lack of a clear statement on the services to be provided under contract. Ashurst noted that 'unless there is a clear statement in the [conditions of contract] as to the different types of Services to be provided, there will be confusion, dispute between the Contractor and Defence and the risk of real uncertainty in the administration of the Contract'.

2.33 These risks became issues during the tender period. The original closing date of the RFT, 29 April 2013, was extended to 13 May 2013 and at least 41 changes ranging from minor to substantive were made to the tender documentation.⁶⁴ Substantive changes included the addition of an appendix with Australian Industry Capability Plan requirements and amendments to the third party intellectual property provisions of the tender documents.

60 In addition to the TISSC and CSC procurements, the LHDSP0 was also managing the procurement for the LHD landing craft In-Service Support Contract.

61 'Above the line' contractors are a contracted resource that undertakes APS roles on behalf of Defence. Above the line contractors are generally contracted due to a lack of resource capacity or skillset. The 2023 Defence 'Above the Line' Contractor Strategy has a commitment to reduce the contracted workforce by 2000 Full Time Equivalent (FTE) by the end of 2024.

62 Defence's preferred model was documented in December 2011 by QinetiQ, which stated that there was 'to be no direct commercial relationship between the CSC and other entities which provide services to LHDSP0.'

63 Refer to paragraph 2.34 in relation to Defence's arrangements for disclosure restricted entities.

64 Potential tenderers were advised of these changes in seven addenda, published by Defence between 8 March and 19 April 2013.

2.34 The disclosure restricted entity provisions were required due to Defence's contractual obligations to the LHD acquisition contractors (BAE and SAAB, or 'Interested Parties') to prevent the release of sensitive intellectual property to specified commercial competitors. In February 2013, Ashurst advised Defence that 'the proposed arrangements' in the RFT gave 'the Interested Parties with a large degree of control over who may be considered for the role of CSC'. To address this issue, Defence required disclosure restricted entities to provide a letter of consent from the nominated interested parties granting access to the relevant intellectual property and information.

2.35 On 28 March and 15 April 2013 two tenderers contacted Defence to advise that they were unable to obtain the letters of consent, effectively excluding them from tendering on the CSC. On 16 April 2013 Defence released an addendum removing the prohibition of an interested party from being a subcontractor to CSC tenderers and providing a two-week extension to the tender closing time.

2.36 The tender evaluation plan was finalised on 8 May 2013. The plan stated that tender responses would be assessed against seven unweighted criteria and ranked by order of merit. The results were to inform a value for money assessment conducted by the tender evaluation board and the formulation of recommendations to the delegate.

Evaluation against criteria

2.37 Six responses were received by the close of tender on 13 May 2013 and each were assessed as compliant in the initial screening process by 17 May 2013. Three separate tender evaluation working groups undertook detailed commercial, technical and financial evaluations of tenders between 16 May to 23 July 2013. The tender evaluation board (comprising nine members, including each of the working group leads) convened at least 10 times between May and July 2013.

2.38 The evaluation criteria listed in the evaluation plan included an additional sub-criterion for the financial evaluation that was not included in the RFT documentation or subsequent addenda.⁶⁵ The financial TEWG evaluation was, however, limited by the extent of information made available to the tenderers in the RFT. The RFT specified Defence's budget and required tendered cost rates to be within that budget cap. This reduced the TEWG's level of confidence in the proposed pricings offered. The TEB agreed that the price estimates provided by the tenderers could not be taken into account.

2.39 The commercial and financial TEWGs recommended all six tenders proceed to offer definition phase and the technical TEWG recommended that four proceed.

2.40 The tender evaluation board decided that two of the seven evaluation criteria — the 'technical competence' and 'trusted advisor' criteria — were 'critical to the successful delivery of CSC services' and the greatest area of differentiation between tenders. On this basis, the board recommended, and the delegate approved (on 23 July 2013), the two tenderers with the highest scores against the two priority criteria progressing to the offer definition phase. This approach represented a departure from the published tender process by placing greater importance on two criteria from a total of seven. The seven criteria were not weighted and were to have equal importance.

⁶⁵ The tender evaluation plan included 'the efficiency of the tenderer's performance of the Services, and the potential impact of that on the cost to the Commonwealth'. The draft financial TEWG report references this sub-criterion.

Management of probity issue

2.41 In January 2013, a Navy reservist working part-time on the 'Rizzo Reform Program' contacted the LHDSPo to advise that he had been approached by a tenderer to help develop their tender for the CSC. The tenderer formally contacted Defence on 4 March 2013 requesting written confirmation that engaging this official would not cause a conflict of interest. After seeking advice from the Australian Government Solicitor (AGS), the procurement's legal process/probity advisor, Defence responded on 6 March 2013 advising that there was no conflict of interest.

2.42 In November 2013, after the tenderers had been selected for the offer definition activity, Defence revisited its consideration of the potential conflict of interest in the context of the offer definition stage of the procurement. Between November 2013 and January 2014 Defence engaged with both the AGS and the tenderer on the matter. Defence was advised by AGS that the continued involvement of the particular official represented a number of risks. The LHDSPo provided an update to the AGS on 30 January 2014, advising that it was still considering 'the best approach' to close the issue out. Defence did not request that the official be removed from all further involvement with the offer definition activity process.

Offer definition activity

2.43 The proposed offer definition activity process and documentation was reviewed by the legal advisor (Ashurst Australia) and the probity advisor (AGS) between July and August 2013, with approval provided on 5 and 15 August 2013 respectively. The offer definition activity documentation contained amendments to the CSC RFT, including the conditions of contract and statement of work. This was not aligned with Defence's procurement guidance in place at the time, which set out that offer definition activities are to be used to enable 'Defence to better assess the extent to which shortlisted tenderers are able to meet Defence requirements'. The guidance did not provide for offer definition activities to amend Defence requirements as set out in the RFT or for the provision of revised tenders.

2.44 A gate review conducted on 30 August 2013 documented concerns about potential 'overlaps or gaps' in the different LHD sustainment contractors' roles and concerns that the CSC 'could grow to be a significant "in-sourced" organisation'. The board recommended that the LHDSPo 'review and refine the sustainment strategy' under the direction of the delegate.

2.45 On 18 September 2013, Kellogg Brown and Root (KBR) and one other tenderer were invited to participate in the offer definition activity. On 27 September 2013, the delegate provided guidance to the LHDSPo to adopt a 'lean SPO' model consisting of no more than 50 staff, including CSC personnel. Further delegate direction included transferring some of the proposed functions of the CSC to the TISSC.

2.46 In early October 2013, Defence sought advice from the AGS on the probity considerations of the potential changes to the scope of the TISSC and CSC procurements.⁶⁶ After an iterative review process with the AGS, further amendments were made to the RFT to provide Defence with greater flexibility to vary the scope and volume of services under the CSC. Other amendments included

66 AGS provided advice on 17 October 2013 outlining the risks associated with the proposed changes to the TISSC and CSC functions. The advice referred to the ability to achieve value for money given the extent and nature of changes under consideration. This risk was considered 'very high/high' for the CSC procurement. Risk mitigation strategies put forward included cancelling the CSC RFT and releasing revised request documents to industry for the reduced scope of work.

focusing the CSC role on maintenance monitoring rather than maintenance management, and limiting core staff to 50 people.

2.47 AGS provided 'legal process sign-off' for the revised proposed offer definition activity process on 12 November 2013. Defence did not seek legal clearance from Ashurst for the revised RFT. Ashurst's sign-off in August 2013 for the offer definition activity documentation recorded a range of caveats and risks arising from 'the substantial amendments to the RFT'.

2.48 The offer definition activity documentation was issued to the two tenderers on 12 November 2013. Responses from both tenderers were received by 16 December 2013. Following further assessment against the evaluation criteria, the offer definition evaluation confirmed the original tender evaluation board assessment that ranked KBR first. Defence conducted contract negotiations with KBR between 26 March and 14 May 2014.

2.49 On 14 June 2014, Defence briefed its Minister on its selection of KBR as the CSC noting that the total cost excluding profit of \$48 million was significantly lower than the Commonwealth expenditure cap of \$66 million, as a result of a competitive tender process and 'some reduction in scope' which was not defined in the advice. On 18 June 2014, the delegate approved the selection of KBR under Section 44 of the *Financial Management and Accountability Act 1997* (FMA Act) for an estimated contract value of \$72.37 million.⁶⁷ The CSC contract was executed on 20 June 2014 with an initial term of five years, with the option to extend for no less than 12 months and no more than four years.

Extension to the contractual arrangement

2.50 To determine whether an extension would be granted for the CSC contract, Defence was to undertake an 'extension review' by assessing the contractor's performance against the criteria in the CSC contract.⁶⁸ Defence reviewed KBR's performance in April 2019 and on 15 May 2019 extended the contract by four years to 30 June 2023 for a total of \$148.78 million. The contract was varied 26 times over its life and at the end of the contract in June 2023, the total value was \$171.83 million.⁶⁹

2.51 With no further options available to extend the CSC contract beyond 30 June 2023, a 12 month gap existed between the end of the CSC and the start of the successor arrangements in July 2024.⁷⁰ In September 2022, Defence considered options to cover this gap through the Major Service Provider and/or the Defence Support Services standing offer panel arrangements but did not record a decision on its planned approach.

67 At the time of the CSC procurement approval, the *Financial Management and Accountability Act 1997* (FMA Act) and the *Financial Management and Accountability Regulations 1997* (FMA Regulations) were in force. The FMA Act was replaced by the PGPA Act, which came into effect on 1 July 2014. The \$48 million was for the total budget cost across the first term of the contract. The \$72 million was Defence's expenditure cap, or 'upper limit', across the first term of the contract.

68 The contract established that the decision to offer an extension term would be at the discretion of the Commonwealth. It further noted that the Commonwealth would conduct an extension review if offering an extension term was under consideration. In addition to the criteria set out in the contract, the review considered quarterly contract reporting mechanisms, review meetings and performance measures assessments.

69 The total contract value included costs for the Landing Ship Dock (LSD) which was included within the scope of the CSC in 2015, via a contract amendment. LSD sustainment is budgeted separately under product schedule CN36.

70 These successor arrangements are discussed further at Chapter 4.

2.52 On 2 November 2022, KBR provided Defence with what it described as an ‘unsolicited proposal’ for the continuation of its services for 12 months to June 2024.⁷¹ The proposal was for services valued at \$18.06 million for 38.15 full time equivalent (FTE) staff under Defence’s existing Major Service Provider (MSP) panel arrangements.⁷² Defence declined KBR’s proposal on 8 December 2022, advising that it had ‘decided to go in an alternate direction for above-the-line services after 30 June 2023’. However, on 20 February 2023 Defence advised KBR that a ‘future approach under the Major Service Provider (MSP) Arrangement may occur towards April of 2023’.

2.53 There is no record of Defence subsequently approaching the market through the MSP panel for these positions. Two days before the expiry of the CSC contract (on 28 June 2023), KBR services comprising 36.4 FTE staff were approved by Defence under the MSP panel arrangements for a total contract value of up to \$11.34 million.

2.54 Defence advised the ANAO in August 2024 that it ‘did not establish specific arrangements for the management of probity for the procurement of KBR under the MSP panel following receipt of KBR’s unsolicited proposal.’ Defence’s management of probity in the context of the procurement process for the successor arrangements to the CSC is discussed further in Chapter 4, Case study 2.

Transition In-Service Support Contract

2.55 Consistent with the September 2012 updated sustainment strategy (discussed in paragraph 2.30), the engagement of BAE as the Transition In-Service Support Contract (TISSC or sustainment) contractor through a sole source process for \$183.4 million was approved by the delegate on 24 January 2013. The intention of this approach was to leverage the ‘skills and experience’ of BAE as the acquisition contractor. The approval records stated that this approach had ‘the least schedule risk’ and that costs associated with two separate contractors for acquisition and sustainment would be reduced by having only one contractor for both.

2.56 Defence identified three ‘key risks’ for the sole-source approach, including a ‘lack of competitive pressure’ and ‘compromised short-term value for money’.⁷³ The mitigation strategies listed for these risks in the approval records included:

- establishing a contract development agreement and agreed principles of behaviour with BAE;
- progressing alternate/fallback options to ‘maintain (an element of) competition’; and
- preparing a clear negotiation strategy with required outcomes and maintaining consistency in the strategy’s execution.

2.57 On 18 March 2013, Defence invited BAE to undertake ‘collaborative contract development’, which would involve both parties ‘working together to develop the draft TISSC provisions’. A contract development deed was executed on 29 April 2013, establishing the framework for BAE to work ‘collaboratively and cooperatively’ with Defence. Early consideration of probity, particularly for procurements with high levels of tender interaction, is important to support the integrity of the process. The probity plan for the TISSC procurement was approved around three months after the

71 See also Case study 2 in Chapter 4.

72 Services included work for the LHDs, the LSD and Capability Assurance Program.

73 The other risk related to Defence’s ‘Ability to have effective sustainment arrangements in operation at IMR [initial materiel release]’.

execution of the contract development deed, on 26 July 2013.⁷⁴ As outlined at paragraph 2.26, Defence was aware of BAE's interest in sustainment contracting from at least April 2012. The probity management arrangements established by Defence in 2013 did not support Defence's early engagements with BAE.

2.58 Defence released the TISSC Request for Tender (RFT) to BAE Systems on 18 November 2013 and received a response from BAE on 16 December 2013. The tender was to be evaluated by three working groups reporting to a Tender Evaluation Board. During the first meeting of the evaluation board on 17 January 2014, all three working group leads raised 'significant concerns over the extent of non-compliance in the BAE tender response.'⁷⁵ The delegate was advised of these issues in writing on 24 January 2014 and was informed that 'the BAE tender response significantly erodes the argument used to justify the original single supplier limited tender (sole source) procurement method'. 'Critical issues' identified by the tender working groups included the following.

- a. The BAE tender response does not fully reflect the collaborative discussions held in the latter part of contract development work under the Deed ...
- b. At this stage, only five of the 13 endorsed TISSC Principles established by the Deed are likely to be achieved. ...
- c. [The] requirement for sustainment contractor accountability and reduced transactions is at significant risk. The BAE response attempts to transfer significant accountability, transactions and risk back to the Commonwealth.

2.59 The tender evaluation was suspended to enable BAE to resubmit its tender. A revised tender was submitted by BAE on 11 March 2014. Defence's June 2014 evaluation of the revised tender stated the following.

Overall, the BAES tender contains significant deficiencies and risks that taken together prevent the TEB from determining, at this stage, that the contract constitutes value for money. However, BAES have indicated an acceptance of the requirement to address underlying non-compliances.

2.60 The Tender Evaluation Board recommended that Defence continue 'collaborative development' with BAE to: address the remaining non-compliances and areas of high and extreme risk; and resolve the underlying value for money weaknesses.

2.61 Contract negotiations took place between 14 and 28 August 2014. The negotiated outcome was approved by the delegate on 15 September 2014⁷⁶, providing up to \$215.6 million for the contract with BAE as the TISSC service provider. Defence did not obtain probity advice or clearance

74 A revised version of the probity plan was approved in December 2013 to include the contact details of the AGS as the probity advisor (which were not recorded in the previous version of the plan).

75 Unsatisfactory tender responses arising from a sole source procurement and, collaborative contracting processes conducted by Defence in 2019 were also examined in Auditor-General Report No 47 2023–24, *Defence's Management of Contracts for the Supply of Munitions — Part 1*, ANAO, Canberra, 2024, para 3.44, available from <https://www.anao.gov.au/work/performance-audit/defences-management-of-contracts-for-the-supply-of-munitions-part-1> [accessed 17 June 2025].

76 The approval also included a \$86.89 million increase to the amount initially approved in 2013 under FMA Regulation 9. This brought the spending proposal to a total of \$270.32 million, which included the initial contract term of four years, plus a one-year extension until 30 June 2019.

during the TISSC procurement.⁷⁷ In advice to the delegate regarding the significant non-compliances and risks, Defence stated the following.

Resolving these issues has been a protracted process involving an extension to the original tender period, and a more comprehensive collaborative effort to improve Commonwealth's confidence and reduce uncertainty.

2.62 The advice to the delegate did not address whether the additional collaborative discussions had resolved the deficiencies listed in the value for money assessment in the June 2014 tender evaluation report. The advice did not mention the concessions made by Defence on base profit during negotiations, as detailed in the contract negotiation report.

2.63 On 29 August 2014, Defence advised its Minister of its finalisation of negotiations with BAE, at a price of approximately \$220 million over four years. In contrast to its brief on the CSC selection (refer to paragraph 2.49), Defence did not inform the Minister that the contract value exceeded the approved cost of \$183 million. Defence entered into the TISSC on 26 September 2014, and the operative date was achieved on 15 December 2014 upon acceptance of the first LHD. The initial contract value was reported on AusTender as \$185.56 million for a four year term.⁷⁸ Defence records indicate that there were 20 variations to the contract, including one in February 2018 to extend the contract term by 12 months. Financial approvals under section 23 of the PGPA Act for the last three variations were either not retained by Defence or not signed by the delegate. These variations included the cost settlements (or true-ups) for the final two financial years. As at 5 June 2024, a total contract value of \$355.04 million was reported on AusTender.

2.64 In October 2017, Bechtel was engaged to conduct a review of the LHDSPO commercial arrangements. Among other things, the report concluded that the original decision to sole source the TISSC to BAE was a valid mitigation for transition issues but 'the poor performance by BAE [had] negated this decision.' The poor performance involved: insufficient and inadequately skilled resources; lack of planning for works, such as the procurement of required parts for external maintenance periods; and a failure to use Defence systems.⁷⁹

2.65 The report stated that Defence had not exercised its contractual rights and had instead stepped in to perform work on behalf of BAE.⁸⁰ It was also reported that in some instances, Defence had 'provided cost relief for poor performance' by allowing BAE to delay work that had not been

77 The approval documentation stated that legal advice was obtained. The legal sign-off provided by Ashurst specifically stated that the procurement records had not been reviewed from a probity perspective, nor was probity advice provided throughout the procurement process.

78 The Section 23 approval listed commitment and expenditure of up to \$215.60 million, inclusive of \$29.99 million to be incorporated by contract change proposal (CCP) before the contract operative date to cover subcontractor costs. This resulted in an initial contract value of approximately \$185.60 million. As Defence did not retain the original executed contract, AusTender reporting was relied upon to confirm the initial contract value (\$185.56 million).

79 Defence also used 'company scorecards' as a contractor performance measurement tool for acquisition contracts valued at and above \$10 million and sustainment contracts valued at \$5 million or greater. The scorecards from 2015 to 2017 documented concerns with BAE Systems' performance under the TISSC, including maintenance scheduling issues and response times to urgent defects, timeliness of the close out of maintenance tasks in Defence systems leading to delays in invoicing, and delays in updates to management plans. On 6 June 2025 BAE Systems Australia advised the ANAO that 'BAE Systems' belief is that its ability to perform obligations under TISSC was adversely impacted by continuing issues from the acquisition phase attributable to the performance of other parties, and that these residual acquisition contract issues were in fact resolved over the years of TISSC'.

80 The report stated that this work was undertaken by either Defence or the CSC contractor stepping in.

completed on time until the ships' next availability (irrespective of whether delays to that work were caused by Defence or BAE). A May 2017 Defence Seaworthiness Board report had raised similar concerns, summarising the reason for the performance issues as follows.

In reality two very separate arms of BAES Corporation have taken on Acquisition and Sustainment and the expected transfer of corporate knowledge to provide for a smooth transition has not eventuated.

Phase 2: LHD Asset Class Prime Contractor

2.66 On 21 March 2018, Defence approved a procurement strategy for the selection of a new LHD sustainment contractor. Under these new arrangements, the in-service support sustainment contracts were to be consolidated under a single Asset Class Prime Contractor (ACPC) covering the LHDs and LLCs. The strategy also envisaged a reduced dependence on the CSC contractor over time.

2.67 The approach to market was approved on 12 March 2018 for an estimated value of \$2.02 billion (GST inclusive) over a 15-year period. The advice to the delegate reported that one benefit of a 15-year contract was 'to obtain the return on investment made in changing the SEM [Supplier Engagement Model]'. The approval outlined a two-stage procurement process involving:

- Stage 1: Invitation to Register Interest (ITR) to shortlist respondents; and
- Stage 2: Collaborative Requirements Definition Activities with down-selected respondents prior to the release of a restricted Request for Tender (RFT) and evaluation.

2.68 The external probity adviser for the ACPC procurement (Sparke Helmore) was engaged in March 2018.⁸¹ Under Defence's probity plan, the LHDSPD was required to maintain a probity and conflict of interest register for the ACPC procurement. Entries for 167 personnel and contractors involved in the procurement were recorded in the register between July 2017 to November 2018. The register was not complete, with 109 (65 per cent) of individuals recorded as receiving a probity briefing, and 148 (89 per cent) completing a conflict of interest declaration. Of those 148 declarations, five potential conflicts of interest were reported.⁸²

2.69 On 24 September 2018, four days before the RFT closure date, a conflict of interest was declared by a senior Defence official who was in active negotiations with NSM for a job opportunity they 'were likely to take'. The official had contributed to the ACPC procurement process and relevant activities. Prior to this, the official had also been approached by NSM in May 2018 for information related to the ACPC procurement.

2.70 Defence determined that the offer of employment did not give rise to a conflict of interest, however on 26 September 2018, Defence prohibited the individual from any further participation in the tender activities. On 28 September 2018, the NSM tender response listed the senior Defence official, who was still employed by Defence, as one of NSM's key personnel (the program director)

81 A legal process and probity plan for the ACPC procurement was approved on 30 June 2017. The June 2017 plan was edited in October 2018 to reflect the appointment of Sparke Helmore.

82 Defence considered that three declarations required no action and two were manageable.

if awarded the contract. In November 2018, this individual participated in Offer Definition Improvement Activity (ODIA) negotiations on behalf of NSM.⁸³

2.71 NSM did not seek, and Defence did not provide, written approval for the inclusion of the individual in NSM's tender response and ODIA negotiations as required by the Tenderers Deed of Undertaking for the RFT process, as executed by NSM. Additionally, when Defence became aware of the individual's involvement, it took no action.

2.72 Defence published the ITR on AusTender on 23 April 2018. An initial industry briefing was held on 30 April 2018, followed by one-on-one industry briefing sessions held between 3 and 7 May 2018. The ITR closed on 11 June 2018, with six responses received prior to the closing date. After an initial screening of all responses, all six tenders were evaluated against the criteria in the tender evaluation plan approved in March 2018.⁸⁴ On 5 July 2018, the Tender Evaluation Board (TEB) Chair approved the ITR evaluation report, which recommended that the three highest ranked tenderers be invited to participate in an RFT process.

2.73 Defence released the RFT to the three down-selected tenderers on 2 August 2018. The RFT closed on 28 September 2018, with responses received from all three. The responses underwent initial screening and were then evaluated by the 'Tender Evaluation Organisation' in accordance with the approved tender evaluation plan.

2.74 The Tender Evaluation Organisation consisted of three Tender Evaluation Working Groups (TEWGs) — commercial, technical, and financial. The TEWGs provided their assessments against the criteria, including a comparative assessment, to the TEB.⁸⁵ On 26 October 2018, the delegate endorsed the evaluation report for the RFT. The TEB assessed NSM as the preferred tenderer, stating that its response provided 'the best overall response against the evaluation criteria and was the most likely to be affordable and provide value for money for the Commonwealth.' The TEB also reported that NSM had 'strongly demonstrated their willingness to engage in accordance with the behaviours and approach that the Commonwealth seeks.'

2.75 Following an ODIA process with NSM, a Contract Negotiation Directive was approved by the delegate on 16 November 2018 setting out Defence's framework for the negotiations process, and the security, confidentiality and probity arrangements.⁸⁶

83 Clause 4.3.c of the Tenderers Deed of Undertaking for the RFT process, including the ODIA, required that tenderers: 'have not and will not, without prior written approval from the Commonwealth, permit any current or former Commonwealth Personnel, or Defence Service Provider to contribute to, or participate in, any process or activity relating to the preparation of the Tender or the RFT process, if: (i) the person was involved at any time in the planning of the procurement to which this RFT relates, the preparation of this RFT, or the management of the RFT process; or (ii) the person was at any time during the 12 months immediately preceding the date of issue of the RFT involved in a Defence procurement process or activity relevant or related to the RFT.'

84 The evaluation criteria were not weighted or put in any order of priority, and included: the respondent's willingness to engage as a strategic partner and work collaboratively; ability to build the Commonwealth knowledge base; bring know how/know why to LHD/LLC sustainment; supply chain solution including relationships with national and international suppliers; capacity to support LHD/LLC in the provision of asset management, operating support, maintenance support, engineering support and supply chain management services; scalability to manage surge; and commitment to effective joint governance of the 'Enterprise'.

85 The same evaluation criteria applied to both the ITR and RFT.

86 A negotiation matrix, provided as an annexure to the directive, detailed 17 negotiation issues of which three were classified as significant and 14 as minor.

2.76 The contract between Defence and NSM was negotiated over three days (from 19 to 21 November 2018). On 23 November 2018, the probity advisor (Sparke Helmore Lawyers) provided a probity report and sign-off for the ACPC procurement. The Contract Negotiation Report, endorsed by the delegate on 26 November 2018, stated that no actual or potential conflicts of interest were raised, and provided commentary on three 'significant issues' — Navantia labour rates, the fixed management services tendered price, and the value of liability limits.

2.77 On 26 November 2018, the delegate approved the commitment and expenditure of funds for the engagement of NSM as the LHD prime contractor under section 23 of the PGPA Act. The approval committed a not-to-exceed cost of \$654.28 million over the five years of the initial contract term, in addition to the phase-in period. On 28 November 2018, Defence advised the Minister for Defence of the selection of NSM for the ACPC contract and of Defence's intention to proceed to contract signature. On 3 December 2018, the Minister announced the selection of NSM to sustain and support the LHDs for 15 years from July 2019. Defence entered into the ACPC contract with NSM on 3 December 2018, for a total contract value of \$599.98 million (GST inclusive). Defence's management of the ACPC contract is examined in Chapter 3.

Did Defence effectively forecast and manage sustainment costs?

Defence's forecast and management of sustainment costs has been impacted by deficiencies from acquisition extending into sustainment. Since final operating capability was declared in 2019, the LHD sustainment funding provision per financial year has not met in-year requirements, with some sustainment work deferred and future costs increasing. In 2024 senior Defence officials considered options to address Navy sustainment funding pressures. Following consultation with the Minister for Defence in 2024, Navy sustainment funding was increased by an additional \$300 million over two years to June 2026, of which Defence allocated \$36 million towards LHD sustainment funding for 2024–25.

Sustainment cost baseline

2.78 In 2007 Defence outlined a baseline operating cost estimate in its second pass submission to government of \$1,349 million over the 40-year life-of-type.⁸⁷ The estimate included \$81.8 million over the following decade and an annual mature figure of \$34.2 million. The submission also provided the estimated average annual personnel and operating cost of the LHDs at \$138.5 million, including personnel at \$66.6 million, fuel, lubricants and stores at \$38.7 million, maintenance at \$32.6 million and 'other' at \$0.58 million. Defence advised to government that overall cost risk was low to medium with a high level of confidence as tendered costs were supported by sufficient detail.⁸⁸

87 This estimate was based on Net Personnel and Operating Cost (NPOC) with a crew size of 346 per ship, up to 180 sea days per year and funding based on Budget 2007–08 constant price and exchange.

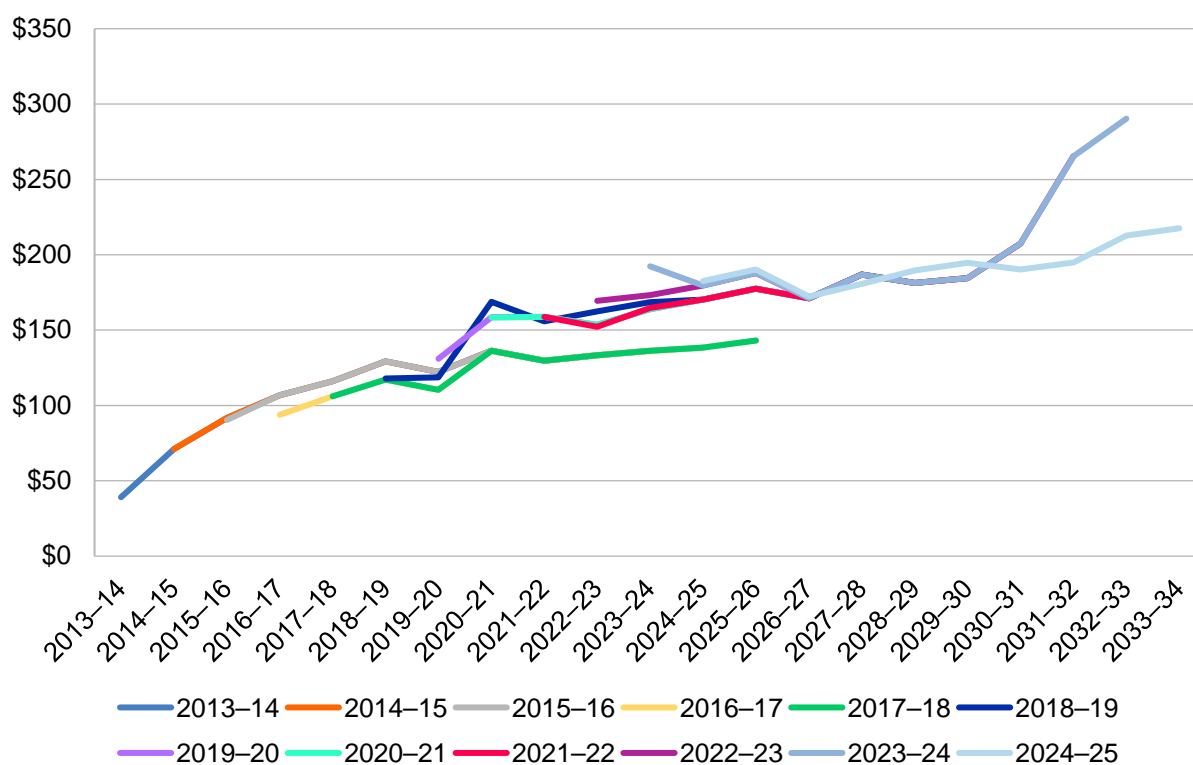
88 Auditor-General Report No. 2, 2017–18, *Defence's Management of Materiel Sustainment*, noted at paragraph 3.36 that 'Numerous reviews and audits have urged greater focus on whole-of-life costs and better knowledge of the total costs of ownership of military assets, including sustainment, but have found that Defence has struggled to establish the skills, systems and data for this activity'.

Pre-final operational capability sustainment cost reviews

2.79 Since 2007 Defence has regularly reviewed and reprofiled LHD sustainment costs. A 2011 gate review reported various shortcomings in the original business case and that the materiel annual support cost advised at second pass was a 'serious underestimate'. In April 2011, the Defence Capability and Investment Committee was subsequently advised that this situation had resulted from: 'an understated business case, a changing strategic environment, contractor performance, and delays in establishing the necessary sustainment arrangements'.

2.80 Sustainment funding provisions for the LHDs have been reviewed and adjusted as part of the fleet screening process by the Navy Sustainment Review Board (NSRB).⁸⁹ Annual updates to the LHD Materiel Sustainment Agreement (Product Schedule) progressively increased funding provisions per financial year. The Product Schedule includes in-year funding requirements and a 'whole of life' cost plan for the coming decade. Total funding allocations for the LHDs since 2013 are outlined in Figure 2.1.

Figure 2.1: Approved LHD sustainment decade funding provisions (\$ million), 2013–14 to 2024–25



Source: ANAO based on Defence documents.

⁸⁹ The NSRB is chaired by the Deputy Chief of Navy and reports to the Defence Finance and Resourcing Committee (chaired by the Chief Finance Officer). The effectiveness of sustainment activities and the adequacy of funding for LHD sustainment has also been subject to review through the Independent Assurance Reviews process.

Post-final operational capability sustainment cost reviews

2.81 Funding reviews conducted after final operational capability (November 2019) observed continued funding pressures.⁹⁰ On 19 September 2022 the Defence Committee⁹¹ considered sustainment funding pressures across the department in the context of a requirement to identify an additional \$400 million in 2022–23 for estate and ICT sustainment. To meet this requirement, the committee decided that Air Force and Navy would contribute \$140 million each and Army \$120 million, funded from sustainment budgets. Meeting minutes stated that:

CDI [Chief of Defence Intelligence] highlighted that the brief did not outline what impact the reduced sustainment funding would have on the three Services as a result of this reallocation. The Committee agreed that the Services should advise the impact through preparedness reporting.⁹²

2.82 On 13 December 2022, the Defence Finance and Resourcing Committee (DFRC) considered the need to absorb budget reductions of \$140 million following the Defence Committee direction. The ‘Deep Dive’ paper presented to the DFRC reported that ‘measures taken to reduce in year pressures will add to out year pressures, pending application of [Defence Strategic Review] outcomes to the sustainment budget’.⁹³ In relation to LHD sustainment, underfunded requirements totalled \$128 million for the period 2023–24 to 2026–27 driven by unplanned maintenance, inventory for maintenance and engineering change tasks and stock replenishment. The DFRC was informed that sustainment funding pressures elevate capability risks including:

Increased technical debt and risk across Navy platforms due to deferral of planned maintenance and engineering change proposals resulting in reduced system and/or platform availability.

2.83 A November 2023 meeting of the DFRC was advised that:

Increased inflation induces significant price uncertainty. Sustainment costs have increased at 5.8% per annum between 2018 and 2022, with funding indexed at 2.5%. Due to the indexation gap, it is estimated a sustainment uplift of between \$960m and \$1,200m is required to maintain current levels of activity over the FEs [forward estimates].

2.84 The Chief of Navy prepared a minute for the 3 June 2024 Defence Committee on Navy sustainment pressures. The minute advised that since 2021, Navy has consistently identified funding pressures over the forward estimates and, despite efforts to reduce spending, Navy has overspent its sustainment budget for the last four years:

90 The 2019 NSRB review reported that ‘FY 19/20 remains underfunded despite the deferral of scheduled docking availabilities and increase in funding at Oct 18 NSRB’. In 2021, the NSRB observed that:
end of year forecast for Priority 1 requirements against the baseline work forecast has increased from \$158.4M to \$183.328M (15.7% over spend) however up to \$16.9M of this increase will be funded from other sources — the CASG Group Operating Budget for the LSAe initiative, JP2048 Ph 4 for TARP-related remediation work, and JP2048 Ph 6 for CAP-related work.

91 The Defence Committee is chaired by the Secretary of Defence and is the most senior enterprise-level committee within the department.

92 The Preparedness Reporting during this period did not refer to the impact on Navy of the reduction of sustainment funding in 2022–23. Preparedness reporting is examined in Chapter 4, paragraphs 4.47 to 4.53.

93 The committee was informed that, to manage funding pressures, capability upgrades and life of type extension projects were better managed as part of the acquisition project process and work has commenced to consider the budget classification of those projects.

Historical errors in cost models, combined with failure to realize full cost model recommendations in Sustainment and increased costs associated with transition and sustainment for new capabilities continue to impact significantly on the Navy Sustainment Budget.

2.85 The May 2024 minute identified a Navy sustainment shortfall of \$2.7 billion between 2023–24 and 2027–28, with \$500 million required for 2024–25 and 2025–26. Chief of Navy advised that '[s]upplementation is required immediately to remedy sustainment concerns, safety issues, meet contractual obligations, and mitigate further degradation of capability', and there are 'few realistic other options to reduce availability of platforms without significant risk'.

2.86 Further consideration was given to the issue in the August 2024 meeting, of the Defence Committee which decided to provide additional funding to Navy sustainment pending consultation with the Minister for Defence and clarification of options. In September 2024, the Defence Committee was advised that recommendations were agreed following the Secretary and Chief of Defence Force consultation with the Minister for Defence on 21 August 2024. The October 2024 NSRB fleet screening recorded an additional \$300 million for Navy sustainment in 2024–25 and 2025–26.⁹⁴

Recommendation no. 2

2.87 To support the future requirements for the LHDs, the Department of Defence develops and maintains class-specific lifecycle sustainment plans for the Navy fleet, including funding requirements for the planned life of type, to ensure that the required capability is maintained across the classes' whole of life, at a rate of agreed availability.

Department of Defence response: *Agreed.*

2.88 *Defence agrees to the recommendation.*

⁹⁴ The LHDs received an additional \$36 million in sustainment funding for 2024–25.

3. Sustainment management

Areas examined

This chapter examines whether the Department of Defence (Defence) has effectively managed the sustainment of the Landing Helicopter Docks (LHDs).

Conclusion

Sustainment of the LHDs was not managed effectively by Defence through its prime contractor arrangements. Governance arrangements, contract management guidance, and risk management practices were not implemented in a timely manner and contract-specific probity arrangements were not developed. Defence did not take reasonable steps, as required by the *Public Governance, Performance and Accountability Act 2013* (PGPA Act), to manage systemic poor procurement practices by the prime contractor or investigate claims of fraudulent activity in sub-contracting arrangements in accordance with its own policies. Defence did not use the full range of contractual levers available to manage its primary sustainment contract. This approach impacted the quality of service delivery and undermined the achievement of value for money through the contract.

Areas for improvement

The ANAO made four recommendations aimed at updating the Materiel Sustainment Agreement as the primary sustainment management framework, improving risk management and strengthening Defence's management of contractors.

3.1 Effective and fit-for-purpose contract and governance arrangements support compliance with the requirements of the PGPA Act and Defence's Accountable Authority Instructions for proper resource use, the achievement of value for money, transparency, and accountability.

Did Defence establish fit-for-purpose governance arrangements to support contract management?

Defence established governance arrangements to support its management of LHD sustainment contracts. These arrangements were either not implemented effectively or not maintained by Defence, resulting in a number of shortcomings.

- Since 2012, updates to the Materiel Sustainment Agreement (head agreement) between Navy and the Naval Shipbuilding and Sustainment Group have not been timely, occurring several years after key changes in responsibilities or organisational restructures had taken effect.
- A contract management plan was not established for the first 17 months of the ACPC contract. Contract risks, including those identified during the procurement process, were not revisited as planned or covered in the contract management plan.
- Contract-specific probity arrangements were not established for the ACPC contract. Defence relied solely on its broader departmental arrangements instead, which require Defence personnel to proactively identify and declare any actual, potential or perceived conflicts of interest as and when they arise.

- LHD sustainment risks at the strategic level are managed separately and in isolation from risks at the operational and technical levels. There is no hierarchy or clear line of sight between the risks identified in the Materiel Sustainment Agreement and those being managed day-to-day.

Materiel Sustainment Agreement

3.2 Defence uses formalised arrangements known as Materiel Sustainment Agreements as its primary framework to oversee the sustainment of specialist military equipment. These agreements define the relationship between Defence's sustainment delivery group (or the 'product manager') and the Australian Defence Force's (ADF) 'capability managers' — primarily the Chiefs of the Royal Australian Navy (Navy), Australian Army and Royal Australian Air Force.

3.3 A Materiel Sustainment Agreement consists of two sections: the head agreement, which details the high-level overarching arrangements, and the 'product schedules' which detail the specific sustainment arrangements for individual Defence products, including one for the LHDs.⁹⁵

Heads of agreement

3.4 The first Navy Materiel Sustainment Agreement was established by the Defence Materiel Organisation (DMO) in 2005. Since then, updates have been infrequent and retrospective, largely centred around reflecting key changes from several years prior, such as organisational restructures or changes to responsibilities. For example:

- in early 2015, the Materiel Sustainment Agreement between Navy and DMO was updated to give effect to recommendations from the 2011 Rizzo review. This included that the agreement 'should be transformed into an active 'contract' that meaningfully captures the mutual obligations of Navy and DMO, supported by business like performance measures'⁹⁶;
- in December 2019, the Materiel Sustainment Agreement between Navy and Defence's Capability Acquisition and Sustainment Group (CASG) was established, reflecting the delisting of DMO as a prescribed agency in mid-2015⁹⁷; and
- in June 2024, the Materiel Sustainment Agreement between Navy and CASG was updated to reflect the 2022 transfer of responsibility for the majority of naval sustainment, including for the LHDs, from CASG to the Naval Shipbuilding and Sustainment Group (NSSG)⁹⁸; and

95 The interim Navy Materiel Sustainment Agreement with NSSG has 24 Product Schedules with each tailored to a specific platform or product.

96 Defence guidance provides that it is the capability-specific Product Schedule attachments that are to be maintained as 'contract like' documents, rather than the Materiel Sustainment Agreement. See: P. Rizzo, *Plan to Reform Support Ships Repair and Management Practices*, 2011, p. 49.

97 The update in December 2019 occurred after a March 2019 ANAO audit advised that 'Defence should consider updating the Navy Heads of Agreement to reflect the current departmental structure'. See: Auditor-General Report No.30 2018–19, *ANZAC Class Frigates — Sustainment*, paragraph 2.4.

98 CASG retained responsibility for the sustainment of Navy's navigation, communications, unmanned and aviation systems.

- in August 2024, an interim Materiel Sustainment Agreement between Navy and NSSG was established to reflect the 2022 transfer of responsibility for the majority of naval sustainment, including for the LHDs NSSG.

3.5 According to the interim agreement, Navy and NSSG have committed to:

- ‘commencing the next iteration’ of the Materiel Sustainment Agreement during 2024; and
- working together ‘to progress jointly agreed initiatives and activities to improve the sustainment of Navy capability, including utilising International Benchmarking and Total Cost of Ownership methodologies.’

Recommendation no. 3

3.6 The Department of Defence promptly reviews and updates, Navy’s Materiel Sustainment Agreements with the Capability Acquisition and Sustainment Group and Naval Shipbuilding and Sustainment Group, following significant changes in organisational structures, or at least every three years.

Department of Defence response: *Agreed.*

3.7 *Defence agrees to the recommendation.*

Product schedules

3.8 The LHD product schedule sets out Navy’s requirements for the sustainment of the LHDs, with reference to: the Operating and Support Intent, Product Operating Profile and Product Activity Plan; specific performance measures; governance arrangements; funding requirements and provisions; and key responsibilities.⁹⁹ The Capability Manager's Representative (Navy) and the Amphibious Combat and Sealift Systems Program Office (ACSSPO) Director (NSSG) are jointly responsible for managing the product schedule.

3.9 The LHD Product Schedule was established on 19 June 2013 and has been reviewed regularly, including by the Navy Sustainment Review Board and the Independent Assurance Review Board.¹⁰⁰ At June 2024, the product schedule had been updated 25 times (including once in 2023 for the establishment of the NSSG).

3.10 Revisions to the product schedule have primarily focused on updating: the financial information section, statement of work and the annexures for the ‘product activity plan’, ‘approved capability improvement, sustainment and retirement initiatives’, and ‘accepted materiel capability limitations and risks’. Parts of the document receiving fewer updates in recent years include the outline of the work requirements (which refers to an outdated Sustainment Acquisition Strategy version 2.0 from February 2014), and the performance measures (which refers to CASG rather than NSSG).¹⁰¹

⁹⁹ The LHD Operating and Support Intent is discussed further at paragraphs 4.22 to 4.29.

¹⁰⁰ The product schedules under the Materiel Sustainment Agreement are reviewed annually by Defence and have been updated in-year to reflect changes (for example, changes to funding or materiel ready day requirements).

¹⁰¹ Performance measures established under the LHD product schedule are examined at paragraphs 4.4 to 4.14.

Contractual arrangements

Contractual provisions to incentivise performance

3.11 The Asset Class Prime Contractor (ACPC) contract was based on Defence's standard contract template for sustainment services¹⁰², which included provisions to protect the interests of the Commonwealth, as summarised in Table 3.1. Defence did not include the provisions for liquidated damages in the ACPC contract.

Table 3.1: Financial levers included in the ACPC contract

Financial lever	Contract description
Exercise of securities	If the contractor fails to provide or maintain any security required under the contract, the Commonwealth may withhold all or part of any payment under the contract until the contractor meets those obligations.
Stop payment events	Stop payment events enable the Commonwealth, at its discretion, to withhold some or all payments where specific contractual and performance requirements have not been met.
Restrictions on certain payments	Restrictions apply to claims for incentive payments and are intended to ensure that incentive payments are not made in certain circumstances where key requirements have not been met. The Commonwealth is entitled to terminate the contract for default.
Painshare/gainshare provisions	Under the contract, the Commonwealth and contractor share in any cost overrun or cost saving that occurs as a result of the differences between the actual costs incurred during a Target Cost Estimate period and the corresponding budgeted amounts for that period. ^a The painshare/gainshare for the contract is 50:50 between the Commonwealth and contractor.
Performance payment score	The performance payment score is determined based on an assessment of the contractor's operational performance against the key performance indicators (KPIs). A performance payment score is calculated for each Target Cost Estimate period and used to moderate the contractor's profit entitlement.

Note a: Defence was to make in-advance payments to the contractor in accordance with an agreed annual work plan. At the end of each target cost estimate period (that is, at the end of each financial year), a reconciliation, or 'true up' process, to compare actual costs against the advance payments for the period.

Source: ANAO analysis of Defence's ACPC contract.

3.12 The ACPC contract provided for the establishment of management plans, annual work plans, and oversight through a Steering Group, Executive Management Group and Integrated Project Teams. The scope of work included maintenance support, support services management, and continuous improvement and efficiencies.¹⁰³ Work conducted under the support services management component was to be subject to, among other things, periodic performance reviews, contract performance reviews, performance assessment reviews, periodic cost reviews, enterprise management planning and risk and issue management.

102 The Australian Standard for Defence Contracting (ASDEFCON) Support contract template is a performance based contracting template used for 'the support of materiel systems including platform based mission systems, vehicle fleets, complex ICT systems and complex subsystems fitted to one or multiple mission system types' See: <https://www.defence.gov.au/business-industry/procurement/contracting-templates/asdefcon-suite/support> [accessed 11 June 2024].

103 The remainder of the scope of work comprised: asset management, operational support, engineering support, supply support, resource management, verification and validation, quality management and work health, safety and environmental management.

3.13 The contractor was also required to manage a Continuous Improvement and Efficiency Program through an approved 'efficiency implementation plan'. This involved arrangements to identify, analyse and implement agreed efficiencies. The contractor submitted the 'efficiency implementation plan' as required in 2019 and updated the plan in response to Defence's feedback. Subsequent updates submitted in 2020 and 2021 were approved by Defence with no feedback or requested changes. The contractor did not provide any efficiency proposals over the five-year term of the contract.¹⁰⁴

Contract management plan

3.14 According to the Defence Contract Management Handbook, established in July 2018, a Contract Management Plan should be developed before a contract is awarded and treated 'as a living document' after contract negotiations are complete.¹⁰⁵ The handbook also states that artefacts from the relevant procurement process, such as the risks and issues identified during an Offer Definition and Improvement Activity (ODIA) or contract negotiation process, should be used as a starting point for Defence personnel conducting a contract management risk assessment.

3.15 Consistent with the Defence Procurement Policy Manual in effect at the time, Defence completed a liability risk assessment for the ACPC contract on 8 June 2018 prior to the selection of the preferred tenderer.¹⁰⁶ High risks identified in the liability risk assessment included poor work practices, delays to work instructions, and breaches of work, health and safety requirements. The liability risk assessment recommended that the assessment be revisited after the tender selection to inform contract negotiation, finalisation and execution. This additional assessment was not undertaken.

3.16 On 1 May 2020, Defence approved a high-level ACPC contract management plan, around 17 months after the contract was executed in December 2018.¹⁰⁷ The contract management plan did not state how contract risks, including those previously identified during the procurement process, were to be addressed.

Probity

3.17 Commonwealth officials are required to take reasonable steps to avoid real or apparent conflicts of interest and disclose any relevant material personal interests in accordance with Commonwealth legislation.¹⁰⁸ Defence personnel are also required to comply with the Defence Instruction — Administrative and Governance Provision 5 (AG5) - Conflicts of interest and post-

104 In September 2023, Defence advised the ANAO that it had not requested the contractor to provide efficiency proposals, as the focus had been on remediation of issues (see paragraphs 3.48 to 3.51).

105 This is consistent with the Department of Finance, *Australian Government Contract Management Guide*, July 2023, p. 16.

106 The Defence Procurement Policy Manual (version 1.1, 19 December 2017, Defence Procurement Policy Directive D6), required a liability risk assessment to be undertaken prior to agreeing to a contingent liability.

107 As noted in paragraph 2.77, the ACPC contract was executed on 3 December 2018. This allowed approximately seven months for phase-in planning and handover activities with the outgoing contractor (BAE Systems). The operative date of the contract (commencement of sustainment activities under the ACPC) was 1 July 2019.

108 PGPA Act section 29, PGPA Rule sections 12 to 16D, and *Public Service Act 1999*, subsection 13(7).

separation employment — and identify and manage conflict of interests in a systematic and transparent manner.¹⁰⁹

3.18 As at June 2025, declarations of interest and conflict of interest declarations were recorded for three ACSSPO staff between 2019 and May 2025. In each case the delegate concluded that there was no conflict.

- In one case, no information about the discloser's interests was provided. The delegate recorded that there was 'No conflict of interest'.
- In a second case, the official declared previous employment with an LHD contractor (Navantia Australia). The delegate decided that this did not give rise to a conflict of interest due to the time elapsed since the employment and further commented that: 'the disclosed previous employment commonly occurs within the defence sector, and there is little reasonable basis for any perception by the public that a conflict of interest could in fact arise. This conclusion accords with the advice of our nominated Probity Advisor'.
- In a third case, a subcontractor to the ACPC contractor was also engaged as an individual contractor by the Materiel Sustainment Division to undertake an audit of the ACSSPO. After receiving advice from Defence Ethics, the consultant was restricted from undertaking the audit, as it would have created 'a perceived conflict of interest'.

3.19 Members of the Senior Leadership Group (including all star-ranked and Senior Executive Service personnel) are required to submit an annual written declaration of their interests and other officials are to submit declarations on an as needs basis. Defence personnel are also required to report any offer of post separation employment that could lead to a conflict of interest, prior to accepting the offer. Defence records show that declaration of interest forms were received from the delegate between 2019 and 2024, but not for 2023.

3.20 Mandatory Fraud and Integrity Awareness training must be completed by Defence personnel, at least every two years. Of the 42 personnel involved in LHD sustainment between January 2019 and December 2023, 40 had completed both the initial training and two-yearly renewal of Mandatory Fraud and Integrity Awareness training.¹¹⁰ Of the remaining two personnel, there was no data for one and the other had not renewed the training within the two-year timeframe.

3.21 In addition to Defence's general probity requirements, the Australian Government Contract Management Guide states that entities are to consider developing a probity plan which 'details the mechanisms for assuring probity for the management of the contract'.¹¹¹ Defence did not develop a probity plan for the ACPC contract.

Oversight

3.22 Governance, oversight and coordination arrangements for the management of LHD sustainment are set by the Materiel Sustainment Agreement (and Product Schedule), and until it

109 Department of Defence Accountable Authority Instruction (AAI) 1 Managing Risk and Accountability.

110 A total of 42 training records were reviewed. While the August 2023 ACSSPO organisational chart listed 51 positions, some positions were vacant, and several Defence officials were listed against multiple roles. In addition to the staff listed in the organisational chart, training records were also reviewed for former ACSSPO officials, finance advisors, and the delegate (past and present).

111 Department of Finance, *Australian Government Contract Management Guide*, July 2023, p. 18.

expired in mid-2024, the ACPC contract. The Materiel Sustainment Agreement-related forums — Navy Sustainment Review Board, Ship Repair Governance Board, Operational Sustainment Management Meetings and the Project Executive Board — met in accordance with their terms of reference.

3.23 In respect to the key ACPC-based forums:

- the LHD Asset Class Enterprise Steering Group was established in August 2021, two years after the commencement of the ACPC; and
- the LHD Asset Class Enterprise Executive Management Group had been operating for two and a half years without approved terms of reference and there were shortcomings in the meeting records for 23 out of 52 meetings (44 per cent).

Risk management

3.24 Section 16 of the PGPA Act requires accountable authorities of Commonwealth entities to establish and maintain appropriate systems and internal controls for the oversight and management of risk. Risk management arrangements with respect to LHD sustainment are dispersed across a range of artefacts, including the Materiel Sustainment Agreement, the LHD product schedule, the ACPC contract and other Defence plans or policies.¹¹² These artefacts allocate risk management responsibilities at various levels (from strategic to operational) and to various parties (such as NSSG, Navy and the prime contractor), and require risks to be documented in a number of disparate systems.

Risks managed by Defence

3.25 An integrated approach to risk management has been a goal within Defence since at least 2013, with each product schedule since then stating that:

- ‘Navy and [CASG/NSSG] are to operate under their existing Program Enterprise Risk Management Systems and the integrated risk management approach detailed in the MSA [Materiel Sustainment Agreement]’.
- the parties are to ‘work towards a mutually accessible and integrated Enterprise Risk Management System’.

3.26 As set out in Table 3.2, there remains substantial scope for Defence to achieve further integration between its risk management systems, providing greater line of sight between enterprise level and product level risks.

112 Other artefacts include the Defence Capability Manual (and supporting guidance documents), the Capability Acquisition and Sustainment Risk Management Manual, Navy’s N-Library procedural framework, and the ACSSPO Enterprise Risk Management Plan.

Table 3.2: Sources of risk management requirements for the LHDs and corresponding ICT systems or registers to capture the assessment of risks

Source document	ICT system or register
Risks managed by Defence	
2019 Materiel Sustainment Agreement Six interdependent CASG and Navy-level risks. ^a	Sustainment Performance Management System (SPMS) — Defence's primary sustainment reporting and performance management system (see paragraphs 4.15 to 4.17).
LHD Product Schedule Five capability limitations and risks specific to the LHDs. ^b	Predict! risk register^c — mandated business tool for documenting project- and product-level risks since May 2023. At January 2024, a total of 11 risks were recorded for LHD sustainment in Predict!: eight had a rating of medium, two were low, and one was very low. Of these 11 risks, one had been reviewed at least annually, and risk status information was recorded for three risks. There was no status or review history recorded for the other seven risks.
Technical risks and hazard reporting Technical risks are managed as part of the engineering change management process and are associated with approved Requests for Problem Resolution (RPRs) and deferred planned maintenance.	Technical Regulatory Management System (TRMS) — for engineering risks that adversely affect materiel seaworthiness, safety or capability. At January 2024, there were 113 active risks relating to LHD sustainment in TRMS, of which none were rated as high or very high. There were 58 risks rated very low, 45 rated low and 10 with a risk rating of medium. Asset Management and Planning System (AMPS) — the primary maintenance management tool for the maritime domain, including the LHDs (see paragraphs 3.35 to 3.39 and 4.15). Configuration Management Tool — Unified (CMT-U) — Maritime whole-of-fleet configuration management tool, intended to be the single source of truth for all ships Sentinel — Defence's work, health and safety (WHS) management information system.
ACSSPO Enterprise Risk Management Plan Provides guidance to ACSSPO decision makers in 'identifying, analysing, prioritising, and mitigating risk through tailored assurance activities.' ^c	The ERMP states that: <ul style="list-style-type: none"> in addition to the governance and oversight forums Quarterly Enterprise Risk Reviews and internal audits may be used as risk review mechanisms; and a Supplier Assurance Register is used to document supply and contractor risks. As at May 2024, Defence had not established a Supplier Assurance Register. As at May 2023, the ACSSPO Enterprise Risk Management Plan was last approved in February 2023.
Sea Release Assurance Framework Outlines arrangements for seaworthiness and battleworthiness risk.	Seaworthiness Management Assurance and Reporting Tool (SMART) — Navy's register for seaworthiness issues and risks (for example, Urgent Defects, Operational Limitations, overdue maintenance tasks); and manage day to day fleet seaworthiness risks and issues.

Source document	ICT system or register
Risks managed by the ACPC contractor	
Enterprise Risk and Issue Management Plan (ERIMP)	<ul style="list-style-type: none"> • Risk and issues registers to be maintained by separate functional areas, programs and integrated project teams. • A further register that was to be submitted to Defence with each Total Budget Estimate (TBE) period and updated annually (see paragraphs 3.28 to 3.30).

Note a: These risks were: inadequate whole-of-life asset management; inaccurate whole-of-life costing of assets; Navy and CASG acting independently; failure to promote a technical excellence culture; failure to provide clear direction and guidance; and failure to take accountability and responsibility.

Note b: These risks or limitations were: incomplete or incorrect stores available for maintenance; current operational limitations; sustainment budget/future affordability; issues with the configuration baseline of the LHDs; and limited availability of trained marine technicians.

Note c: Predict! was initially rolled out during 2022. Auditor-General Report No.14 2023–24, *2022–23 Major Projects Report*, paragraph 1.92, outlined four key application control weaknesses in the Predict! system.

Source: ANAO analysis of Defence records.

3.27 The approach adopted by Defence for managing sustainment-related risks has resulted in risks at the strategic and operational levels being managed separately. That is, there is no hierarchy or clear line of sight between the organisational level risks identified in the Materiel Sustainment Agreement and those at the operational and technical levels, including the LHD-related risks documented in the LHD product schedule.

Risks managed by the ACPC contractor

3.28 The ACPC contract allocated some LHD-related risks and issues to be managed by the prime contractor. These risks were managed under the Enterprise Risk and Issue Management Plan (ERIMP), approved on 8 November 2019.¹¹³ The ERIMP set out that risk and issues registers would be maintained by separate functional areas, programs and integrated project teams, with overall ownership and management of registers sitting with the LHD Executive Management Group established under the ACPC contract.

3.29 The prime contractor also maintained a further risk register that was established in 2019, to be updated and submitted to Defence annually with each Total Budget Estimate (TBE) submission. For the five TBE periods examined:

- registers for two TBE periods — TBE 2 (2020–21) and TBE 3 (2021–22) — were not submitted; and
- registers for TBE 4 (2022–23) and TBE 5 (2023–24) were submitted in February 2023 and July 2023, respectively.

3.30 The number of risks recorded in the registers decreased over time, from 56 risks in 2019, to 28 in 2022–23, and 11 in 2023–24. Risks relating to the delivery of quality work and value for money by the prime contractor and its sub-contractors were not covered by the registers for the ACPC and Capability Support Coordinator contracts. These risks were later realised, as discussed in paragraphs 3.47 to 3.70.

¹¹³ The ACPC contractor's ERIMP stated that there was no formal definition of risk in the head contract, and for the purposes of the plan was defined as 'the likelihood and consequence of a hazard occurring where a hazard is a potential loss or harm'.

Recommendation no. 4

3.31 The Department of Defence reviews and documents its LHD risk management arrangements, including the use of various ICT systems and oversight forums, with a view to identifying efficiencies, where possible, and ensuring that risks are appropriately identified, and actively managed with clear line of sight.

Department of Defence response: *Agreed.*

3.32 *Defence agrees to the recommendation.*

Has Defence effectively managed its sustainment contracts?

Defence did not manage its primary LHD sustainment contracts as intended by its performance-based design. As a result, Defence cannot assure itself or ministers that sustainment services were delivered effectively and in accordance with the contracted requirements. Key deficiencies were that Defence did not:

- ensure that all mandatory reports were submitted in a timely manner by the contractor;
- undertake full or timely assessments of the contractor's performance;
- ensure that all key sustainment deliverables had been completed in full prior to making payments to the contractor; or
- use the full range of levers available in the contract to drive satisfactory performance.

Between 2021 and 2023 there were at least three separate allegations of fraudulent activities or instances of poor sub-contracting practices related to the ACPC contract. Defence did not seek further information from the contractor on the 2023 allegations and did not change its approach to managing the contract after being notified of the various issues.

Contract variations

3.33 Defence varied the ACPC contract 47 times between December 2018 and June 2024. Of those 47 changes, 17 had no impact on the price of the contract, nine reduced its value, and 21 increased its value. The approval (under the PGPA Act) for the final variation recorded a total contract value of \$705.29 million (GST inclusive), an increase of \$105.31 million from the original contract value of \$599.98 million.¹¹⁴

Milestone deliverables and assurance arrangements

3.34 The ACPC contract set out five 'phase-in milestones' and, across each financial year (or Target Cost Estimate period) of the contract, 30 'management services key activity milestones'. Most milestones required a Commonwealth representative to certify Defence's acceptance and/or approval for achievement of the milestone. Over the life of the ACPC contract, milestone payment

¹¹⁴ Some increases to the ACPC contract value were funded through the Capability Assurance Program, rather than through LHD sustainment funding. These increases were captured in the ACPC contract change proposals. Increases to the value through the survey and quote mechanism under the contract were not documented in ACPC contract change proposals.

amounts were amended and 13 additional milestones were added through contract change proposal processes.

3.35 Defence has an established framework to identify need, plan, execute and assure itself of the completion of sustainment activities — primarily through procedures in the ‘N Library’ suite of documents and the Asset Management Planning System (AMPS).¹¹⁵

3.36 Planned maintenance tasks are to be raised through an annual work program planning process and by the ship’s crew on an as needed basis by submitting maintenance requests through AMPS. Once completed, maintenance tasks are to be documented by the prime contractor in a Task Progress/Completion Certificate and accompanied by ‘Objective Quality Evidence’ for each task.¹¹⁶ The Task Progress/Completion Certificate, work package completion report and supporting data on AMPS is then used to inform a report on the condition of a vessel on completion of an external maintenance activity.

3.37 The ACPC contract contained specific provisions for audit work or surveillance activities on the work performed by the ACPC contractor or its sub-contractors.¹¹⁷ To date, Defence has conducted a number of internal audits, including audits of the LHD Enterprise, 11 supplier safety assurance audits and five supplier quality assurance audits. Of the 57 audits planned as at July 2024, 10 had yet to commence, three were incomplete and seven were ‘cancelled’.

Asset Management Planning System (AMPS) upgrade issues

3.38 In 2020, Defence identified the need to replace AMPS version 6.3 with version 7 in order to maintain and assure cyber worthiness and seaworthiness of Navy surface platforms.¹¹⁸ The AMPS 7 upgrade project experienced implementation issues including reduced functionality, data loss between shore and ship, and a growing backlog of data. In February 2023, the prime contractor reported to the ACSSPO that the rollout of AMPS 7 had caused ‘large delays and continuous duplication of efforts’.

3.39 AMPS issues have impacted productivity, with end users reporting that AMPS 7 was ‘significantly slower to plan and close out maintenance [tasks] than AMPS6.3’. For example, it was recorded in the SPMS that the close out of 400 maintenance tasks went from being finalised in three days under AMPS 6.3 to 27 working days under AMPS 7. A review into the AMPS 7 Upgrade Project (conducted by Deloitte) also reported that the AMPS 7 reporting capability was not fit for purpose and was considered to be ‘insufficient in addressing the business needs’.¹¹⁹ These issues can undermine Commonwealth assurance over the completion of contractor maintenance tasks.

115 AMPS is the primary maintenance management tool for Navy’s maritime vessels, including the LHDs, frigates, air warfare destroyers and offshore patrol vessels.

116 Objective quality evidence may include an opening report, evidence of work completed, installation and test plan(s), calibration documentation, certification documentation and closing report. All evidence is to be saved on AMPS. On 14 February 2024, Defence advised the ANAO that prior to the Commonwealth signing off on the Task Progress / Completion Certificate, objective quality evidence is verified and validated to ensure that work is conducted in accordance with work instructions.

117 The contract set out that the Commonwealth may perform site inspections, system audits, process audits and product audits in relation to work performed by the contractor or subcontractors.

118 AMPS 6.3 was also at high risk of becoming incompatible with planned upgrades of the Defence Protected Environment (DPE) and Fleet Information Environment.

119 The review stated that generating reports in AMPS 7 took much longer — 20 minutes compared to two minutes under AMPS 6.3.

Contracted reporting and monitoring arrangements

Contract reporting requirements

3.40 The contract set out two types of regular reports to be submitted by the contractor: annual contract status reports and quarterly combined services summary reports (see Appendix 3). The ACPC Statement of Work Contract Data Requirement List summarised over 60 other contract deliverables to be submitted by the prime contractor.

3.41 The contract status report was to be ‘the Contractor’s principal statement and explanation of the status of the Contract at the end of each reporting period.’ In August 2022, Defence raised a ‘corrective action request’ with the ACPC contractor, Naval Ship Management (NSM), stating that there was ‘no evidence to show that’ contract status reports for 2019–20, 2020–21 and 2021–22 had been prepared and submitted.¹²⁰ In September 2023, Defence advised the ANAO that NSM had yet to submit a contract status report, and no further action had been taken by Defence at that time.

3.42 On 9 May 2024, NSM submitted the contract status report for the fourth period (2022–23), 10 months after the end of the reporting period. Contract status reports for the first three years of the contract were not submitted. On 20 May 2024, 42 days before expiry of the ACPC contract, Defence varied the contract to remove the requirement for NSM to submit the 2023–24 contract status report — the fifth and final target cost estimate period under the contract.¹²¹

3.43 A May 2021 Independent Assurance Review (IAR) of LHD sustainment raised concerns about both the quality and timeliness of the quarterly combined services summary reports (CSSRs) required from NSM. Summary reports for 2019–20 were submitted between six and 15 months late, with all four reports submitted on 10 January 2021. The IAR report stated that the summary reports were ‘not adequate to support good governance’ and that the timeliness of reporting ‘needs serious attention.’ Defence established quarterly CSSR review meetings with NSM in 2022, as recommended by the IAR. In September 2023, Defence advised the ANAO that minutes were not recorded for these meetings.

3.44 Contract management guidance established by the Department of Finance indicates that maintaining and circulating meeting minutes, file notes and other records is a key element of effective contract administration.¹²² Failure to maintain appropriate records is also not consistent with Defence’s record management policy and exposes Defence to risk where key points of discussion, outcomes or actions are not properly recorded, particularly if disputes arise between parties to a contract.¹²³

120 The corrective action request also recorded that ‘other performance measures’ were not implemented as per the contract provisions.

121 The contract variation also removed the requirement for NSM to submit other plans and deliverables due in the fifth period, as they were considered to be ‘obsolete or no longer relevant’. The variation also added a new obligation for NSM to report on its workforce structure in quarterly combined services summary reports.

122 Department of Finance, *Australian Government Contract Management Guide*, Canberra, July 2023, p. 34, paragraph 2.8 available from <https://www.finance.gov.au/sites/default/files/2023-07/australian-government-contract-management-guide-july-2023.pdf> [accessed 17 June 2025].

123 These findings align with those of a 2023 Defence internal audit of contract management practices, which noted that ‘inconsistent record keeping, and weak assurance and compliance monitoring processes’ had contributed to deficiencies in contract management practices.

Contract monitoring arrangements

3.45 Performance reviews and award term assessments are processes to assess the contractor's performance against the ACPC contract. These processes are central to Defence's performance-based contracting framework. The ACPC contract set out four types of performance reviews to be undertaken: combined services performance reviews, contract performance reviews, performance assessment reviews and periodic cost reviews. Appendix 3 details the frequency of required performance review meetings.

3.46 Over its life, the contract provided for up to 45 performance review meetings to be conducted by Defence. In August 2024, Defence advised the ANAO that it had conducted seven combined services performance review meetings but did not undertake any periodic cost reviews.¹²⁴ Defence did not record minutes or otherwise document the review meetings that were undertaken.¹²⁵ An award term assessment was undertaken in 2022 and is discussed at paragraphs 3.52 to 3.53.

Management of performance issues

3.47 As discussed in paragraph 3.11, the contract contained provisions to protect the interests of the Commonwealth which may be exercised if the contractor did not provide the contracted services to an acceptable standard in accordance with the contract. These provisions included issuing a direction, exercising rights to substituted performance, requiring the contractor to prepare and comply with a remediation plan, withholding payments, recovering compensation, and issuing a default notice.

3.48 The May 2021 IAR of LHD sustainment found that NSM had been under-performing as the ACPC and stated that 'addressing NSM's issues is at the heart of improving the sustainment system.'¹²⁶ The IAR report stated that Defence was not well placed to decide whether to award a contract extension to NSM, because:

- a formal assessment of performance has not been performed to date, and the methodology has not yet been defined;
- the number of performance reports available to support a decision is limited;
- although under-performance has reportedly been frankly discussed with ACPC management and the Joint Venture board members, NSM has not been comprehensively and formally informed of the aspects of under-performance that need to be addressed to support a decision to award a term extension.

124 In December 2023, Defence advised the ANAO that it could not provide documentation of Defence's six-monthly assessment of strategic performance measures or NSM's six-monthly system health indicators reports.

125 In August 2024, Defence provided the ANAO with copies of seven calendar invitations for combined services performance review meetings held between August 2022 and March 2024. Defence also advised that Executive Management Group meetings were used as a forum to review NSM's service delivery and financial performance.

126 The May 2021 IAR reported that above-the-line resources (the CSC contractor) and Navy personnel had been stepping in to supplement the work of the ACPC — a situation which had also happened under the previous TISSC contract (discussed at paragraphs 2.55 to 2.65). It also noted that priority had been placed on achieving materiel availability (that the ship be available to Navy) and supporting operational tasking (for example, exercises, operations and humanitarian and disaster relief), at the expense of attention to sustainment efficiency and materiel confidence.

3.49 Other than requesting remediation plans, Defence did not exercise any of the available contractual provisions for performance management under the ACPC contract.

Remediation plans

3.50 Defence could request that a contractor prepare and comply with a remediation plan to address any problems, or failure to perform or provide any of the services under the ACPC contract. Over the life of the contract, Defence issued three requests for remediation plans to NSM as follows.

- On 29 October 2020 — two remediation plans: one for the supply support area due to ‘significant omissions’ in the inventory investment plan (relating to stock procurement); and the second for the maintenance area, due to ‘a significant gap’ in the cost estimates for HMAS *Canberra*’s external maintenance periods in 2020–21.
- On 5 May 2021 — one remediation plan (the ‘enterprise remediation plan’), due to issues with the quality and timeliness of Task Progress/Completion Certificates and the associated supporting evidence. Defence’s request referred to ‘significant deviations’ between the reported seaworthiness status of HMAS *Canberra* in the final condition report and the submitted Task Progress/Completion Certificate and supporting evidence. In some instances, tasks were listed as ‘physically completed’ on the condition report, but in the closing reports and supporting evidence the same tasks were ‘either not undertaken, not completed, or had significant deficiencies’.
- On 7 October 2021 — one ‘master remediation plan’, which detailed a consolidated list of requirements and planned actions outstanding from previous plans. Defence specified a deadline of 28 February 2022 for the completion of all items and stated the following.

Completion of all of the steps and activities contained in Approved Remediation Plans, within the period specified in those plans, is a prerequisite, but not the only consideration or requirement, to NSM receiving a satisfactory performance rating for any Award Assessment Period ...

3.51 On 28 February 2022, NSM advised Defence that it considered all remediation plan items to be actioned and closed. In response, on 4 May 2022, Defence advised NSM that one item remained outstanding. That item was the submission of a contract change proposal, which was required to update the Annual Work List and Total Budget Estimate. This action item was closed about five months later.¹²⁷

Award term assessment

3.52 Under the ACPC contract, Defence was to conduct an award term assessment to determine whether a five-year extension to the contract should be granted. This involved assessing the contractor’s performance against the assessment criteria prescribed in the contract. On 9 May 2022, Defence completed an award term assessment of NSM’s performance, covering the period 1 July 2019 to 11 March 2022. The result was that the required performance standard had not been met for four of the seven criteria, with Defence assessing NSM as ‘unsatisfactory’ against the following criteria:

- the Contractor has performed its obligations in a manner which satisfies the [value for money] objectives of the Contract

¹²⁷ The contract change proposal was submitted by NSM on 25 May 2022. The resulting deed of amendment executed by Defence on 5 August 2022.

- the Contractor's behaviours have positively contributed to the Contractor's performance against [the contract]
- the Contractor's performance for each KPI in every Review Period during the Award Assessment Period was assessed as being in Performance Band A or B
- the Contractor has not been required to raise a Remediation Plan or, where one or more ... have been required the Contractor has ... completed all of the steps and activities contained in the Approved Remediation Plan(s)

3.53 The contractor's performance against some of the KPIs had been excluded from the assessment where Defence had granted performance relief or where KPI scores had not been finalised. The remaining three criteria were deemed 'not applicable' as Defence and NSM had not undertaken an assessment of these criteria during the award term assessment period.¹²⁸ On 24 June 2022, Defence informed NSM that the:

Commonwealth has decided not to accept [NSM's award term extension] proposal in light of the Award Term Determination and [Defence's] strategic decision to transition LHD sustainment to the Future Maritime Sustainment Model in July 2024.

3.54 The Maritime Sustainment Model is discussed from paragraph 4.54.

Management of allegations of mismanagement and fraudulent activity

3.55 In the period 4 to 9 September 2022, two anonymous disclosures concerning NSM's procurement practices were made to a Navy officer conducting an Inquiry Officer Inquiry.¹²⁹ The inquiry was examining the 'facts and circumstances surrounding the two total power failures in HMAS *Adelaide*' while the ship was deployed to Tonga in January 2022 for humanitarian and disaster relief work. The disclosers reported issues 'specifically in relation to the EMP (External Maintenance Period) completed prior to HMAS *Adelaide*'s departure for Tonga in January 2022'. These disclosures included the following claims.

- Favouritism by the ACPC contractor towards certain subcontractors, as well as sub-standard work practices, 'blacklisting' of suppliers if concerns were raised with the contractor, and alleged 'bribery or kick-backs requiring sub-contractors to pay individuals cash to receive a subsequent contract'; and
- Invoices were submitted and paid for before tasks had been completed in full or prior to the submission of close-out reports as required by the contract. It was also reported that the ACPC contractor would 'shop around' to find a Commonwealth representative to sign-off on the completion of tasks.

3.56 Defence Administrative Policy states that managers and commanders must report incidents within 24 hours to a Defence Investigative Authority for consideration of formal investigation under

128 The three criteria deemed 'not applicable' involved the contractor's performance against 'other performance measures', outcomes of any periodic cost reviews, and an assessment or review of the continuous improvement and efficiency program.

129 The inquiry was conducted under the *Defence (Inquiry) Regulations 2018*. Defence's 'Administrative Inquiries Manual' states that inquiries are a means 'to determine the facts and circumstances surrounding an incident or situation so that informed decisions can be made about what actions are required.' The inquiry followed on from a 'technical investigation' into the incident and was to expand on some of that investigation's findings.

the Australian Government Investigation Standards.¹³⁰ Navy determined that these issues were outside the scope of the inquiry and referred the allegations to CASG (now NSSG) on 25 September 2022. The following day, some three weeks after the first disclosure was made, Defence Integrity Division was informed of the allegations.

3.57 During this period, CASG also commenced its own enquiries into the allegations.¹³¹ Defence guidance states that the conduct of informal reviews, such as CASG's enquiries, introduces the risk of irretrievable prejudice to possible future disciplinary or criminal proceedings. Defence advised the ANAO in June 2025 that the enquiries informed the Defence Integrity Division decision not to commence a formal investigation. According to Defence's investigations case management system, the matter was closed due to the absence of further information.

3.58 CASG advised NSM directly of the issues on 18 October 2022. The issues were further discussed between a senior CASG and a senior representatives at a meeting on 21 October 2022.¹³² At this meeting, NSM advised that it had investigated similar complaints in 2021 and provided Defence with an extract from the respective September 2021 report.¹³³ The report upheld the allegations of poor procurement practices and favouritism towards certain subcontractors and included recommendations to 'assist with improving procurement practices at NSM.' The 2021 NSM review did not cover the allegations in relation to kick-backs or bribes.

3.59 The one-star CASG representative concluded in a noting brief for Defence leadership that '[w]ithout further information or evidence on allegations of offering bribes for subcontracts, there is no evidence held by [CASG] or NSM to support that claim ... Unless the anonymous complainants can provide further evidence a conclusion of no corrupt activity is concluded.'¹³⁴ For noting briefs such as this, Defence's usual practice is to include key supporting documents such as the NSM report extract as an attachment. The report was not provided with the brief, nor was it filed in Defence's record keeping system at the time.¹³⁵

3.60 The noting brief was finalised on 28 November 2022 and on 5 December 2022 the Defence Integrity Division confirmed that CASG's approach was 'a sufficient response to the allegation of corrupt behaviour'. The brief — which in April 2023 was provided to the Chief of Navy — documented the similarities between the 2021 and 2022 allegations, but focused largely on the 2021 NSM report rather than the more recent matters reported to Defence. The brief stated that

130 Defence policy at the time defined a Defence Investigative Authority as the Directorate of Investigations and Recovery within the Defence Integrity Division; the Joint Military Policing Unit; and the Directorate of Security Intelligence and Investigations within the Defence Security and Vetting Service.

131 The review was conducted by the senior Defence officer (one-star) with responsibility for the ACSSPO's relationship with NSM and the performance of the ACPC contract.

132 Defence was represented by the same one-star officer responsible for the ACPC contract. While a representative from the Defence Integrity Division was not present at the meeting, CASG had agreed to keep Defence Integrity informed of its discussions with NSM.

133 In June 2021, NSM staff raised concerns regarding NSM's conduct under the ACPC contract. The claims were made as a whistleblower report under the UGL whistleblower policy. At the time of the allegations, UGL was the Joint Venture 'parent' company of NSM. UGL undertook a 'procurement audit' to investigate the allegations to determine whether they held merit. The report was completed in September 2021.

134 The delegate sent a draft copy of the brief to NSM's General Manager for review and 'broad feedback' on 23 October 2022, prior to it being sent to senior Defence officials later that day. NSM provided comments on 24 October 2022. These comments were not adopted in the final version of the brief.

135 Defence filed a redacted extract of the 2021 NSM report summary during the course of this audit, in December 2023.

the incident did not constitute a notifiable incident. This was not consistent with Defence's definition of a notifiable incident, which includes any incident that 'involves allegations of fraud, corrupt practices or behaviour' and 'collusive tendering'. The brief also stated the following.

- NSM's response to the previous allegations 'was of the highest order' and was 'a thorough, appropriate and sufficiently independent investigation to satisfy a standard that would be acceptable to the Commonwealth.'
- A range of 'contributing factors' were identified as creating 'an environment' for the issues to have occurred and that the consecutive dockings of HMAS *Adelaide* and HMAS *Canberra*¹³⁶, poor LHD data quality from acquisition, an immature NSM workforce, impacts of COVID-19 and shortfalls in Navy and CASG workforce were also contributing factors to NSM's poor procurement practices.
- Since the 2021 allegations, there was a 'notable increase' in NSM's performance as a result of implemented remediation plans (see paragraphs 3.50 to 3.51) and the recruitment of a number of 'highly skilled and capable managers.'

3.61 As discussed in paragraph 3.37, the ACPC contract contains a provision for Defence to undertake supplier quality assurance (QA) audits. The noting brief recommended that the ACSSPO should: 'conduct additional Supplier quality assurance activities on NSM procurement and maintenance practices over the next six months and provide formal reports' to the responsible one-star CASG officer. Defence advised the ANAO in December 2023 that the additional QA activities recommended in November 2022 were 'not required' since a supplier assurance audit on NSM had already commenced in June 2022.¹³⁷ A report for that QA audit was not prepared. After this, no further supplier assurance audits of NSM were undertaken.¹³⁸

3.62 Defence did not seek assurance from NSM that the recommendations in its September 2021 report had been implemented. Defence was also unaware of how many recommendations were made as it did not request a full copy of the report. Defence advised the ANAO in August 2024 that '[i]nternal confidential audits by a Supplier that do not find criminal or fraudulent actions are not routinely required to be notified to Defence'. Defence also noted that NSM had been assessed as under-performing against the contract requirements and 'as "Not achieving Value For Money" during this period'.

3.63 Whole-of-government contract management guidance recommends that a fraud control plan be developed where significant risks are identified. Defence did not develop a contract level fraud control plan in response to the allegations. Neither the ACPC Contract Management Plan nor the ACPC Liability Risk Assessment (discussed at paragraphs 3.14 to 3.16) addressed fraud-related

136 The completion of the major 'external maintenance period' for HMAS *Canberra* was delayed and resulted in both ships being in maintenance concurrently in late 2021.

137 The June 2022 supplier assurance audit focused on the selection of repair agents. Defence reviewed a sample of 10 requests for quotations for maintenance tasks, the quotes received from repair agents, and the final costs of each sampled maintenance task. This information was requested from NSM in November 2022. NSM provided its response in March 2023.

138 Defence has undertaken supplier safety assurance audits since that time, which focused on NSM's compliance with work, health, and safety (WHS) requirements.

risks in the context of extensive subcontracting under a prime contractor model.¹³⁹ The ACPC Liability Risk Assessment was not updated since it was prepared in June 2018, and as noted in Table 3.3, Defence did not establish a Supplier Assurance Register to document contractor risks.

3.64 The allegations of fraudulent conduct in September 2022 did not result in further contract risk assessments or a change in Defence's approach to managing the contract. Existing contractual provisions, such as additional supplier assurance audits and periodic cost reviews — which exist in part to provide assurance over NSM's procurement and sub-contracting arrangements — were not employed by Defence.¹⁴⁰

2023 notification of possible illegal conduct

3.65 In accordance with the requirements of the ACPC contract, NSM wrote to Defence on 18 October 2023 to advise of possible illegal conduct involving suppliers at the Garden Island Defence Precinct. The correspondence advised that NSM had already referred the matter to the relevant external investigation authority, completed an internal investigation, and planned to provide additional training to its staff 'to assist with early detection and prevention of these types of activities.'

3.66 The ACSSPO notified the CASG Materiel Procurement Branch and Defence Integrity Division of the allegations on 18 and 19 October 2023, respectively.¹⁴¹ Advice from each area related to whether the issue was a 'notifiable incident' under Defence's Administrative Policy framework (see paragraph 3.56). Defence Integrity Division advised the ACSSPO that, as there was no 'direct involvement' of a Defence employee, this was not a notifiable incident, and recommended that the ACSSPO tell the contractor to 'report the matter, abiding by their legislative requirements.' This advice was inconsistent with Defence's Accountable Authority Instruction 1, which defines Defence personnel to include contractors, consultants, and outsourced service providers. The advice also did not state what these legislative requirements were and did not acknowledge that a prime contractor had reported the matter to the ACSSPO as it was required to do under the contract and in accordance with Defence policy.

3.67 The Defence Integrity Division further advised that if the ACSSPO 'become[s] aware of any specific details or companies involved, we would suggest referring the matter to fraud investigations.'¹⁴² In August 2024, Defence advised the ANAO that NSM had not provided further information or updates on the matter, and no further action had been taken by Defence.¹⁴³

139 The contract management plan does not refer to fraud risk. The liability risk assessment refers to fraud in relation to liability exclusions. A 2023 Defence Internal Audit on contract management practices found that 83 per cent of complex contracts did not meet the additional contract management requirements in relation to security, probity and fraud risk.

140 During this period (June 2021 and October 2022), NSM's parent company Babcock tendered for two contracts under Defence's Maritime Sustainment Model: Regional Maintenance Provider (RMP) West, which was awarded to Babcock in October 2022; and RMP East, for which the request for tender closed in October 2022. RMP East is discussed further in Chapter 4.

141 ACSSPO provided a copy of the formal correspondence received from NSM in the email to CASG Materiel Procurement Branch but did not provide a copy of the letter, or identify the name of the prime contractor, in the email to Defence Integrity Division.

142 Fraud Investigations is a Branch within the Defence Integrity Division.

143 On 13 June 2025, Defence advised the ANAO that 'The information provided to Defence Integrity Division was incomplete, which lead to the provision of advice that was inconsistent with Defence's Accountable Authority Instruction 1.

3.68 Defence's policy framework, as well as its 2022 Fraud and Corruption Control Plan, establish that an instance of alleged fraud or corruption is considered a notifiable incident, and 'must be reported to the chain of command/management and a Defence Investigative Authority.' Defence guidance to industry sets out that private sector individuals should report concerns about unethical or unlawful conduct to the nominated Defence point of contact. After receiving the report of alleged illegal conduct, Defence did not request further information from the prime contractor or advise the contractor to report the matter directly to Defence Fraud Investigations (within the Defence Integrity Division).

Recommendation no. 5

3.69 Where the Department of Defence is notified of incidents such as suspected fraud or unethical conduct, the Department of Defence ensures that its response is fully documented and conforms to Defence policies and the *Commonwealth Fraud and Corruption Control Framework*.

Department of Defence response: *Agreed.*

3.70 *Defence agrees to the recommendation.*

Arrangements for financial management

3.71 The ACPC contract used a target cost incentive model, which was designed to allow Defence to assess the contractor's cost performance and moderate its entitlement to profit through a target cost estimate (TCE) and true-up process (discussed at paragraphs 3.75 to 3.77).

Claims for payment

3.72 Defence has approved and made milestones payments for deliverables that it later reported to the contractor as substandard and in need of remediation. For example, on 21 September 2020, Defence approved the submission of an inventory investment plan, noting 'minor omissions or defects'.¹⁴⁴ The approval correspondence requested that NSM submit an invoice for this milestone payment. On 29 October 2020, the same milestone deliverable was subject to a remediation request, with Defence citing 'significant omissions' relating to stock procurement in the inventory investment plan.¹⁴⁵

3.73 On 22 February 2021, Defence executed a contract change proposal that increased the budget for 2020–21 (TBE 2) by \$8.67 million (GST exclusive). Advice to the delegate reported that the budget increase was 'ultimately a function of incomplete pricing and poor assumptions' by the contractor when developing the TBE 2 budget and the omission of 'significant pod propulsion work' from the inventory investment plan.¹⁴⁶ The budgeted amount for pass through stock items had also tripled, from \$4.85 million to \$14.60 million, because stock items had largely been procured through sub-contractors. The advice to delegate stated that there was 'an obvious value for money issue'

144 The approval matrix listed three categories for approval: 1) issue is serious and a ground for non-approval; 2) issue is minor and must be rectified; and 3) these comments are provided for information and assistance. The inventory investment plan was approved as category 2.

145 The request for remediation plan letter noted 'While the IIP [inventory investment plan] was approved noting this omission (Reference B), it raises the inference that NSM's supply support area failed to engage with the [Systems Program Office], despite the continued assistance of [Systems Program Office] personnel'.

146 Defence approved NSM's budget submission for 2020–21 (TBE 2) on 28 September 2020.

that ‘raises the concern that this expenditure is not an efficient, effective and economic means of utilising public funds’.

3.74 Whole-of-government contract management guidance provides that that ‘payment for goods and services should always be linked with satisfactory performance’.¹⁴⁷ By accepting and paying for a milestone deliverable that was below the expected contractual standard, Defence did not appropriately discharge its legislative duties for the proper use of public funds or in accordance with Australian Government and Defence contract management policies.¹⁴⁸

True-up process and painshare/gainshare results

3.75 The true-up process is designed to create cost accountability through an assessment of the contractor’s actual costs against the corresponding budgeted amounts for a given annual TCE period. The contract provided that NSM could raise Enterprise Efficiency Proposals detailing actions and estimates of savings, for Defence’s assessment. If approved, the incentive payment to NSM was to be 60 per cent of the efficiency saving. Over the life of the ACPC contract, no enterprise efficiency proposal profit was included in true-up profit calculations (see paragraph 3.13).

3.76 NSM received performance payment scores of 100 per cent for three out of four true-ups. This includes TCE 3 (2021–22), which coincided with the ongoing close out of remediation action items.¹⁴⁹ In August 2024, Defence advised the ANAO that NSM’s issues of underperformance ‘did not relate to performance against the [KPIs] defined in the contract’, so could not be considered for performance payment scores. Table 3.3 summarises the contractor’s gainshare amounts and performance payment scores for each TCE period.

Table 3.3: ACPC painshare/gainshare results and performance payment scores

TCE period	Gainshare (\$ AUD)	Performance payment score
TCE 1 (2019–20)	1,143,316	100.0 ^a
TCE 2 (2020–21)	1,424,017	69.3
TCE 3 (2021–22)	1,494,605	100.0
TCE 4 (2022–23)	1,616,774	100.0

Note a: Defence approved a CCP (CCP 003) in September 2019 that entitled NSM to an ‘adjusted performance score’ of 100 per cent for all KPIs for TCE 1, regardless of the actual adjusted performance scores achieved. The PGPA Act section 23 commitment approval for CCP003 stated that this change was ‘because the Commonwealth acknowledges that NSM is still transitioning into the ACPC’. As a result, a Performance Payment Score of 100 per cent was assumed for TCE 1.

Source: ANAO analysis of Defence documents.

3.77 The TCE 1 true-up was submitted in July 2021, 13 months after the close of the TCE period.¹⁵⁰ The TCE 2 was submitted 12 months after the close of the TCE period. The TCE 3 true-up was

147 The Defence Contract Management Handbook further states that, ‘before making any payments to the contractor, ensure that: a valid tax invoice has been received, and the good or services to which the payment relates meet the requirements of the contract’.

148 An entity’s accountable authority has a duty to promote the proper (efficient, effective, economical and ethical) use and management of public resources in accordance with the *Public Governance, Performance and Accountability Act 2013* (PGPA Act).

149 Examined in paragraphs 3.50 to 3.51. At May 2022, Defence advised NSM that one remediation plan action item was outstanding.

150 The Practical User Guide for the LHD ACPC contract indicates that the close out of the previous financial year’s True Up takes places in July and August — two months after the close of the TCE period.

submitted seven months after the close of the TCE Period, and TCE 4 true-up was submitted approximately five months after the end of the TCE period. These delays can limit Defence’s ability to use true-up cost information to inform future management activities.

Recommendation no. 6

3.78 Where the Department of Defence’s contracts with industry include mechanisms to obtain assurance over the completion of activities under the contract and the performance of suppliers, the Department of Defence ensures that contractual mechanisms are implemented.

Department of Defence response: *Agreed.*

3.79 *Defence agrees to the recommendation.*

4. Performance monitoring and reporting

Areas examined

This chapter examines the Department of Defence's (Defence) establishment of appropriate performance monitoring and reporting arrangements for the Canberra class Landing Helicopter Docks (LHDs).

Conclusion

Defence has established partly appropriate performance monitoring and reporting arrangements for the Canberra class LHDs. Sustainment outcomes have largely met Navy's requirements for the operational use of the platforms. The long-term availability and reliability of the LHDs is at risk primarily due to the accumulation of urgent defects, maintenance backlogs and shortfalls in personnel to undertake organic level maintenance. As a result, the LHDs have experienced critical failures, impacting on Navy operations.

Defence's transition to the new Maritime Sustainment Model lacked reliable and complete information on the expected performance of sustainment contractors. Value for money outcomes for the procurements under the new model were limited by poorly implemented probity arrangements and the procurements commencing later than planned, reducing the time available to resolve issues during contract negotiations.

Areas for improvement

The ANAO made three recommendations for Defence to strengthen its performance framework, improve its probity arrangements and benchmark performance under the Maritime Sustainment Model.

4.1 Defence's performance framework for materiel sustainment is a key tool for gauging whether its sustainment activities are effective and meeting Navy's operational requirements. In July 2024, Defence transitioned its sustainment contracting and delivery arrangements for the LHDs from the Asset Class Prime Contractor to a new Maritime Sustainment Model. The new model was introduced to improve coordination, standardisation and consistency in naval sustainment and was established through three procurement processes.

Did Defence implement an appropriate sustainment performance framework?

Defence has established a sustainment performance framework for the LHDs, with performance measures set out in a written agreement and reporting provided to senior Defence leadership. The performance measures adopted are relevant to the LHDs but are not fully reliable and do not provide a complete and clear picture of sustainment performance as some important areas of sustainment are not covered. For some performance measures, the nature of the targets selected has led to reporting that does not provide a fair presentation of performance results for the LHDs.

4.2 Navy's *Materiel Sustainment Agreement Performance Framework* (MSA performance framework) provides guidance to Defence personnel on selecting appropriate performance

measures for each of Navy's capabilities and platforms. The framework was established in 2014 and last reviewed in full in 2020.

4.3 The performance reporting arrangements agreed between the Royal Australian Navy (Navy) and Defence's Naval Shipbuilding and Sustainment Group (NSSG) for the LHDs are recorded in the 'Product Schedule' (see paragraphs 3.8 to 3.10).

Performance measures for LHD sustainment

4.4 Performance measures are selected on a case by case basis for each platform from a suite of seven key performance indicators (KPIs) and 15 key health indicators (KHIs) detailed in the MSA performance framework.¹⁵¹ The combination of measures chosen 'must contribute directly to the achievement of 'one or all' of the following three 'core outputs'.

- Materiel availability: the Navy product is available for use at its agreed specification and configuration baseline, in accordance with air- and sea-worthiness requirements.
- Materiel confidence: that the Navy product will remain available and at the agreed performance specification through its life.
- Sustainment efficiency: use of the funds available (expenditure against planned and allocated budgets) and the actions to improve the cost-effective use of those funds.

4.5 The LHDs are monitored against four KPIs and 15 KHIs from the MSA performance framework.¹⁵² The four KPIs are titled: 'monthly materiel ready days achievement'¹⁵³; 'external maintenance period — milestone achievement'; 'year to date price achievement'; and 'conformance to operating intent'.

Appropriateness of performance measures

4.6 Appropriate and meaningful performance information includes measures that are relevant to purposes, reliable and unbiased, and complete.¹⁵⁴ The performance measures in the LHD product schedule are relevant to the sustainment of the LHDs and contribute towards Navy's three core outputs to varying degrees. Some of these measures have direct links to a core output, while others have secondary or indirect links. In aggregate however, the LHD performance measures are not fully reliable as they do not provide a complete and clear picture of performance as they have limited coverage over some important areas. For example:

151 Under the framework KPIs provide guidance as to the effectiveness of actions and processes put in place between both parties to the agreement and have a direct relationship between an individual KPI and a particular product output. KHIs assist, through the identification and measurement of constraints, with the identification of contributing factors to future performance outcomes. The framework states that KHIs are best viewed in concert with other KPIs and KHIs.

152 One KHI is reported against separately for both the LHD and LHD landing craft.

153 A materiel ready day is a day where a ship is not in an external maintenance period, not in extended readiness, or is not subject to a Priority 1 urgent defect report that because of its nature prevents the ship from achieving its current tasking. Extended readiness is when a ship's level of readiness for operations is reduced (for example, it has been placed in dry dock or had crewing reduced) and it will require greater length of time to be ready for operational deployments. For further discussion on levels of readiness, see paragraphs 4.20 and 4.30 to 4.33.

154 The review of sustainment performance measures was informed by ANAO, *Insights: Reporting meaningful performance information*, ANAO, Canberra, June 2023, available from <https://www.anao.gov.au/work/insights/reporting-meaningful-performance-information> [accessed 17 June 2025].

- there is no available measure in to address conformance to the support intent (it is not included as performance measure in the MSA performance framework)¹⁵⁵;
- the LHD measures do not include the configuration baseline accuracy¹⁵⁶ or obsolescence liability¹⁵⁷ measures. The latter two measures were to be adopted by the Maritime Systems Division for all of its products, including the LHDs (see paragraphs 4.9 to 4.14); and
- the KPI for ‘monthly materiel ready days achievement’ (adopted for the LHDs) identifies the availability of the platforms but not whether the platforms were able to fully meet operational needs.

4.7 The MSA performance framework is accompanied by additional standardised instructions in ‘detailed data sheets’ for each performance indicator under the framework.¹⁵⁸ These instructions exist to support consistent measurement and reporting across all Navy products and platforms and state that each measure should have either a hard target or a rolling monthly average target.

4.8 All of the LHD’s documented performance measures have targets: the four KPIs have ‘hard’ targets and the 15 KHIs have either a short-term rolling average target, a hard target, or both. There are instances where the type of targets selected for some of these measures has led to reporting that does not clearly convey performance results for the LHDs. For example:

- Five KHIs are reported against short-term rolling averages rather than ‘hard’ targets. The short-term rolling average is an average of the outcomes from the last three months. Regular changes in the short-term rolling average can mask longer-term changes in performance, as targets are adjusted up or down in line with changes in performance over time. For example, there were instances where similar performance outcomes received different traffic-light ratings and different performance outcomes received similar traffic-light ratings.¹⁵⁹
- The KPIs for ‘monthly materiel ready days achievement’ and ‘price reliability — year to date price achievement’ are expressed as percentages against a plan or target for each month. The targets for these measures were subject to in-year changes during 2022–23 and 2023–24, with 17 instances where the monthly target differed to that set out in the

155 A measure for ‘support intent’ would provide an indicator for any deviation from the agreed support arrangements (such as workforce levels and competencies, support system, design and configuration and supply requirements). Ongoing non-conformance with the support intent would be a flag for the risk of a reduced platform life over the long term.

156 ‘Configuration baseline’ refers to the collective data and documentation that captures, among other things, the technical detail of the functional characteristics of the capability’s systems, all of the actual as-built physical characteristics of the platform systems, and the status of all configuration change proposals under development for changing the platform’s baseline at any point in time. The ability to maintain, change and control the configuration baseline of the ship is key to ensuring its long-term supportability.

157 An ‘obsolescence liability’ measure would indicate the degree to which the supply chain is confined by the obsolescence of system components or spare parts. High obsolescence correlates with increased urgent defects and the cannibalisation of other platforms.

158 Most of the detailed data sheets were last amended in either 2019 or 2020.

159 For example: the ‘external maintenance backlog’ for the LHD Landing Craft in February 2021 had a traffic light rating of ‘green’ against a threshold of less than 230 overdue jobs. In January 2022, the rating was ‘green’ against a threshold of less than 47 overdue jobs; and the ‘platform demand satisfaction rate’ in May 2023 had a traffic-light rating of ‘red’ against a threshold of 67.72 per cent. In November 2023, the rating was ‘white’ against a threshold of 67.89 per cent. For definition of the traffic light ratings, see footnote 166.

LHD product schedule. Targets set in this way have the potential to mask deterioration and/or improvements in performance.

- For some KHIs, only raw numbers are reported or only a subset of a bigger activity or issue is measured. Reporting on raw numbers may not provide a sense of proportion in the context of broader activities. Some engineering-related issues are not captured under the 'open engineering changes' measure as they have not progressed to a certain stage in the engineering change process.
- Reporting on the 'external maintenance backlog' does not convey the gravity of the potential risks or whether the backlog is an indicator of a risk-based decision or trade-off to manage other risks (such as delayed maintenance tasks to meet operational needs or a deliberate decision to defer certain tasks for efficiency reasons). This indicator can fluctuate regardless of the risk composition of the incomplete tasks.

Reviews of performance measures

4.9 Defence has reviewed the MSA performance framework twice, in 2016 and 2020.¹⁶⁰ As part of the 2016 review, it was recommended that the performance measures for configuration baseline accuracy and obsolescence liability be adopted by the Maritime Systems Division for each of its platforms (including the LHDs). At the next review in 2020, these measures had not been implemented due to 'an absence of available data or methodology' and lack of 'an agreed standard approach to obsolescence management and reporting'.

4.10 These measures have not been implemented. In June 2025 Defence advised the ANAO that Navy engineering and maintenance systems are scheduled to be replaced as part of Enterprise Resource Planning (ERP) system tranche 3, to be rolled out by the end of the decade.¹⁶¹

4.11 Under the MSA performance framework, the 'cost per materiel-ready day' KPI is one of two core KPIs that 'directly reflects achievement' against the key output of sustainment efficiency (that is, the cost-effective use of the available sustainment funding). This KPI was removed from the framework as part of the 2016 review but was recommended for readoption during the 2020 review for all products managed by the Maritime Sustainment Division.¹⁶² The 2020 review also recommended that Defence adopt hard targets for KHIs instead of using a short-term rolling average approach.¹⁶³

160 The framework was established in 2014 to establish a standard suite of KPIs and KHIs for its Product Schedules in response to recommendation 12 of the Rizzo Report and to take advantage of Defence's development of the Sustainment Performance Management System (SPMS). Recommendation 12 of the Rizzo Report was: 'More Effective Information Exchange: Navy and DMO must improve their internal reporting by capturing direct, timely and candid, document-based information that draws on a rigorous set of metrics.'

161 The ERP program involves the streamlining of Defence business processes associated with hundreds of separate Defence ICT applications into one SAP S/4HANA system, with the intent of enabling better governance, faster processing and lower maintenance and support costs.

162 The measure was removed on the basis that it required the Systems Program Office to enter four separate data elements and 'stakeholder compliance' was reportedly low. Rather, this indicator became a 'Strategic Sustainment Analytic', a 'high-level sustainment health indicator that can be used for broad cross-product comparison'.

163 Other 2020 recommendations were directed at further developing measures for tasks completed by Navy's Fleet Service Unit (FSU) and continuing to progress the development of the obsolescence liability and configuration baseline accuracy measures.

4.12 The recommendations from the 2020 review were agreed in principle in January 2021. As at August 2024, neither the hard targets for KHIs nor the ‘cost per materiel ready day’ KPI had been implemented, as neither were included in the product schedule or reporting for the LHDs under the August 2024 interim materiel sustainment agreement.

Recommendation no. 7

4.13 The Department of Defence review the performance measures for the sustainment of the LHDs to support a more reliable and complete assessment of sustainment performance.

Department of Defence response: *Agreed.*

4.14 *Defence agrees to the recommendation.*

Performance reporting

4.15 Defence uses its Sustainment Performance Management System (SPMS) to produce monthly reporting against KPIs and KHIs.¹⁶⁴ To enable comprehensive reporting, data must be imported into SPMS from a range of other sources. Some of these sources are prone to data integrity issues, impacting the reliability of the reporting generated. One of these sources is Defence’s Asset Management and Planning System (AMPS). A number of issues arose following Defence’s roll out of version 7 of AMPS, including the potential corruption of AMPS data (see paragraphs 3.38 to 3.39).¹⁶⁵

4.16 The performance outcomes recorded in SPMS are used to inform reporting to Defence leadership and stakeholders including the Minister for Defence and Minister for Defence Industry. Defence’s recorded LHD KPI results indicate that over the 2019–20 and 2023–24 period the average percentage of ‘red’ ratings per year has improved over time from a high of 27 per cent in 2020–21 to nine per cent in 2023–24.¹⁶⁶ As at February 2025, 2024–25 had an increase in ‘red ratings’ to 16 per cent.

4.17 Between 2019–20 to 2024–25 (as at February 2025), the two KPIs with the highest proportion of red indicators were ‘external maintenance period milestone achievement’ and ‘end of year price forecast and achievement’. Performance against specific KPIs is discussed further from paragraph 4.20.

164 SPMS is Defence’s primary sustainment reporting and performance management system. SPMS is a web-based system designed to provide performance reports to CASG (and NSSG) and Capability Managers. Defence’s use of the system was examined in Auditor-General Report No.2 2017–18, *Defence’s Management of Materiel Sustainment*.

165 For example, corrupted data was identified by Defence as the potential underlying cause for significant fluctuations in the figures reported for the KHI ‘Planned organic level maintenance backlog — LHD Landing Craft’. With a target of 600 for this KHI, there were 3990 overdue maintenance jobs recorded in July 2023, which fell to 58 in August 2023. From September 2023 to November 2023, this figure increased to over 4,500. In August 2024, Defence advised the ANAO these issues were due to differences in the way end users were using AMPS. In April 2025 Defence established arrangements to support consistent use of AMPS and manage non-conformance with the AMPs business rules.

166 SPMS uses one traffic-light rating system for KPIs — ‘red’, ‘amber’ and ‘green’ — and a different one for KHIs — ‘red’, ‘white’, ‘green’ and ‘N’. Defence establishes rating thresholds for each performance measure, which varies depending on the measure (e.g. percentage below or above target, number of events, etc).

4.18 There were several iterations of reporting to ministers in the five years between 2019–20 and 2024–25 (as at February 2025), with reporting frequency varying from monthly to quarterly.¹⁶⁷ Information reported on LHD sustainment was principally on Australian industry content, platform availability and budget expenditure, and supported by Defence commentary. LHD sustainment was also reported on as Product of Interest over this period. Previous Auditor-General reports have highlighted issues with the timeliness and accuracy of the quarterly reports.¹⁶⁸

Have sustainment outcomes met Navy requirements?

Navy's operational requirements have been impacted by shortcomings in the management of LHD sustainment. Sustainment outcomes have included an accumulation of urgent defects, persistent maintenance backlogs, and the degradation of the condition of the platforms. The LHDs have fallen short of meeting availability targets since 2020–21 and sustainment-related deficiencies and workforce shortfalls have given rise to risks involving critical failures in the vessels, possible damage to Navy's reputation and concerns for the sustainability of the LHDs over the long-term. Some of these risks have materialised, including:

- total power failures in 2022 and 2023, making the LHDs temporarily unavailable while providing humanitarian assistance and disaster relief support in Tonga and Vanuatu; and
- a reduction from three ships to two available for deployment in the amphibious force during 2025.

4.19 In addition to the KPIs and KHIs, the LHD Product Schedule also refers to relevant requirements outlined in the Chief of the Defence Force (CDF) Preparedness Directive¹⁶⁹ and the LHD 'Operating and Support Intent'. The 'operating intent' relates to Navy's use of the LHDs and the 'support intent' refers to NSSG's sustainment activities. Effective delivery of the support intent enables the Navy's operating intent to be achieved.

Materiel availability

4.20 The KPI for 'monthly materiel-ready days achievement' is designed to measure the actual number of days the ships were available compared to the targeted number of available days. Defence's performance reporting indicated that it had exceeded its target of 100 per cent in 2019–20 but had fallen short of this target in the four financial years to 2023–24, as outlined in Table 4.1.

167 The different types of reports included the: 'CASG Quarterly Performance Report', quarterly (for 2015 to June 2020); 'Project and Sustainment Report', biannually (February to September 2021); 'Acquisition and Sustainment Update', quarterly (October 2021 to October 2022); 'Acquisition and Sustainment Performance Report', monthly (October 2022 to June 2023); 'Projects and Products of Interest and Concern Report', monthly (from June 2023); and 'Quarterly Performance Report', quarterly (from June 2023).

168 See: Auditor-General Report No.3 2019–20, *Defence's Quarterly Performance Report on Acquisition and Sustainment*, ANAO, Canberra, 2019, available from <https://www.anao.gov.au/work/performance-audit/defence-quarterly-performance-report-acquisition-and-sustainment> [accessed 17 June 2025] and Auditor-General Report No.14 2023–24, *2022–23 Major Projects Report*, 9 February 2024, paragraphs 1.45 to 1.47.

169 The CDF preparedness directive outlines the level of readiness and notice to move requirements for various elements of ADF capability and for various ADF missions and roles.

Table 4.1: Reported outcomes for LHD materiel-ready days, 2019–20 to 2024–25 (as at March 2025)

Materiel-ready days	2019–20	2020–21	2021–22	2022–23	2023–24	2024–25
Target # of days	466	384	511	511	480	268 ^a
Actual (number of days)	476	350	420	495	434	264
Difference (number of days)	10	(34)	(91)	(16)	(46)	(4)
Target days met (%)	102	91	82	97	90	99

Note a: This is the year-to-date target number of days, as of March 2025. The overall target for the year is 450.

Source: ANAO analysis of Defence documentation.

4.21 The KPI for ‘achievement of external maintenance period planning milestones’ is also designed to measure materiel availability, with a target of zero failures to meet planning stage milestones. Failure to achieve planning milestones is a contributing constraint and has a direct impact on NSSG’s ability to deliver platforms out of maintenance periods on time.¹⁷⁰ Defence reported meeting this target in 2023–24, which indicated an improvement on the results from the preceding four financial years, as shown in Table 4.2. As at June 2025, Defence had reported six milestone failures following the transition to the new Regional Maintenance Provider East contract in July 2024.

Table 4.2: Reported outcomes for the achievement of planning milestones for LHD external maintenance periods, 2019–20 to 2024–25 (as at March 2025)

Failure to achieve planning milestones	2019–20	2020–21	2021–22	2022–23	2023–24	2024–25
Actual # of failures	7	6	12	1	0	6
Target # of failures	0	0	0	0	0	0

Source: ANAO analysis of Defence documentation.

Materiel confidence

Deviations or excursions from the Operating and Support Intent

4.22 Under the LHD’s Operating and Support Intent, a change in either the operational intensity or the support arrangements requires a commensurate change in the other to maintain balance.¹⁷¹ Inevitably, there are occasions where the operating and/or support arrangements cannot be met, including due to defects, shortfalls in inputs such as workforce and supplies, or operational demands that require the ships to operate at unplanned times or tempos.¹⁷² On these occasions, a temporary

170 Defence, *Navy MSA Performance Framework Validation – 2020*, 1 September 2020.

171 The Operating and Support Intent for the LHDs was first approved in October 2014 and was most recently updated on 30 June 2020. Defence updated its Operating and Support Intent framework in August 2024. At June 2025, the updated Operating and Support Intent had yet to be finalised.

172 Auditor-General Report No.30 2018–19 *ANZAC Class Frigates — Sustainment* found the ANZAC class had experienced degradation of the ships’ hulls and sub-systems, with successive reviews and performance information highlighting the link between lack of conformance to operating intent/requirement, reduced platform life and reduced sustainment efficiency. Auditor-General Report No.30 2018–19 *ANZAC Class Frigates — Sustainment*, ANAO, Canberra, 2019, paragraph 17.

deviation from the Operating and Support Intent may be required. These changes are to be documented, along with how the associated risks will be managed.

4.23 In 2022, NSSG reported internally that the LHDs were not in conformance with the support element of the Operating and Support Intent due to reductions in funding. A 2023 internal review into the materiel seaworthiness of the surface fleet found that '[f]requent, and in some cases significant, departures from the OSI [Operating and Support Intent] remain undocumented with no formal approval being recorded for the excursion from, or change to, the baseline'. The Chief of Navy and the Chief of Navy Senior Advisory Committee were briefed on these findings in September 2023 and February 2024, respectively.

4.24 As of March 2025, Defence had recorded two deviations¹⁷³ from the LHD Operating and Support Intent in Defence's systems:

- in November 2022, HMAS *Adelaide* was in greater use and carrying more personnel than planned that year.¹⁷⁴ As a consequence, the timeframe to conduct the required maintenance tasks was compressed and risks to the completion of those tasks within the time available were increased.¹⁷⁵ That year, the ship was unable to maintain humanitarian assistance and disaster relief activities for two of its programmed weeks in December 2022 due to propulsion plant defects and a change of vessel was required until these problems were rectified.
- in October 2024, HMAS *Adelaide* carried more personnel and spent more time at sea than planned in order to meet a deployment. The deviation had the potential to impact seaworthiness and support; in particular habitability, endurance and sparing deficiencies. Mitigating measures were put in place and OPLIMs were imposed for the duration of that deployment.

4.25 In 2024, Defence revised the operational use of the LHDs due to a lack of marine technicians, providing more balance between the support and operating requirements of the Operating and Support Intent.¹⁷⁶

Operational limitations

4.26 Temporary deviations from the OSI can be managed as an 'operational limitation' (or OPLIM). This is where the ship is unable to operate in a particular way or execute a particular function because of an issue or defect with equipment and/or lack of qualified personnel onboard. For example, operating propulsion pods at specific speeds during specified activities to reduce vibration. Operational limitations have been recorded because of issues with systems such as medical facilities and propulsion pods, which are considered critical to the achievement of specific missions.

173 This does not include the 'operational limitations' that have been recorded,

174 The LHD is usually expected to carry more than 400 personnel only for up to 10 per cent of the year, in tropical conditions. However, HMAS *Adelaide* was deployed with greater than 400 personnel for 38 per cent of 2022. The SPMS record stated that the deviation from the operating and support intent was 'accepted ... before the ship deployed' on humanitarian assistance and disaster relief activities.

175 Navy's performance management documentation notes '[t]here is a proven link between lack of conformance to operating intent / UUC [usage upkeep cycle] and future unplanned defects / reduced platform life.'

176 Operational limitations have been in place to manage workforce shortages, including for marine technicians. For further discussion on marine technician shortages, see paragraphs 4.40 to 4.45.

4.27 Since 2015–16, Defence has recorded 66 operational limitations applicable to the LHDs and landing craft, with two remaining in effect as at 24 March 2025.¹⁷⁷ The LHDs have the highest proportion of recorded operational limitations per ship compared to other classes in the surface fleet. The LHDs' operational limitations have derived largely from issues of poor build quality, defects, or the inability of Defence to meet the support intent.

4.28 Closed operational limitations had an average duration of 13 months. The two operational limitations still in effect on 24 March 2025 had been in place for seven and eight years. In some instances, operational limitations have been lifted and a new, modified operational limitation raised on the same day.

4.29 Defence advised the ANAO in February 2024 that:

No OPLIM [operational limitation] has [had] an enduring impact on capability or a requirement to change the "Operation" element of the OSI [Operating and Support Intent] ... As such, no OPLIM has been incorporated into the OSI.

Operational tempo

4.30 Both LHDs were to be available for 240 'materiel ready days' in 2023–24 with an operational tempo of each LHD at 150 sea days per year.¹⁷⁸ Along with the Landing Ship Dock (LSD), the two LHDs form part of a three ship force where at least one of the ships is to be available to the Navy, at all times, for deployment within a specified notice to move period.

4.31 'Notice to Move' requirements are established to ensure a ship can be operational within a required timeframe (for example, 48 hours or seven days). These requirements can restrict the time for and completion of maintenance tasks, potentially resulting in: schedule compression and/or scope reduction of an external maintenance period; deferral of preventive and corrective maintenance; limited windows to fix emergent defects; and overlapping external maintenance periods.¹⁷⁹

4.32 In February and March 2022 both LHDs were deployed as part of Operation Tonga Assist and in March 2023 HMAS *Canberra* was deployed for Operation Vanuatu Assist.¹⁸⁰ To undertake these operations, external maintenance periods were shortened and/or deferred on both occasions, which resulted in the external maintenance periods for both LHDs overlapping later in the year. Such overlap can become problematic if one ship (or both) is subject to a notice to move requirement for all or part of the maintenance period. Having multiple ships in external maintenance can increase tactical pressure, impact the conduct of sustainment activities and increase demands on a limited workforce.

4.33 The short notice deployment of HMAS *Canberra* to Operation Vanuatu Assist in March 2023 led in part to all three amphibious force ships being alongside in concurrent external maintenance periods in the second half of 2023. HMAS *Canberra* was the designated response vessel during this

177 LHD-applicable operational limitations have been applied to either: the fleet and surface combatants (three per cent); the class (17 per cent); an individual LHD (77 per cent); or the LHD landing craft (three per cent).

178 For 2023–24, the landing craft were approved to deliver up to 400 hours per craft per year.

179 An external maintenance period consists of pre-production (one week), production (four to six weeks), and post-production time (one week).

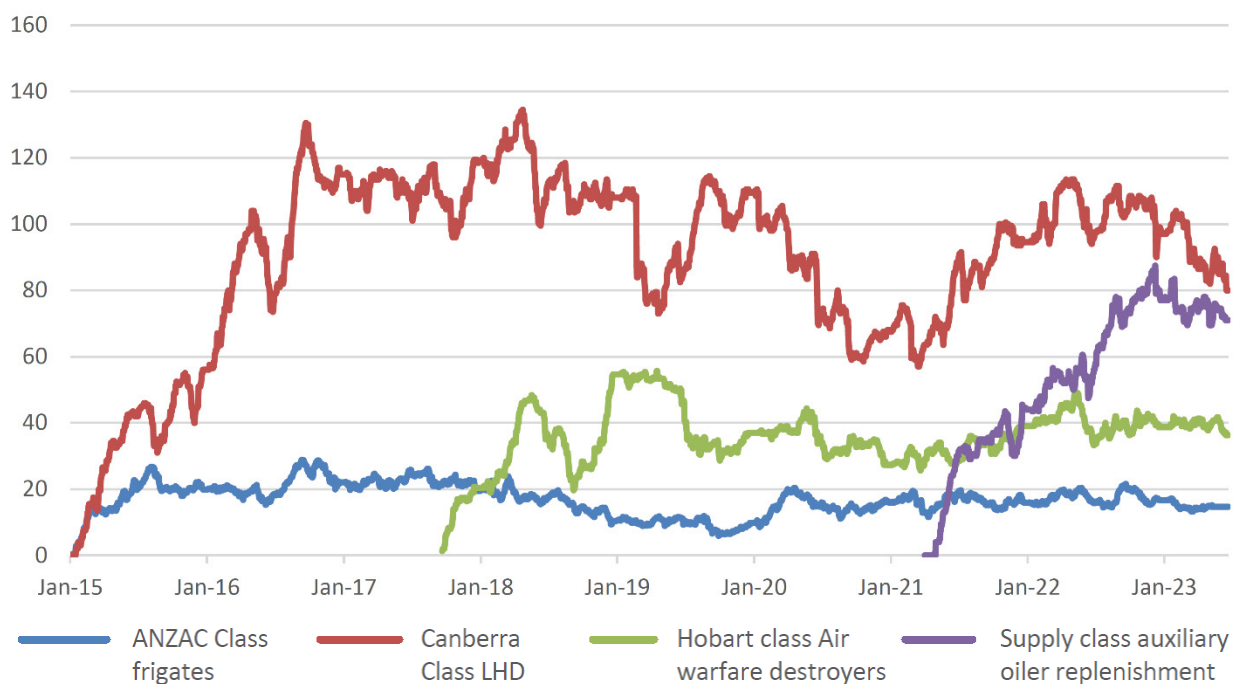
180 For the latter event, HMAS *Canberra* was not the designated response vessel at the time but was deployed due to issues with HMAS *Choules*, the designated response vessel, and the operation's capability requirements.

period and was held at notice to move for 15 days (27 per cent) of the seven week maintenance production period. Therefore, the only maintenance tasks that could be undertaken were those that did not prevent the ship from being operational within the specified notice to move period.¹⁸¹ Prioritising operational demand over the completion of non-urgent maintenance can result in an accumulation of overdue external maintenance tasks and ships returning to sea with higher-than-normal defects.¹⁸²

Urgent defects

4.34 Between 2019–20 and 2024–25 (as at February 2025) the number of overdue external maintenance tasks for the LHDs remained above 373, with a high of 731 in 2021–22. As with operational limitations, the LHDs have the highest number and rate of recorded urgent defects compared to other classes in the Surface Fleet (normalised by the number of ships), as illustrated in Figure 4.1.

Figure 4.1: Number of urgent defects, normalised by number of ships per class, 2015 to 2023^a



Note a: As at July 2023, the number of ships per class were as follows: eight ANZAC class frigates; two Canberra class LHDs; three Hobart class Air warfare destroyers; and two Supply class auxiliary replenishment oilers.

Source: ANAO extract from Defence records: *Report into the Materiel Seaworthiness of the Fleet*, July 2023.

4.35 On 16 June 2025, Defence reporting indicated that 223 open urgent defects (priority one, two and three) were for the LHDs. Urgent defects in ships maintenance can be raised, rectified or

181 For example, planned maintenance tasks including the five-yearly inspection of waste tanks and the planned cleaning of grey water tanks were deferred due to the requirement for HMAS *Canberra* to remain habitable. The replacement of defective pipework was also deferred as the 'extensive scope' of the work was unachievable due to the risk HMAS *Canberra* would be required to move at short notice.

182 The risks of a short-term mission focus at the expense of a long-term sustainability were outlined in the 2011 Rizzo Review, which stated that for 'many years, preventative and corrective maintenance has not been carried out because of the higher priority afforded to operational demands over maintenance requirements'. See: Rizzo Review, pp. 23–24.

have their status regraded (for example, from a priority one to priority two) on a regular basis. Based on available data on open urgent defect duration to March 2025: 9.6 per cent had been opened between 2017–18 and 2021–22; 11.3 per cent in 2022–23; 25.3 per cent in 2023–24; and 53.8 per cent in 2024–25.

4.36 In September 2022, the Defence Committee agreed to reduce the Navy sustainment budget by \$140 million to address ICT and estate sustainment pressures (see paragraph 2.81). The Deputy Chief of Navy was subsequently advised on 1 November 2022 that due to a \$24 million cost pressure, ‘a growing maintenance liability will likely escalate into Priority 1 or 2 defects that will [a]ffect mission critical systems’. The Deputy Chief of Navy was further advised that for four LHD systems (some of which have high mission criticality), there was between a 97 and 99 per cent chance of a system failure incurring a priority two status defect within the first 90 days of deployment.¹⁸³

4.37 When a high number of urgent defects need to be managed, this limits the ability of ship’s staff to progress organic level maintenance, further exacerbating the risk of defects. Evidence provided at the March 2024 Sea Release Board for HMAS *Canberra* was that the ship ‘currently has a large number of overdue [organic level maintenance] Debt of approx. [approximately] 500 active and inactive tasks combined with in excess of 3000 defect tasks’.

4.38 Defence’s 2023 review into the materiel seaworthiness of the surface fleet (discussed at paragraph 4.23) found that the materiel condition of several platforms, including the LHDs, had degraded and the platforms were at ‘greater risk of both short-term mission failure and long-term sustainability failure.’ The review noted that:

Consistently high numbers of URDEFs [urgent defects] on a platform or class indicate poor support and/or materiel state but perhaps more importantly they justify the perception of “Normalised Deviance”.¹⁸⁴

4.39 The review recommended that Defence: ‘Drive to remediate the material state of platforms with significant numbers of URDEFs.’ Defence closed this recommendation in February 2024, stating that it had been ‘subsumed by BAU [business as usual] activities’ — largely under Navy’s Sea Release Assurance Framework, which has been in place since 2021.¹⁸⁵

Marine technicians

4.40 Defence’s forecasting in July 2023 indicated a significant reduction from January 2024 in the number of marine technicians¹⁸⁶ posted to the LHDs (at the completion of the routine two-year

183 These systems included: electrical systems; air conditioning (HVAC); mechanical handling systems (including aircraft elevators); and pollution control systems (food waste equipment, solid waste systems, sewage collection and treatment, incinerators and oily waste systems).

184 Normalised deviance, or normalisation of deviance, is a process where something that was previously considered to be an unacceptable standard gradually becomes acceptable over time.

185 The Sea Release Assurance Framework provides Navy with positive assurance of the seaworthiness and battleworthiness of individual fleet elements. The Sea Release Board, an integral component of the framework, assesses the operational effectiveness, safety and environmental compliance of a capability to undertake operational tasking.

186 Responsibilities of marine technicians include organic level maintenance ranging from operating, maintaining and repairing a ship’s machinery and systems, to welding a ship’s hull and fittings.

posting cycle).¹⁸⁷ Advice to the Chief of Navy stated that this reduction meant that Defence would be unable to meet the support requirements of the Operating and Support Intent and both LHDs were at risk of being unable to meet preparedness requirements.

4.41 To address this issue, in November 2023, the Fleet Command Board¹⁸⁸ agreed to prioritise marine technician personnel to HMAS *Adelaide*. This provided 64 of the 80 required personnel (85 per cent), enabling the ship to conduct planned deployments and contribute to the preparedness requirements of the amphibious force.

4.42 This prioritisation was estimated to leave HMAS *Canberra* 'critically short' of marine technicians (approximately 36 personnel), with an operating intent temporarily reduced in 2024 to short-duration, domestic force generation activities. In November 2023 the Fleet Command Board was advised that having only two ships available (one LHD and HMAS *Choules*) for deployment rather than three throughout 2024 would result in:

- overlapping external maintenance periods increasing the risk of preparedness requirements not being met;
- an estimated additional \$4 million per annum required to engage contractors for organic level maintenance; and
- additional time in maintenance periods to support contractor work.

4.43 In July 2024, Defence advised the ANAO that the availability of marine technicians did not fall as low as expected in 2024.¹⁸⁹ Defence advised the ANAO that both ships had 79–80 per cent (60–61 personnel) of the marine technicians required during July 2024.

4.44 High risks to the availability of the LHDs are expected to persist into 2025, (that is, two of three ships in the amphibious force would be available for deployments). Defence advised the ANAO in June 2025 that it has prioritised marine technicians in the final stages of HMAS *Canberra*'s five-year docking cycle. This re-prioritisation may impact HMAS *Adelaide*'s participation in Navy exercises during that period and up until HMAS *Adelaide*'s five-yearly docking cycle that year. In December 2023, the Deputy Chief of Navy was advised that:

The MT [marine technician] shortfall issue will need to be remediated across both ships by Q1 [quarter one] 2026 when [HMAS] *Adelaide* returns to the Fleet. Otherwise there is a risk that an LHD will have to be laid up, with insufficient personnel available to return it to sea.

4.45 Defence advised the ANAO that it had not briefed the government on the specific workforce risks relating to LHD availability, because LHD preparedness is managed collectively as part of 'preparedness across the amphibious force' via Navy's preparedness system. Defence stated that it

187 Marine technician numbers were forecast to reduce from 60 personnel (80 per cent of required personnel per ship) in December 2023 to 43 to 45 personnel (57 to 60 per cent) in January 2024, and to 34 to 40 personnel (45 to 53 per cent) in mid-2024. Between 2019–20 and 2023–24, the lowest marine technician staffing profile for an individual LHD was 61 per cent, with 91 per cent the highest.

188 The Fleet Command Board is chaired by Commander Australian Fleet and is the subordinate committee to the Chief of Navy Senior Advisory Committee. The board aims to 'provide a coherent and balanced perspective on matters affecting the whole-of-Fleet Command, the Fleet-in-Being and, where appropriate, the Future Fleet; it also provides updates on Navy Headquarters (NHQ) issues in which Fleet Command is a stakeholder'.

189 These efforts included sailors extending their posting to the LHDs and/or being posted to the LHDs with less than the preferred six-month posting notice.

has communicated Navy's broader workforce risks, such as shortfalls in the submarine and technical workforces, to government and at Senate Estimates routinely.

Reporting on Navy requirements

4.46 Shortcomings within the LHD sustainment arrangements and the risks to mission capability have been covered in Navy's internal monitoring and reporting, specifically: the 'Surface Force Capability Report' and the 'Commanding Officer's Capability Report'. As outlined in Table 4.3, instances have been identified in these reports where materiel availability and confidence for the LHDs (that is, availability over the short and long term) was impacted due to sustainment related issues.

Table 4.3: Navy's reports covering LHD capability

Capability report	Description of reporting
Surface Force capability report <ul style="list-style-type: none"> Weekly report on each surface force vessel. Includes status of mission capability, and current issues faced. Prepared for weekly Seaworthiness Positive Assurance Meeting (SPAM), chaired by Commander Surface Force. 	Reporting covered: <ul style="list-style-type: none"> performance issues, fragile systems and/or lost system redundancy (including instances where issues were not resolved despite remedial maintenance or changes to the ships' operation); external maintenance period tasks remaining incomplete or outstanding, and/or the impact of operational requirements on an external maintenance period; an accumulation of maintenance debt, including as a result of organic level maintenance tasks being delayed or not conducted; and impacts on operational taskings, including increased risks where ships were required to meet a future and/or different type of operational tasking.
Commanding Officer's capability report <ul style="list-style-type: none"> Weekly report includes the materiel state of the ship, and personnel state Informs the Fleet Scorecard for the Commander Surface Force, which in turn informs the Fleet Command Board. 	The reports identified instances where: <ul style="list-style-type: none"> the ships were not mission capable (for example, due to the cannibalisation of parts to support the sister ship) and sea days were recorded as lost (including for engineering defects or organic level maintenance and defect rectification). 'technical' risks contributed to higher 'operational' risks. This was considered manageable by Navy in some instances due to the nature of taskings. However, it was noted that challenges could be presented if these taskings were to change.

Source: ANAO analysis of Defence documentation.

Reporting on preparedness

4.47 Defence reports against the Chief of the Defence Force (CDF) Preparedness Directive, internally and to the Minister for Defence. Internal Defence reporting comprises the quarterly 'Defence Preparedness Report' and a six-monthly 'Defence Preparedness and Mobilisation Assurance Report' (previously the Preparedness Assurance Report). Reporting to the Minister occurs through a six-monthly 'Preparedness Assurance and Concurrency Statement'. These reports have comprised information on the ability of the LHDs, or the amphibious force more broadly, to meet preparedness requirements and have covered matters such as concurrency and availability pressures and/or capability issues.

4.48 In September 2024, Defence advised the ANAO that preparedness reporting had not been provided to the Minister in 2023 and 2024 due to development of the 2023 Defence Strategic Review. Defence advised the ANAO that:

- Defence expects the updated preparedness reporting to be in place by mid-2025; and
- Defence's advice to the Minister on preparedness in the meantime has been through 'other means', including during conversations with the Minister for Defence.¹⁹⁰

Humanitarian assistance and disaster relief operations

4.49 The LHDs are an essential element of Australia's humanitarian assistance and disaster relief efforts, both at home and abroad. Since commissioning, the LHDs have been deployed on domestic and international humanitarian assistance and disaster relief operations, and bilateral and multi-lateral military exercises.¹⁹¹

4.50 During 2019–20, the amphibious warfare force supported Australian emergency services in responding to and communities impacted by the significant bushfires along Australia's east coast. The LHDs were also deployed to Tonga (HMAS *Adelaide*) following a volcanic eruption and tsunami in January 2022 and Vanuatu (HMAS *Canberra*) in the wake of tropical cyclones events in March 2023.

4.51 During both Operations Tonga and Vanuatu Assist, the respective LHD experienced power failure issues. Both incidences resulted in periods where the ships were unavailable, requiring significant and urgent defect rectification. To examine the power failure events, among other things, Defence conducted a technical investigation in March 2022 and internal inquiry process in March 2023 for HMAS *Adelaide*, and a lessons learnt process in August 2023 for HMAS *Canberra*. These processes identified several sustainment-related issues contributing to the power failures, including:

- inadequate preparation and planning for external maintenance periods;
- the prioritisation of short-term maintenance and defect rectification to meet operational commitments while operating within a constrained budget;
- limited analysis of data to identify potential system failure rates;
- 'issues with the technical drawings in [one LHD] which led to the incorrect [items] being cannibalised' from the sister ship;
- maintenance activities being: deferred, left incomplete, not documented or not conducted at the correct frequency;
- that the 'maturity of the [sustainment] organisation was not commensurate with the work load required of a ship preparing to enter a significant maintenance period'; and
- shortfalls and lack of experience in the marine technician workforce.

4.52 The March 2022 technical investigation resulted in 41 recommendations, the March 2023 inquiry report comprised 15 recommendations and 26 findings, and the August 2023 lessons learnt

190 In September 2024, Defence advised the ANAO that the 'other means' included conversations with the Minister for Defence during the development of the 2023 Defence Strategic Review and the 2024 National Defence Strategy.

191 At least one LHD has been involved in the biennial exercise Talisman Sabre with the United States since 2017, with the most recent exercise in 2023.

process produced 11 action items. Defence's oversight arrangements for the implementation of these tasks varied.

- Navy's pre-existing 'Technical Investigation Review Board' oversaw completion of the recommendations from the technical investigation from June 2022 to March 2024.¹⁹²
- In July 2024, Defence established a working group specifically for overseeing the 'complete and comprehensive' implementation of recommendations arising from both reviews relating to HMAS *Adelaide*.¹⁹³
- There was no documented implementation of the action items arising from the lessons learnt process for HMAS *Canberra*.

4.53 During senior-level Defence meetings in 2023 (after Operation Vanuatu Assist), Navy representatives reflected on the adverse attention on the LHDs and noted that such 'catastrophic failures' have negative impacts on 'Navy's reputation with the community, the government and international partners (US, UK), and ... their confidence in the Navy to operate nuclear submarines.'

Has Defence implemented appropriate planning and governance arrangements to support the Maritime Sustainment Model?

In July 2024, Defence transitioned LHD sustainment to the 'Maritime Sustainment Model', which involved the procurement and contracting of new commercial arrangements. Defence started the procurements later than planned, which limited the options available to Defence to manage issues and strengthen value for money outcomes during negotiations. Arrangements to manage probity were not robust and, in respect to the LHD Capability Life Cycle Manager procurement, probity was poorly managed. Defence has not benchmarked or established expected sustainment performance levels for the Maritime Sustainment Model.

Maritime Sustainment Model

4.54 In October 2019, Defence released 'Plan Galileo', which was designed to improve naval surface ship sustainment by 2025 in support of the larger naval fleet intended from the National Naval Shipbuilding Plan.¹⁹⁴ The three strategic objectives of Plan Galileo are to: enhance and evolve support to Navy; deliver sustainment efficiency; and build a sovereign sustainment capability.

4.55 Plan Galileo is to be delivered through the implementation of a Maritime Sustainment Model (MSM) for the surface fleet. The MSM is intended to achieve Plan Galileo's objectives by improving coordination, standardisation and consistency through the redistribution of

192 By March 2024, all recommendations but one were closed or converted into a business-as-usual process.

193 The working group was chaired by the Deputy Fleet Commander and was to report monthly 'until all recommendations are implemented'.

194 The Australian Government's Naval Shipbuilding Plan was released on 16 May 2017. For further information on Defence's early implementation of this plan, see: Auditor-General Report No.39 2017–18, *Naval Construction Programs—Mobilisation*, ANAO, Canberra, 2018, available from <https://www.anao.gov.au/work/performance-audit/naval-construction-programs-mobilisation> [accessed 17 June 2025]

responsibilities for naval sustainment.¹⁹⁵ Three new contracts for LHD sustainment have been established with industry under the new model, as follows.

- Regional Maintenance Provider (RMP) — to provide external maintenance activities for specified classes, through new Regional Maintenance Centres in Cairns (RMC North East); Darwin (RMC North); Henderson (RMC West); and Sydney (RMC East).
- Capability Life Cycle Manager (CLCM) — to provide specialist asset management services for specific asset classes through life, including managing any capability enhancements and upgrades.
- Designer Support Contract (DSC) — the original equipment designer for the asset class to provide advice and design change support.

4.56 Defence commenced contracting under the MSM in 2020 for the surface fleet.¹⁹⁶ In September 2022, Defence advised the Minister for Defence Industry that the Regional Maintenance Centre network will improve value for money for Defence as it is expected to reduce costs by approximately \$11 million in 2025 to 2026, with efficiencies to include: reduced site induction arrangements; standard instructions, improving maintenance outcomes and productivity; reduction in turnaround times; and improvements in supply chain and industry engagement with Defence. Defence did not have supporting evidence or analysis underpinning this advice to government.

4.57 The procurement processes to transition LHD sustainment to the new commercial arrangements commenced in 2022. An overview of the three LHD-related procurement processes conducted to establish these new commercial arrangements is provided in Table 4.4.

195 The transition to the MSM involves changes to Defence's longstanding Systems Program Office based sustainment model. Further information on the changes with respect to different sustainment functions are presented in Appendix 4.

196 Other MSM procurement processes to date have included: CLCM Offshore Patrol Vessels (Arafura class) — RFT February to May 2020, awarded December 2020 (CN3735073); RMP North East (Cairns) — RFT November 2020 to March 2021, awarded December 2021 (CN3840967); RMP West (Henderson) — RFT March to June 2021, awarded October 2022 (CN3928168); CLCM Destroyer (Hobart class) — RFT October 2021 to February 2022, awarded October 2022 (CN3922248); RMP North (Darwin) — RFT March to August 2022, awarded December 2023 (CN4027811).

Table 4.4: Phase 3: Maritime Sustainment Model — LHD-related procurements

Contract	Regional Maintenance Provider East	Capability Life Cycle Manager	Designer Support Contract
Approach to market and management of probity (paragraphs 4.59 to 4.64)			
Form of tender	Open tender	Open tender	Limited tender ^a
Delegate approval	13 April 2022	30 January 2023	16 July 2023 and 15 December 2023
Contract term	Five-year contract, two optional five-year extensions	Six-year period, two optional five-year extensions	Seven-year contract, option to extend for a further 23 years
Estimated value	\$3.36 billion	\$2.66 billion	\$510 million
Products to be supported	DDGs, LSD, LHDs and LLCs, and from 01 July 2025, Auxiliary Oiler Replenishment (AOR).	LSD, LHDs, LLCs and, from July 2025, the AOR	Navantia designed LHDs, LLCs, DDGs, and AORs
Approval of probity plan	16 December 2021	10 May 2023	29 June 2023 (not approved by delegate)
Tender evaluation (paragraphs 4.66 to 4.70)			
Tender period and no. of addenda to RFT	11 May to 17 October 2022 (including a four-week extension) with six addenda	30 January to 19 May 2023 (including a four-week extension) with 16 addenda	15 December 2023 to 1 March 2024 (including an 11-day extension) with five addenda
Approval of tender evaluation plan	17 October 2022 initial and 20 October 2022 revised	10 May 2023	27 February 2024
No. of tender responses	Four tender responses	Three tender responses	One tender response
Tender evaluation	Two proceeded to detailed evaluation between October 2022 and June 2023	Three proceeded to detailed evaluation between June and October 2023	March 2024 evaluation
Approval for negotiations	21 June 2023, one tenderer	17 October 2023, one tenderer	26 March 2024, one tenderer
Contract negotiations (paragraphs 4.71 to 4.73)			
Negotiation meetings	Delegate advised that three meetings held between 11 July to 1 August 2023	Delegate advised that 17 meetings held between 10 November 2023 and 28 March 2024	Meetings commenced 3 April 2024. Reached impasse on 11 December 2024. The impasse was resolved between the delegate and the

Contract	Regional Maintenance Provider East	Capability Life Cycle Manager	Designer Support Contract
			Navantia S.A. Board Chairman on 12 December 2024.
Delegate approval of negotiation outcomes	31 October 2023	10 April 2024	12 February 2025
Contract award (paragraphs 4.74 to 4.76)			
Approved contractor	Thales Australia Ltd	Kellogg Brown and Root Pty Ltd	Navantia Australia Pty Ltd
Contract signature	2 November 2023	12 April 2024	21 February 2025
Effective date and contract term	1 July 2024, initial seven-year contract (maximum 15-year term) for \$240 million for phase-in and management services fixed costs ^b	1 July 2024, initial five-year contract (maximum 32-year term) for \$199 million ^c	1 July 2025, initial seven-year contract (maximum 30-year term) for \$1.4 billion ^d
Contract value (as at March 2025)	\$1.4 billion	\$211.53 million	\$481.60 million

Note a: A tripartite deed between Defence, Navantia Australia Pty Ltd and Navantia, S.A., S.M.E. (Navantia S.A.) was established in February 2024 (effective until terminated). Navantia Australia Pty Ltd is a subsidiary of Navantia S.A. S.M.E.

Note b: Consistent with the Asset Class Prime Contractor contract, the contract comprised of fixed management services and target cost incentive components (including the annual total budget estimates and 'true up' processes).

Note c: On 3 May 2024, Defence reported the contract on AusTender with a total value of \$211.53 million. Defence advised the ANAO in August 2024 that this included an additional \$12.36 million provision for survey and quote orders not yet approved.

Note d: Of the initial term contract value, 29 per cent relates to the LHDs.

Source: ANAO analysis of Defence documentation.

4.58 The following sections examine the different stages of the procurement processes as they applied to the three LHD-related MSM procurements. As these procurements commenced or were undertaken during the course of audit fieldwork, the key planning, execution and decision-making processes were reviewed against the core legal requirements of the PGPA Act and the CPRs. The assessment did not include the extent to which value for money has been achieved through contract management activities.

Approach to market

4.59 In 2020 Defence established a 'proof of concept' pilot in Cairns to inform future procurements under the MSM. Planning for the three LHD-related procurements was not informed by this pilot. Defence did not establish an industry engagement strategy to support the transition to the MSM. The development of the tender documentation was undertaken in compressed timeframes and not adequately prepared at the time of the approach to market. Legal and commercial advisors noted that the required tender documentation was either not complete or not provided in sufficient time for review. Additional changes to the RFT documentation were also made following legal clearance.

4.60 As presented in Table 4.4, Defence amended the RFT documentation during the open period for each procurement. For CLCM, this included changes to the asset management requirements half-way through the original open period. For RMP East, this included the RFT being released with the unresolved decision as to how the Captain Cook Graving Dock would be incorporated into the contract (including its use for commercial work). The issue was resolved and an addendum issued two weeks before original scheduled RFT closure date. Defence extended the tender period by four weeks to provide industry additional time to respond to the addenda. The DSC limited tender had five addenda over 11-weeks with Navantia provided an 11-day extension.

Management of probity

4.61 The following issues were observed in Defence's management of probity in the three LHD-related MSM procurements.¹⁹⁷

- Conflict of interest registers were incomplete with declarations not recorded for all Defence personnel involved in the procurement process. This included Tender Evaluation Organisation members and on at least one occasion, the delegate.
- Communication protocols with industry participants or incumbent providers were not established, established after the tender opened, or not maintained.
- Records of conversation or outcomes of meetings between Defence and tenderers or potential tenderers during key procurement phases, including contract negotiations were not fully documented and maintained.¹⁹⁸

4.62 Probity risks and issues also arose during contract negotiations for the procurements. The realisation of these risks was reasonably foreseeable, indicating limitations in the understanding of appropriate probity arrangements within Defence at the time. For example:

¹⁹⁷ The issues above were largely consistent with Defence's management of probity in the sustainment procurements examined in Chapter 2.

¹⁹⁸ For example, Defence did not document its position for each issue prior to commencement of the DSC negotiations and did not fully document outcomes of the 12 December 2022 meeting between Navantia S.A. representative and the delegate.

- Defence provided inconsistent advice to Navantia during contract negotiations for the DSC. Early in the process, Defence agreed that Navantia could liaise directly with relevant Systems Program Offices (SPOs) on DSC phase-in activities and business-as-usual activities (including potential extension under existing arrangements with Navantia). Later in the process, following further requests for clarity on probity requirements by Navantia, Defence decided that Navantia should not discuss phase-in activities with the SPOs.
- Defence provided Thales with its nine-year sustainment budget for the new RMP East contract being negotiated.¹⁹⁹ Defence advised the ANAO in August 2024 that this information was provided to Thales as Defence was seeking a reduction in the profit margin in the contract. This information was commercially sensitive, particularly in the context of an active contract negotiation process.

Recommendation no. 8

4.63 The Department of Defence establishes arrangements to ensure that its internal policies for the establishment of appropriate probity processes commensurate with the size, scale and risk of its procurement activities are complied with.

Department of Defence response: *Agreed.*

4.64 *Defence agrees to the recommendation.*

4.65 When an incumbent provider competes for new work, it may have (or be perceived to have) certain advantages, such as understanding of an agency's needs, established relationships with agency staff, and knowledge that is not available to other potential suppliers.²⁰⁰ Incumbency risks in the CLCM procurement are discussed in Case study 2.

Case study 2. Management of an incumbent provider

In September 2020 Defence removed Kellogg Brown & Root Pty Ltd (KBR) personnel, (contracted under Defence's Major Service Provider (MSP) panel, from the Systems Program Office responsible for the Hobart class destroyers — 13 months before the release of the RFT for the Destroyer CLCM procurement. In August 2020, Defence advised KBR that this was:

[t]o mitigate any actual, potential or perceived conflict of interests which may arise if/when DDGSPO commences approach to market activities, the Commonwealth notifies KEY Team [KBR] of its intention to discontinue all the above-the-line support to DDGSPO.

This approach was not adopted for the LHD CLCM. KBR was the incumbent provider as the Capability Support Coordinator (CSC) for Defence until 30 June 2023 which included the period of the LHD CLCM procurement.^a In September 2022 the delegate was advised that the existing sustainment service providers including KBR, intended to bid for a future LHD CLCM Contract'.

199 The information included pricing information on maintenance for four classes of Navy capabilities, including the two ANZAC class frigates based at Fleet Base East. These vessels were intended to be added to the contract at a later date but were not listed in the initial RFT documentation.

200 NSW ICAC, *Dealing with incumbent providers in procurement*, NSW ICAC, 23 November 2021, available from <https://www.icac.nsw.gov.au/prevention/corruption-prevention-publications/latest-corruption-prevention-publications/dealing-with-incumbent-providers-in-procurement> [accessed 17 June 2025].

The delegate was also advised that probity arrangements would be established with ‘specific protocols to govern interactions with incumbent suppliers’.

KBR provided Defence an ‘unsolicited proposal’ for the continuation of the CSC services in November 2022. In the proposal, KBR stated its ‘intention to bid for the ACSSPO CLCM contract’ and noted that ‘[a]s an implication, KBR and the Commonwealth will need to manage conflicts of interest throughout the ACSSPO CLCM RFT period’.

When considering the proposal in November 2022, the ACSSPO observed:

- potential probity risks with KBR continuing while tendering for the CLCM;
- that it would be difficult to compartmentalise information from a tenderer embedded in a role alongside Defence personnel; and
- that KBR’s ‘presence’ on Defence premises and the award of an additional contract from an unsolicited proposal ‘could be perceived as a conflict of interest or favourable treatment to one entity’.

Defence did not establish procurement-specific probity arrangements or seek specialist advice on its handling of the proposal, as its policy framework required it to do. On 28 June 2023, the delegate approved the retention of KBR for an additional 12 months (to June 2024) under the MSP panel arrangement — six days after the delegate had approved KBR to proceed to detailed evaluation in the CLCM procurement.

The identified potential probity risks became issues between August and October 2023, when Defence identified that KBR personnel had sought ‘information of commercial value’ from ACSSPO personnel. This contact was in the context of work being undertaken by KBR on the MSM under another MSP contract (also within the Maritime Sustainment Division of NSSG).

The contacts by KBR were recorded in the contact register for the LHD CLCM procurement and the requested information was not provided. ACSSPO sought internal probity advice on whether further action was required. ACSSPO also raised concerns there could be a perception that KBR has: access to information not available to other tenderers and; a ‘conflict of interest in delivering services as an MSP that relate to defining the role of the CLCM while competing for a CLCM Contract’. The probity advice provided in response to the request from ACSSPO included additional measures to document the interests of three KBR staff and to confirm arrangements with KBR on how it would manage the issue internally, ‘including whether they have internal barriers in place between staff working on Plan Galileo activities and staff working on KBR’s bid for the ACS CLCM Contract’. The implementation of these measures was not fully documented.

KBR was selected as the preferred tenderer for the CLCM on 17 October 2023.

Note a: Defence’s management of the CSC contractual arrangements with KBR are examined in paragraphs 2.50 to 2.54.

Tender evaluation

4.66 The tender documentation for all three procurements outlined that tender submissions would be evaluated against the published tender evaluation criteria.²⁰¹ The criteria adopted for each procurement covered a range of factors relevant to the service objectives and achieving value for money. The criteria were not weighted and no order of importance was indicated.

4.67 The tender evaluation plans for each procurement set out the methodology and processes to be followed by Defence when evaluating submissions. Defence approved the evaluation plans for two of the procurements prior to the close of tenders. The other evaluation plan, for the RMP East procurement, was approved prior to the closing date but revised three days later. This sequencing does not align with the intent of the CPRs and internal procurement policy.²⁰²

4.68 Defence conducted initial and detailed evaluations of all tendered responses. The detailed evaluation process for the RMP East procurement, discussed in Case Study 3, was not conducted in full.

Case study 3: RMP East procurement detailed tender evaluation

The RFT documentation and tender evaluation plan for the RMP East procurement included eight unweighted evaluation criteria. An initial screening process was conducted in accordance with the tender evaluation plan, which included identifying whether tenderers had met minimum requirements or were associated with a current project of concern. Defence found that tenderer two was:

- associated with a Project of Concern as a subcontractor on AIR 9000 MRH-90 project (Phases 2, 4 and 6); and
- subject to a Comcare charge under section 32 of the *Work Health and Safety Act 2011* (WHS Act).

The Tender Evaluation Board (TEB) recommended that both matters be considered during detailed evaluation as they were either ‘not associated with the Maritime Domain’ or ‘not considered to affect [the tenderer’s] provision of warranties as required through the Deed of Undertaking’. The delegate approved this approach and the shortlisting of two tenderers for full evaluation.

These matters were not considered in full during the detailed evaluations. The Technical Tender Evaluation Working Group (TEWG) did not consider the Comcare charge and proceedings as required^a, and the Commercial TEWG did not consider tenderer two’s association with the AIR 9000 project. The tenderer’s association with the OneSKY project (re-listed as a Project of Concern after RFT closure) was considered but the Commercial TEWG found that the tender was ‘**COMPLIANT** and presents a **LOW** risk’ [emphasis original], as the project was ‘of less relevance’ to the tenderer’s maritime experience.^b Following the detailed assessment of each tender, the TEB was to conduct a comparative assessment of the results for both tenders across

201 For the two open tenders — the RMP East and CLCM procurements — this evaluation would utilise eight criteria and the limited tender for the DSC listed seven criteria.

202 The Defence Procurement Manual (DPM), in place at the time of the procurements, stated: ‘to reduce the risks of a perceived or actual bias in the procurement process, Defence officials should preferably develop and finalise the [tender evaluation] plan before an approach is made to the market, however, it must be completed before submissions are opened’.

all eight unweighted evaluation criteria. The TEB took a different approach, as it considered there to be 'no appreciable difference between the tenderers' solutions' for three of the eight criteria (criterion 1, 4 and 8) and did not 'discuss these criteria any further within the comparative assessment'. The TEB undertook a comparative assessment of the remaining five criteria.

During the comparative assessment, the TEB decided to reconsider the TEWG's assessment for the cost criterion (criterion 7) by adjusting and modifying the tendered price data to enable 'a like-for-like comparison' between the two bids.²⁰³ Tenderer two was subsequently assessed by the TEB as providing approximately 23.7 per cent in savings when compared with tender one's adjusted costs. This figure was greater than the 18.7 per cent difference identified by the Finance TEWG.

Following the TEB's comparative assessment across the five criteria, tenderer one was ranked highest for four and tenderer two scored highest for one criterion (criterion 7). In its value for money assessment, the TEB recorded that:

- for the four criteria where tenderer one was ranked higher, the TEB considered the differences between the tenderers was slight or minor; and
- for the one criterion where tenderer two was ranked higher, the TEB considered that the adjusted lower cost (as calculated by the TEB during the comparative assessment for criterion 7) to be the significant differentiating factor between the two tenders.

On 20 June 2023, the TEB recommended proceeding to contract negotiations with tenderer two, Thales Australia Ltd (Thales), as the preferred tenderer. The delegate approved the negotiated outcome on 31 October 2023.

It was open to the TEB to recommend conducting an 'Offer Definition and Improvement Activity' (ODIA) with the two tenderers prior to the selection of a preferred tenderer. According to Defence's procurement framework, a key aim of ODIA is 'to seek that tenderers, under competitive tension, improve their respective offers', and as a result, '[i]mproving the value for money of tenders is a key benefit of conducting ODIA'. This approach was not canvassed in the TEB's advice to the delegate.

Note a: The Comcare charge was directly relevant to tender evaluation criterion 4: the capability of the tenderer to satisfy the requirements of the draft Contract in relation to the environment and health and safety, including in relation to proposed Subcontractors, and the assessed level of risk relating to performance of the Services in accordance with those requirements.

Note b: The association with a Project of Concern is directly related to criterion 1: past performance of contractual obligations by the tenderer, proposed Subcontractor any Related Bodies Corporate, or special purpose vehicle (in which any of these entities have been involved) including: (i) involvement of any of them in any contract that is or has been listed as a Project of Concern; and (ii) the nature and health of the tenderer's and proposed Subcontractors' previous contractual relationships and behaviour.

Value for money

4.69 Following detailed tender evaluation for the DSC procurement, the delegate approved proceeding to negotiations with Navantia Australia based on a value for money assessment which concluded the following.

203 The Finance TEWG report stated that 'no Normalisations or Adjustments were performed to the Tendered prices of the Tenderers during the evaluation as none were necessary, however a level of sensitivity analysis was required in order to ensure a like-for-like pricing comparison'.

- a. as currently tendered, Navantia's offer does not yet represent value for money, *however*
- b. with carefully structured commercial, technical and financial negotiations, the TEB concluded that the tenderer is capable of meeting the requirements for the subject procurement activity and providing value for money, with a more appropriate balance of technical merit, price and overall risk. [Emphasis original]

4.70 Following negotiations, the delegate approval for the commitment of public funds stated:

The deed provides value for money for the CoA as it rationalises IP and confidentiality arrangements under the DSC and existing Program Agreements between the parties, and can be used for future agreements between the parties, subject to mutual agreement. The DSC and deed ensures these arrangements between the CoA and Navantia are consistent and enable the parties to administer the Program Agreements in the most effective and efficient way.

Contract negotiations

4.71 Defence had originally planned for the new MSM contracts to be in place prior to the end of the existing arrangements.²⁰⁴ Contract negotiations for the new arrangements commenced later than planned.²⁰⁵ These delays increased risks to the continuity of maintenance activities and Defence's ability to effectively negotiate value for money outcomes. For each procurement, Defence did not fully resolve its points of negotiation and left matters to be resolved or undergo 'further maturation' during phase-in. Due to time constraints with the CLCM procurement, Defence agreed to change the delivery dates and milestone payments for phase-in contract deliverables.

4.72 Defence also sought to resolve significant issues identified in the tender evaluation stage during contract negotiations for at least two of the procurements.

- For the sole-sourced DSC procurement, Defence sought to resolve 'high risk critical items' during contract negotiations for a tender proposal it assessed as 'not fit for purpose'.
- For the RMP East procurement, Defence entered a two-stage negotiation, reserving its right to not proceed to stage two and commence negotiations with the other tenderer if 'threshold negotiation issues' from stage one could not be resolved. Use of Defence's Data Management System (DMS) by the RMP East contractor was a threshold issue, as it was 'an essential requirement' for the new Maritime Sustainment Model.²⁰⁶ Defence reported achieving an 'acceptable position' rather than its 'preferred' or 'fallback' positions during negotiations.²⁰⁷

4.73 The contract negotiations were approved by the delegate for all three procurements. Advice to the delegate on the negotiated outcomes included the following.

204 Defence commenced contract negotiations between two and eleven months before the end of the extant ACPC and CSC contracts.

205 This was between 20 days and two months before the planned contract start date for the CLCM and DSC procurements, and eight days after the planned contract start for the DSC procurement.

206 The RMP East RFT stated that 'The DMS is an essential requirement in the approach undertaken by the Commonwealth for the sustainment of the Products Being Supported ... and as such, the Commonwealth will provide systems which shall be utilised by the Contractor. These mandated Commonwealth information systems form the DMS'.

207 The TEB had recommended proceeding to negotiations with Thales 'subject to the Commonwealth obtaining an acceptable position in relation to common access to information held by Thales across the broader RMC [Regional Maintenance Centre] network.'

- RMP East: consultation with the delegate was required during negotiations on issues beyond the scope of the approved contract negotiation directive; there was an agreed 1.5 per cent reduction to the tendered profit rate in exchange for payment terms of 20 days (reduced from 30 days) and an increase to the initial contract period from five to seven years (among other things).
- CLCM: the minimum fallback position for several issues was not achieved; issues outside the scope of the contract negotiation directive required settling; the negotiated price was \$31.5 million higher than originally tendered due to the net impact of scope changes.²⁰⁸
- DSC: The advice to the delegate did not state whether the preferred or fallback positions in the negotiation directive had been achieved. Defence reported that contract negotiations had 'reached an impasse' on 11 December 2024.²⁰⁹ The impasse was resolved between the delegate and the Navantia S.A. Board Chairman on 12 December 2024. Navantia Australia did not agree to the proposed provisions, and Defence instead accepted the inclusion of a Navantia S.A. board member as a senior representative and outreach option in the contract to mitigate risks to Defence.

Contract award

4.74 All three tenderers were awarded contracts following negotiations. The advice to the delegate in approving the RMP East contract did not include updated information on the total estimated value of the contract over its life, such as future total budget estimate costs, additional products and extensions. These elements will be subject to separate approvals under section 23 of the PGPA Act in the future.

4.75 Defence executed the contracts between three and seven months after the planned contract start dates. This was between two and seven months before the end of the respective predecessor arrangements for the CLCM and RMP East procurements, and seven months after for the DSC procurement. As the DSC was not in place by July 2024, Defence requested further services from Navantia Australia under the existing arrangements on 3 July 2024 to address 'an engineering capability gap' that had arisen.²¹⁰ On 12 July 2024, Navantia Australia and Defence executed an official order under the existing deed of standing offer for 2024–25, at a value of \$2.48 million. The total value was \$13.18 million consisting of \$3.44 for LHD support and \$9.75 million for support to the Hobart Class Destroyer ships.

4.76 As outlined in the RMP East contract, Thales was to submit a total budget estimate for the first year prior to the contract's operative date on the 1 July 2024. This requirement was not met, and an estimate was not agreed until January 2025 (seven months later than required). While the

208 During the negotiation period on 5 March 2024, the Minister for Defence Industry was advised by Defence of the contract award to KBR, valued at approximately \$130 million. On 15 March 2024, KBR advised Defence of a \$5.9 million error in the tendered price stating that the wrong rates for a subcontractor had been used. Defence reviewed the revised amount against its earlier tender evaluation and concluded that while the increased cost reduced the value for money offering, it did not impact the overall ranking. Defence concluded that the 'negotiated offer still represents value for money compared to other tenders evaluated'. The negotiated contract price was lower than the tendered price from the other tenderers.'

209 The impasse was in relation to the proposed contract price and the inclusion of a 'walk away' provision in the contract

210 This deed with Navantia expired on 13 July 2024.

estimate was being negotiated, the delegate approved \$168.85 million in payments to Thales to 'allow works to continue as TBE1 [total budget estimate 1] was still being negotiated'.²¹¹

Management of the transition to Maritime Sustainment Model

Governance and risk management

4.77 Defence has established governance arrangements to manage the transition of the LHD sustainment to the MSM. In October 2023, a Fleet Base East MSM Governance Board was established. The board met monthly, with minutes between October 2023 and May 2024 indicating that the board discussed:

- arrangements for managing processes under the MSM — for example, access to engineering services, alignment of policies to reflect the MSM structure, interaction between SPOs and Regional Maintenance Centres;
- transition risks — for example, shortened phase-in of the CLCM, Thales' workforce shortages and lack of presence onsite, and unclear accountabilities; and
- affordability and cost overruns.

4.78 Defence has established a Business Transformation Office to support the transition to the MSM at Garden Island Defence Precinct. In March 2024, Defence advised the ANAO that the Business Transformation Office was developing: a transition risk management plan for the RMC East; governance framework for accountabilities and responsibilities between the ACSSPO and RMC East leadership; and a performance monitoring and reporting framework between all parties. In August 2024, Defence advised the ANAO this work is ongoing.

4.79 The ACSSPO recorded two risks related to the transition to MSM in Predict!: in February 2022, recorded as an ACSSPO business risk; and in September 2023 as a LHD sustainment risk.²¹² The ACSSPO business risk was last reviewed in August 2022 (prior to the commencement of the CLCM procurement process) and has a rating of 'medium' with no current status recorded for the risk. Defence reporting through SPMS has also documented the risk of the transition, and it has been included as a standing agenda item in the Operational Sustainment Management Meeting.

Independent Assurance Reviews

4.80 The implementation of Plan Galileo and the Maritime Sustainment Model has been reviewed by Independent Assurance Reviews (IARs) in November 2021 and October 2023. Consistent with the findings of the 2021 IAR, the 2023 IAR review observed that:

Plan Galileo was not initiated through the development of a traditional Needs Statement from Navy, and has not established an approved Business Case to justify the required investment. Navy has not been involved as a formal 'sponsor' of the Plan. The Plan was initiated within MSD in 2019 based upon a qualitative view that the current SPO based sustainment approaches would not be suitable or sustainable into the future. There was however little detailed analysis conducted at the time to back up the assertion that Plan Galileo, and the revised design of the MSM, would deliver

211 This occurred over three section 23 approvals under the PGPA act: May 2024, \$44.61 million; August 2024, \$39.02 million; and September 2024, \$85.23 million. Note, total differs due to rounding.

212 This risk is recorded as an ACSSPO business risk and is not captured as part of the CN34 LHD sustainment risks. Defence's arrangements to manage risks related to LHD sustainment were examined at paragraphs 3.24 to 3.32. Also refer to recommendation 4.

improved outcomes for Navy. This remains the case today, as there are no quantified performance criteria associated with the delivery of Plan Galileo and the new MSM.

4.81 The IAR Board made 11 recommendations including the development of a benefits realisation plan, a performance model, an industry plan, a change management plan, and a 'quantitative analysis of the performance of the current (SPO centric) operating state, and that the existing sustainment performance be benchmarked'.²¹³ Given the concerns raised by these reviews, transition risks, sustainment funding pressures²¹⁴ and Defence's past performance in managing sustainment contracting²¹⁵, it is important that Defence develops a clear understanding of the extent to which Plan Galileo and the Maritime Sustainment Model is meeting its objectives of enhancing support, delivering efficiency and building sovereign capability.

Recommendation no. 9

4.82 The Department of Defence benchmarks and monitors sustainment performance under the Maritime Sustainment Model to enable an assessment of the achievement of its strategic objectives.

Department of Defence response: *Agreed.*

4.83 *Defence agrees to the recommendation.*



Dr Caralee McLiesh PSM
Auditor-General

Canberra ACT
23 June 2025

213 In December 2024 Defence incorporated the recommendations into the Maritime Sustainment Division transformation governance arrangements.

214 Sustainment funding pressures were discussed at paragraphs 2.81 to 2.88.

215 Defence management of the ACPC contract was discussed at paragraphs 3.33 to 3.79.

Appendices

Appendix 1 Entity responses

Department of Defence



Australian Government
Defence
PO Box 7900 CANBERRA BC ACT 2610

EC25-003406

Dr Caralee McLiesh, PSM
Auditor-General
ANAO
PO BOX 707
CANBERRA ACT 2601

Dear Dr McLiesh

A handwritten signature in cursive script, appearing to read 'Caralee'.

Auditor-General Proposed Report – Sustainment of Canberra Class Amphibious Assault Ships (Landing Helicopter Dock)

Thank you for the opportunity to comment on the Proposed Report for the Auditor-General performance audit *Sustainment of Canberra Class Amphibious Assault Ships (Landing Helicopter Dock)*.

Defence acknowledges that planning and procurement processes, sustainment management arrangements and performance monitoring and reporting were assessed as partly effective.

Defence is committed to ensuring the through-life sustainment of the Canberra Class amphibious assault ships deliver the best possible capability outcomes for the Australian Government and the Australian public.

Defence also welcomes the ANAO's separate engagement with industry through the provision of relevant extracts of the proposed report. This initiative supports Defence's ability to maintain its strong working relationships with our strategic industry providers.

Attached to this letter are Defence's proposed amendments, editorials and comments (**Annex A**), response to requests for information (**Annex B**), response to proposed recommendations (**Annex C**) and Defence's summary response (**Annex D**). These constitute Defence's formal response to the Auditor-General Proposed Report.

2

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

Yours sincerely



Matt Yannopoulos PSM
Acting Secretary



David Johnston AC
Admiral RAN
Chief of the Defence Force

11 June 2025

13 June 2025

Annexes:

- A) Proposed Amendments, Editorials and Comments
- B) Response to Requests for Information
- C) Response to Proposed Recommendations
- D) Defence's Summary Response

BAE Systems Australia Limited

BAE Systems Australia Limited
ABN 29 008 423 005

80 Flinders Street
ADELAIDE SA 5000
PO Box 1068
SALISBURY SA 5108 Australia

BAE SYSTEMS PROPRIETARY

T +61 (0)8 8480 8888
F +61 (0)8 8480 8800
www.baesystems.com/australia

BAE SYSTEMS

6 June 2025

Mr Ian Goodwin
Group Executive Director
Performance Audit Services Group
Australian National Audit Office

BY EMAIL

Dear Sir,

Proposed report into the Sustainment of Canberra Class Amphibious Assault Ships (Landing Helicopter Dock), extract for BAE Systems.

Thank you for the opportunity to provide written comments on those matters contained in the proposed report in which BAE Systems Australia Ltd has a special interest.

BAE Systems makes the following general observations on the proposed report:

- The extract provided makes reference to other sections of the proposed report which are not included but it seems may relate to matters in which BAE Systems has a special interest. We are unable to comment on these excluded sections, and note that it is difficult to comment fully on the material provided in isolation of seeing its entire context.
- The extract makes reference to certain reports and quotations extracted from reports in relation to which BAE Systems was not consulted and has not seen the full final report. Again, it is difficult to comment on those matters in isolation of seeing their entire context.
- The language used at times contains assertions which are inaccurate, or which may lead to an implication that BAE Systems has failed to deliver on contractual obligations or to demonstrate acceptable behaviours, which implication BAE Systems disputes. Any such adverse implication is beyond the scope of the audit criteria applicable here. If these matters are not corrected in the final report, this may be unfairly prejudicial to the commercial interests of BAE Systems.
- The timeframe covered by the draft report relates to matters which occurred in some instances more than ten years ago. It is very difficult to locate personnel or evidence to challenge assertions made after such a length of time.
- BAE Systems is very supportive of an approach to Defence contracting which promotes a collaborative and efficient transfer between acquisition and sustainment programs, especially in relation to complex platforms. A procurement and contracting methodology which does not have a view to such collaboration

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and efficiency risks driving in challenges of the kind witnessed on the LHD sustainment program which is the subject of the proposed report, and which ultimately may not deliver optimum value for money to the Commonwealth of Australia. A good example of collaborative contract performance in sustainment is the DDG Enterprise where BAE Systems achieved and maintained a purple scorecard rating in its role as Managing Contractor after working through the initial challenges of the transition from acquisition.

The attachment to this letter sets out BAE Systems' specific comments for the consideration of the Auditor-General before preparing the final report.

Please do not hesitate to contact me if we can further clarify our comments.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Craig' followed by a stylized surname.

Craig Lockhart
Chief Executive Officer
BAE Systems Australia

M: +61 477 449 932 | **E:** craig.lockhart@baesystems.au



Delivering Solutions, Changing the World®

KBR Ref: S0565

13 June 2025

Dr Caralee McLiesh PSM
Auditor-General for Australia
Australian National Audit Office
By email: OfficeoftheAuditorGeneralPerformanceAudit@anao.gov.au

RE: Auditor-General Proposed Audit Report on Defence's sustainment of Canberra Class Amphibious Assault Ship (Landing Helicopter Dock)

Dear Dr McLiesh

Thank you for the opportunity to provide comment on the proposed audit report on Defence's sustainment of Canberra Class Amphibious Assault Ships (Landing Helicopter Dock) attached to your email of 19 May 2025.

KBR has no specific comments relating to the proposed audit report content provided by ANAO.

In relation to Case Study 2, KBR acknowledges and agrees that it raised the need to manage conflicts of interest when flagging its intention to bid for the ACS CLCM contract. The request for information on or about August – October 2023 was made in relation to work being undertaken in relation to an MSP contract (within the Maritime Sustainment Division). It was not made to obtain 'information of commercial value' to assist with the ACS CLCM bid.

KBR is very cognisant of its obligations regarding potential, actual and perceived conflicts of interest given its position on the Major Service Provider (MSP) panel arrangement and ensures it acts to properly manage these with integrity, professionalism and openness with the customer.

Please don't hesitate to contact me if you require anything further.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'N. Maan', is positioned above the printed name.

Nic Maan
VP Australia Defence & Security Solutions
Email: Nicolas.Maan@kbr.com

Babcock Pty Ltd



Babcock Pty Ltd

Level 9, 70 Franklin Street
ADELAIDE
South Australia 5000
AUSTRALIA

Postal Address:
(GPO BOX 1275, Adelaide)
(South Australia 5001)
(AUSTRALIA)

Tel +61 (0)8 8440 1400
ABN 32 050 019 817
www.babcock.com.au

13 June 2025

Dr Caralee McLiesh PSM
Auditor-General for Australia
Australian National Audit Office
GPO Box 707
CANBERRA ACT 2601

via email: OfficeoftheAuditorGeneralPerformanceAudit@anao.gov.au

Dear Dr McLiesh,

**RE: Auditor-General Proposed Report: Sustainment of Canberra Class Amphibious Assault Ships
(Landing Helicopter Dock)**

Thank you for the opportunity to comment on the Auditor-General's Proposed Report on the Sustainment of Canberra Class Amphibious Assault Ships (Landing Helicopter Dock).

Babcock acknowledges the ANAO's report which references the Landing Helicopter Dock Asset Class Prime Contractor Contract delivered by Naval Ship Management (Australia) Pty. Ltd. (NSM). NSM was established in 2012 as a Joint Venture and acquired fully by Babcock in February 2022.

Enclosed with this letter is Babcock's proposed amendments and comments (Annex A), as well as our entity response (Annex B).

If you require any further information, please do not hesitate to contact me.

Yours sincerely,

Andrew Cridland
Chief Executive Officer Australasia
Babcock International Group

Encl.

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 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. During the course of the audit the ANAO observed Defence update Navy's Materiel Sustainment Agreement (MSA) with the Capability Acquisition and Sustainment Group and establish an interim MSA with the Naval Shipbuilding and Sustainment Group. (paragraph 3.4)

Appendix 3 Contracted performance assessment and reporting arrangements

Performance review/report	Frequency	ANAO comment
Combined services performance reviews Aim: To provide an opportunity for contractor and Commonwealth to discuss the provision of services, and any issues related to services and/or the LHD assets.	Quarterly	In August 2024, Defence provided copies of calendar meeting invitations for seven combined services performance review meetings scheduled between August 2022 and March 2024. Defence did not retain any supporting documentation (such as agendas, meeting minutes) for these meetings.
Contract performance reviews Aim: To consider factors reported in the annual Contract Status Report and to facilitate the early identification and mitigation of the contractor's or Commonwealth's performance under the contract.	Annually First quarter of each Performance Period	Not undertaken
Performance assessment reviews Aim: To enable the Commonwealth to consider the contractor's adjusted performance scores for the KPIs and their performance against applicable Strategic Performance Measures (SPMs) and System Health Indicators (SHIs). Performance assessment reviews allow the Commonwealth to appraise the contractor's performance for matters reported in Contract Status Reports (CSRs) and other matters relevant to the contractor's performance, such as Remediation Plans and allows the Commonwealth to determine Performance Payments.	Quarterly No later than 20 working days after the end of the Review Period a specific KPI	Not undertaken
Periodic cost reviews Aim: To provide the necessary information to enable Defence to: <ul style="list-style-type: none"> determine the allowable costs that the contractor has incurred in providing recurring services during the cost review period; determine any savings achieved by the contractor through approved efficiencies; and ensure that the contract represents, and will continue to represent, value for money for the Commonwealth. 	May be held at the Commonwealth's discretion	Not undertaken

Performance review/report	Frequency	ANAO comment
Award term assessments Aim: To determine whether the contractor's performance during the award assessment period is satisfactory and whether an award term extension will be granted.	Once for each award term ^a	Defence conducted an Award Term Assessment, reviewing NSM's performance during an Award Assessment Period between 1 July 2019 and 11 March 2022 (Award Determination Date).
Contract status reports Contract status reports include regular updates on the progress, planned activities, problems and risks, issues and opportunities, financial management and budgeting, as well as reporting on Australian Industry Capability (AIC), performance measurement, and continuous improvement and efficiencies (CIE).	Annually	Contract status reports were not submitted for the first three years of the contract (2019–20, 2020–21 and 2021–22). The contract status report for TCE 4 (2022–23) was submitted on 9 May 2024. Defence executed a contract change proposal on 20 May 2024 (CCP 045), removing the requirement for NSM to submit the final contract status report for TCE 5 (2023–24).
Combined services summary reports Combined services summary reports (CSSRs) include updates on the activities associated with the provision of services across all service areas during the reporting period. It includes updates on the AIC and Commonwealth Assets Assurance and Stocktaking Report.	Quarterly	As at July 2024, NSM had provided 20 CSSRs. Reports for TCE 1 were not finalised until January 2021. Submission timeframes improved for TCE 2 to TCE 5, with 88% of reports submitted within two months of the close of the reporting period.

Note a: The contract sets out that Defence will advise the contractor if an award term extension will be granted within 120 working days prior to the Off Ramp Date — known as the Award Determination Date. On 17 August 2021, Defence Legal provided advice to ACSSPO that 6 January 2022 was the earliest the Award Determination Date could be, and 29 June 2022 was the latest the Award Determination Date could be Defence formally advised NSM of these Award Determination Dates on 25 August 2021).

Source: ANAO analysis of Defence documentation.

Appendix 4 Comparison of sustainment functions under asset class prime contractor and the Maritime Sustainment Model

1. Under the Systems Program Office model, all sustainment functions for a class of ship (maintenance services, spares, engineering and other support) is managed by a single Systems Program Office at the ships designated home port. The supplier engagement model is typically a class-by-class contract with a prime contractor who carries out most aspects of the sustainment such as asset management, engineering changes, and maintenance execution.

2. The transition to the MSM sees responsibility within Defence for sustainment activity for a class of ship extend beyond a single Systems Program Office, with Regional Maintenance Centres responsible for maintenance support). The supplier engagement model has several industry contracts responsible for different aspects of the sustainment function. Table A.1 compares the sustainment functions under the asset class prime contractor model and the Maritime Sustainment Model.

Table A.1: Comparison sustainment functions under the asset class prime contractor model and the Maritime Sustainment Model

Function			Phase 2 Asset class prime contractor model	Phase 3 Maritime Sustainment Model	
Governance			Systems Program Office (Defence)	Systems Program Office and Regional Maintenance Centres (Defence)	
Assurance services	Maintenance monitoring		Capability support contract	Capability Life Cycle Manager	
	Supply chain management				
Asset management	Asset management		Asset Class Prime Contract		
	Life cycle cost management		Capability support contract		
Engineering support	Whole Ship Integrator	Management services	Asset class prime contract	Regional maintenance provider	
		Engineering services			
		Physical installation	Asset class prime contract		
	Design			Capability support contract	Design support contract
	Configuration baseline management			Asset class prime contract	Capability Life Cycle Manager
	Engineering services				
	Operating support				
Supply support					

Function		Phase 2 Asset class prime contractor model	Phase 3 Maritime Sustainment Model
Maintenance support	Maintenance planning		
	Maintenance execution		Regional maintenance provider

Note: The cells are coloured to indicate the common elements across the phases and functions.

Source: ANAO representation of extracts from Defence documentation.