

The Auditor-General
Audit Report No.48 2008–09
Performance Audit

Planning and Approval of Defence Major Capital Equipment Projects

Department of Defence

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of Australia 2009

ISSN 1036–7632

ISBN 0 642 81081 8

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Canberra ACT
30 June 2009

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Department of Defence in accordance with the authority contained in the *Auditor-General Act 1997*. 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 and the accompanying brochure to the Parliament. The report is titled *Planning and Approval of Defence Major Capital Equipment Projects*.

Following its tabling in Parliament, the report will be placed on the Australian National Audit Office's Homepage—<http://www.anao.gov.au>.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian McPhee', is positioned above the printed name.

Ian McPhee
Auditor-General

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

AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office. The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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Abbreviations

ADF	Australian Defence Force
APMP	Acquisition Project Management Plan
AS	Acquisition Strategy
ASMD	Anti-Ship Missile Defence
AWD	Air Warfare Destroyer
CCDG	Chief of Capability Development Group
CDB	Capability Development Board
CDD	Capability Definition Document
CDF	Chief of the Defence Force
CDG	Capability Development Group
CIOG	Chief Information Officer Group
CIR	Capability Investment and Resources Division
CM	Capability Manager
CPFP	Capability Proposal First Pass
CPSP	Capability Proposal Second Pass
DCC	Defence Capability Committee
DCCDM	Defence Capability Development Manual
DCIC	Defence Capability and Investment Committee
DCP	Defence Capability Plan
DID	Data Item Description

DI(G)	Defence Instruction General
DMO	Defence Materiel Organisation
DPR	2003 Defence Procurement Review (Kinnaird Review)
DRN	Defence Restricted Network
DSN	Defence Secret Network
DSTO	Defence Science and Technology Organisation
FASCIR	First Assistant Secretary Capability Investment and Resources
Finance	Department of Finance and Deregulation (formerly Department of Finance and Administration)
FPS	Function and Performance Specification
HCS	Head Capability Systems
IBC	Initial Business Case
IPT	Integrated Project Team
JCPAA	Joint Committee of Public Accounts and Audit
JSF	Joint Strike Fighter
MCE	Major Capital Equipment
MCF	Major Capital Facilities
MUAV	Multi-mission Unmanned Aerial Vehicle
NPOC	Net Personnel and Operating Costs
NSC	National Security Committee of Cabinet
OCD	Operational Concept Document

ORC	Options Review Committee
PBS	Portfolio Budget Statements
PM&C	Department of the Prime Minister and Cabinet
PMP	Project Management Plan
POCD	Preliminary Operational Concept Document
ROMAN	Resource Output Management and Accounting Network
RFT	Request for Tender
TARDIS	CDG Knowledge and Information Management System
TCD	Test Concept Document
TRL	Technology Readiness Level

Summary and Recommendations

Summary

Introduction

1. The management of major capital equipment projects¹ in Defence is a complex and challenging activity. Defence's performance in this area has been the subject of a number of reports by the Joint Committee of Public Accounts and Audit (JCPAA), the Senate Committee on Foreign Affairs, Defence and Trade, and the ANAO. Over the years, ANAO performance audits into acquisition projects have also identified significant weaknesses in project planning - including risk identification and management, as well as project costing issues - resulting in projects experiencing cost overruns, scope changes and delayed implementation.

2. It was in response to concerns about the procurement process for major Defence acquisitions that the then Government announced, in December 2002, the appointment of a review team, chaired by Mr Malcolm Kinnaird AO, to examine and report on issues associated with major capital acquisitions in Defence. The review team's report, the *Defence Procurement Review* (DPR),² was published in August 2003. The report made ten major recommendations and a number of additional points for consideration.

3. Recommendation No.3 of the DPR was aimed at strengthening the then existing two-pass approval process for Defence's major capital equipment acquisitions. The recommendation was that:

Government should mandate, and enforce via revised Cabinet rules, a rigorous two-pass system for new acquisitions with government considerations dependent on comprehensive analyses of technology, cost (prime and whole-of-life) and schedule risks subjected to external verification.

4. Following the then Government's broad acceptance of the recommendations of the Defence Procurement Review in September 2003, Defence commenced implementing a strengthened two-pass process to support the planning and approval of major capital equipment projects.

¹ Defence defines a major capital equipment project as any project involving expenditure of \$20 million or more, or of less than \$20 million with strategic significance or with individual items of \$1 million or more.

² This is also known as the Kinnaird Review.

5. During the period this audit was undertaken, the Government commissioned the Defence Procurement and Sustainment Review,³ also known as the Mortimer Review. The Review report provided to the Government in September 2008 made 46 recommendations aimed at addressing the five principal areas of concern identified by the Review: inadequate project management resources in the Capability Development Group; the inefficiency of the process leading to Government approvals for new projects; shortages in DMO personnel; delays due to inadequate industry capacity and difficulties in the introduction of equipment into full service.

6. Late in the course of this audit, the Government's response to the Review was released on 2 May 2009, the same day as the *Defence White Paper 2009* was released. Defence agreed to 42 recommendations, agreed in part to a further three recommendations⁴ and did not agree⁵ to one recommendation. Together with providing detailed responses to the review's recommendations, the Government's response to the Mortimer review⁶ also sets out the key elements of the reform program for the capability development areas in Defence, for the DMO, and for enhancing the DMO-Defence relationship as a whole.

Audit objective and scope

7. The objective of this audit was to assess whether the strengthened two-pass approval process for major capital equipment projects is being implemented effectively.

8. The audit's scope included an examination of key capability development documentation prepared for a sample of 20 projects⁷ drawn from the 84⁸ that had received first pass, second pass or both first and second pass approval since the introduction of the strengthened two pass approval process. The audit scope also included a review, against the requirements of the

³ The then Parliamentary Secretary for Defence Procurement announced on 7 May 2008 that Mr David Mortimer AO would chair this review.

⁴ Defence agreed in part to Recommendations 2.2, 4.7 and 5.4 of the Mortimer report.

⁵ Defence did not agree to Recommendation 5.1 of the Review report which recommended that the DMO should be established as an Executive Agency under the *Public Service Act 1999*.

⁶ *The Response to the Report of the Defence Procurement and Sustainment Review*, 2 May 2009.

⁷ Listed at Table 4.1 and described at Appendix 3.

⁸ As at 27 May 2008.

Cabinet Handbook,⁹ of the submissions to Government seeking first and/or second pass approval for these 20 projects. The ANAO's sample included many of the highest value projects, balanced across the various environments (land, sea, air and joint projects) and reflected the diversity of types of major capital equipment acquisitions undertaken by Defence.

Conclusion

9. Defence has established an appropriate administrative framework for implementing the strengthened two-pass approval process, including high-level oversight, and established the Capability Development Group (CDG) to administer the system.¹⁰ Defence has also issued a Defence Capability Development Manual (DCDM),¹¹ that describes the strengthened two-pass approval process and provides 'authoritative guidance to CDG staff in carrying out the Group's core tasks of developing investment proposals (including options) for new Defence capabilities for consideration by Government and managing the Major Capital Equipment program'.¹²

10. The DCDM is complemented by a number of more detailed process documents and tools, in particular the Process Map that is intended to guide

⁹ The *Cabinet Handbook* lays down the principles and conventions by which the Cabinet system operates, and the procedures designed to ensure that the Cabinet process fulfils its central purposes. It also contains the rules applying to submissions and memoranda related to defence procurement. These rules are closely aligned to the DPR's recommendations in respect of a strengthened two-pass approval system.

¹⁰ During the capability development process, CDG carries overall responsibility for the coordination of the preparation of first and second pass proposals. However, for many projects, some capability development work is carried out by DMO under a Memorandum of Arrangement between CDG and DMO. DMO provides specialist engineering, project management and industry expertise that is required in developing capability development documents such as the overall project plan, the acquisition strategy and costing estimates. According to the 2006 *Defence Capability Development Manual* (DCDM) DMO is one of the stakeholders that 'should, as a matter of course, be consulted, and invited to participate in an Integrated Project Team in either a full- or part-time, or advisory, capacity'.

¹¹ The *Defence Capability Development Manual* replaced the *Capability Systems Life Cycle Management Manual* (2002). Version 1.0 of the DCDM was issued in 2005; Version 2.0 of the DCDM was issued in 2006 and was the latest version at the time this audit was conducted.

¹² Under the System of Defence Instructions, the system of policy and procedural instruments which regulates the administration of Defence, compliance with the directions in Defence Manuals is 'mandatory and enforceable'. Defence Manuals are distinguished from other manuals within Defence by their authorisation or endorsement. Defence Manuals are either signed by the Secretary of Defence and the Chief of the Defence Force (CDF), or are endorsed through a Defence Instruction General DI(G) signed by the Secretary and the CDF. Neither version of the DCDM issued thus far is signed by the Secretary or CDF nor are they endorsed by a DI(G), they are signed by the Chief, Capability Development Group. The DCDM is therefore not a Defence Manual in the sense that compliance with it is mandatory and enforceable. Nevertheless, the DCDM is 'authoritative guidance'.

projects through required approval gates¹³. Collectively, the DCDM and its supporting documents and tools provide a sound framework to deliver more effective administrative outcomes over the original two-pass approval process, provided the framework is adhered to and underpinned by adequate and appropriate resourcing, support and training for CDG staff.

11. Despite establishment of a sound administrative framework to implement the strengthened two-pass approval process, the execution of the capability development processes for the case study projects in the ANAO's audit sample at times differed to the authoritative guidance set out in the DCDM and the *Cabinet Handbook*. Poor record-keeping in CDG meant that, in most cases, the ANAO was unable to determine whether Defence's inability to provide key documents, which the DCDM indicated should be prepared during the first and/or second pass approval process, was a consequence of poor records management practices or because the documents had not been prepared. Consequently, Defence was unable to demonstrate, through the provision of access to key project documents, that the procedures outlined in the DCDM and the Process Map were consistently followed in the relevant case study projects,¹⁴ or that appropriate alternative procedures were authorised and followed.

12. Defence advised that the capability development system has evolved since the 2006 DCDM was promulgated, and that the intent of the Kinnaird reforms has been upheld, even though there has not necessarily been strict adherence to the DCDM. Defence further advised that deviations from the process outlined in the DCDM are the result of this evolution, rather than departures from the process, and that the DCDM was developed by Defence to provide generic guidance to desk officers, but in practice the process is tailored for each project.

¹³ The Process Map is intended to provide 'detailed guidance and templates' to CDG staff on capability development to 'enable the key capability products (and supporting products) to be developed, suitably endorsed and then navigated through the required approval gates at all levels'.

¹⁴ Paragraphs 52 and 53 explain that two of the projects in the ANAO's audit sample of 20 case study projects were excluded from the strengthened two-pass approval process, as outlined in the DCDM, at the direction of the then Government. Another became an 'accelerated' acquisition, at the direction of the then Government. A further four projects were developed during the transition period during which the then Government agreed that submissions could be presented with less rigorous requirements. An eighth project, Sea 4000 Phase 3 — Air Warfare Destroyers, was treated differently by Defence because of its complexity, duration and materiality. Defence advised ANAO that the DCDM did not contemplate in detail the kind of approach that Defence and the then Government considered was required for this project. Defence's explanation of the approach to obtaining Government approval of the phases of the SEA 4000 project is explained in Chapter 4, commencing at paragraph 4.58.

13. Nevertheless, where a tailored approach is to be adopted on a project by project basis, it is still important to ensure that key elements required to produce sound proposals to government at first and second pass are clearly identified and executed and that the rationale for, and the elements of, the approach to be applied in a particular project are clearly authorised at an appropriate level. It was not evident that Defence consistently applied this level of discipline in relation to the approaches taken to developing the first and/or second pass approval submissions to Government for the projects in the ANAO's audit sample.

14. Defence is currently preparing a revised DCDM in the context of the *Defence White Paper 2009* and the capability development process reforms outlined in the Government's response to the Mortimer review. The ANAO considers that Defence should ensure that the revised DCDM clearly identifies for CDG staff the key elements that are required to produce robust proposals to Government at first and second pass, and provides guidance on the process to be followed to obtain authorisation for the particular approach to be pursued in the context of an individual project.

15. The ANAO reviewed the 23 submissions, which had been provided to the National Security Committee of Cabinet (NSC) in relation to the 20 projects¹⁵ in our audit sample,¹⁶ against the *Cabinet Handbook* requirements for submissions seeking first and/or second pass approval and noted a significant level of non-adherence, across the sample, to a number of

¹⁵ The ANAO found that 15 of the 20 sample projects followed the documented path for NSC approval. Defence was not required to develop Cabinet submissions for two of the case study projects. The Super Hornet acquisition project, AIR5349 Phase 1, was approved as a New Policy Proposal in the 2007–08 Budget (see paragraph 4.18) with the then Government making this decision outside the two-pass approval process. In accordance with the *Cabinet Handbook*, the second project, Aviation Fire Trucks - JP2095 Phase 1, was not required to be submitted to the NSC for consideration because its value was below \$50 million. This project received combined first and second-pass approval through an exchange of letters between the Ministers for Defence and Finance.

The remaining three sample projects received second pass approval following the introduction of the strengthened two-pass approval process, but not as the result of a second pass submission to the NSC. JP2080 Phase 2B.2 - ROMAN Upgrade received first pass approval from the NSC, and subsequently received second pass approval by the relevant Ministers, because its value was below \$50 million. JP2008 Phase 4 - Military Satellite Capability received first pass approval by the NSC, and subsequently received second pass approval by the then Prime Minister. AIR 8000 Phase 3 - C-17s received combined first and second-pass approval from the NSC in March 2006 despite having been submitted by Defence for first pass approval only.

¹⁶ At the time of the audit, of the 15 sample projects that had followed the documented path for NSC approval, six had received first pass approval only and had not yet received second pass approval when the sample was selected; three had received second pass approval only; and six had received both first and second pass approval.

Cabinet Handbook requirements. The most significant of these are to do with the assessment and description of technical risk,¹⁷ and the presentation of costs,¹⁸ associated with acquiring a new capability.

16. The DPR Report emphasised the importance of the early and continuous involvement of Finance throughout the two-pass process to provide Government with an independent evaluation of capability development proposal costings. Additionally, the DPR Report stated that 'ideally, Defence should provide [to Government] well developed business cases for the proposed investments, based on sound costings models, for validation by Finance'.¹⁹

17. In March 2004, Defence advised the then Government that appropriate working arrangements would be developed by Defence and Finance to ensure Finance received the information required to review cost risks associated with capability development proposals. However, Defence has not implemented, nor set out, appropriate processes and procedures for the early and ongoing engagement of Finance in the development of cost estimates for capability development proposals.

18. The absence of agreed processes and procedures, and of guidance for desk officers and their managers on the approach to be taken in this regard, means that Government may not be consistently provided with the level of independent evaluation of capability development proposal costings envisaged by the DPR. In practice, this has meant that of the 23 submissions to Government reviewed by the ANAO in this audit, four went to Government containing cost estimates that Finance did not agree to.²⁰

19. In this regard, the ANAO notes that the Government's response to the Mortimer Review indicates that one of the actions by which reforms to the Capability Development process will achieve the provision to Government of more reliable information on which to base judgements and a more efficient

¹⁷ See paragraphs 65 to 67 for a discussion of the issues related to the assessments of technical risk included in submissions in the ANAO's audit sample.

¹⁸ See paragraphs 68 to 70 for a discussion of the issues related to the presentation of costs included in submissions in the ANAO's audit sample.

¹⁹ *Defence Procurement Review*, p 17.

²⁰ Paragraph 8.14 of the *Cabinet Handbook* states that 'each first and second pass submission or memorandum requires agreement with Finance on the detailed acquisition and operating costings and financial risk assessment'.

and effective capability process will be through ensuring early consultation with Finance on options, cost estimates and project risks.²¹ The ANAO has recommended that Defence agree with Finance a suitable approach to allow Finance's early and ongoing involvement in the evaluation of capability development proposal costings.

20. A central theme of the Kinnaird and Mortimer Reviews has been the importance of Defence minimising, to the extent possible, the risks attached to major capital equipment acquisition projects by adopting a strengthened two-pass approach to government approval of the capability solution to address an identified capability gap and adopting more rigorous procedures to give greater confidence in budget and delivery estimates for major capability development proposals. Defence put in place a sound administrative framework following the 2003 Kinnaird Review but has not applied sufficient discipline through its governance arrangements to give assurance that the key elements of the framework are consistently applied in the development of capability development proposals. This increases the risk that the benefits, particularly in terms of reduced risks, sought through the reforms flowing from the Kinnaird and Mortimer reviews may not be realised to the extent expected.

21. Given the importance of effective planning and scoping to the successful delivery of capability, further attention to a range of issues is required to provide government with assurance that the body of information provided to inform its decisions on major defence acquisitions meets the standards previously set, and expected, by government. These issues include the need to:

- revise the administrative framework, particularly the DCDM, such that:
 - clear guidance is provided as to the key elements that are required to produce sound proposals to government at first and second pass; and
 - the requirement for authorisation at an appropriate level for the rationale for, and the elements of, the approach to be applied in a particular project is mandated and that such authorisation is recorded;

²¹ *The Response to the Report of the Defence Procurement and Sustainment Review*, pp. 9-10.

- substantially improve CDG's recordkeeping policies and performance to ensure that key material supporting first and second pass submissions is appropriately stored and accessible. Sound document management is particularly important in the context of Defence major capital equipment projects given the sometimes long time-lines associated with both the capability development phase and also the acquisition phase;
- agree with Finance a suitable approach to allow Finance's early and ongoing involvement in the evaluation of capability development proposal costings;
- adequately resource, train and support CDG desk officers; and
- ensure adherence to the requirements of the *Cabinet Handbook*, particularly in relation to preparation and provision of costings and the assessment and description of technical risk in submissions.

Key findings

The strengthened two-pass approval system (Chapter 2)

22. The 2003 DPR found that Government had often been asked to sign off on acquisition proposals at a point where there had not been sufficient analysis within Defence to give confidence that financially and technically robust decisions were being made. The DPR stated that 'too often, poorly defined and inaccurately costed projects had been put to Government and passed to the DMO to acquire.'²² The DPR therefore identified the need for a single point of accountability to provide better integration of the capability definition and assessment process and to ensure that it maintains a joint warfare focus.

23. The 2003 DPR also noted that, at the time, the process of capability definition and assessment in Defence notionally followed a two-pass system. However, the DPR found that, as it was then practised, the system lacked rigour and discipline and was not based on mandatory endorsement of key decisions by relevant stakeholders, nor was external scrutiny applied to significant aspects of proposals being forwarded to Government.

²² *Defence Procurement Review*, pp. iv – v.

24. These findings led to Recommendations 2 and 3 of the DPR. Recommendation 2 was that a three star officer, military or civilian, should be responsible and accountable for managing capability definition and assessment.²³ As noted in paragraph 3, Recommendation No.3 of the DPR was aimed at strengthening the then existing two-pass approval process for Defence's major capital equipment acquisitions.²⁴

25. In response to the DPR, in December 2003, Defence appointed a three star ADF officer as Chief of Capability Development Group (CCDG), with responsibility and accountability for Defence's capability development process. The Capability Development Group (CDG) was then established in February 2004 with the responsibility of managing the process for developing capability development proposals from their entry into the Defence Capability Plan through to final approval by government.

26. In March 2004, the then Government agreed to transitional approval arrangements for projects with a year of decision of 2003–04 or 2004–05. Because of this decision, some projects were specifically exempted from the requirement for first pass approval by the NSC. The NSC also agreed that proposals with a year of decision of 2003–04 or 2004–05 could be submitted for approval despite not meeting all requirements of the new process, provided the level of information was 'sufficiently robust.' Defence did not formulate any specific instructions, guidelines or advice to desk officers in CDG on the process to be followed in preparing capability development proposals for these projects. Due to uncertainty within CDG about the transition status of some projects, the ANAO received conflicting advice from different areas within CDG on the transition status of certain projects within the audit sample.

²³ Recommendation No.2 of the DPR went on to say that this appointment should be on a full-time basis, with a defined tenure (minimum five years) to ensure a coherent, cohesive, holistic and disciplined approach.

²⁴ Recommendation No.3 of the DPR was that:

'Government should mandate, and enforce via revised Cabinet rules, a rigorous two-pass system for new acquisitions with government considerations dependent on comprehensive analyses of technology, cost (prime and whole-of-life) and schedule risks subjected to external verification'.

27. The ANAO found that high-level processes associated with the establishment of CDG²⁵ were essentially sound. It also considers that, collectively, the processes outlined in the 2006 DCDM and Process Map to operationalise the strengthened two-pass approval process provide a sound framework to deliver more effective administrative outcomes over the original two-pass approval process provided the framework is adhered to and underpinned by adequate and appropriate resourcing, support and training for CDG staff.

Independent review of costings

28. CDG's Orientation Booklet describes the role of the CIR Division as to:

- provide independent advice to the DCIC and DCC on capability priorities, resources and balances, in particular relating to the Major Capital Investment Program; and
- advise on the adequacy, alignment, costing and risks associated with individual new Major Capital Equipment proposals and key Major Capital Facilities proposals.

29. However, the ANAO found that the governance arrangements under which CIR Division operates are not conducive to the provision of independent analysis and review of costings, or to the provision of independent advice to the committees considering whether, and in what form, to progress capability proposals. Rather than providing an independent viewpoint, CIR Division staff are accountable to CCDG—as are the desk

²⁵ In October 2003, Defence established the DPR Implementation Team, supported by a DPR Stakeholder Group and a DPR Steering Group to implement the recommendations made in the DPR. The DPR Steering Group—chaired by the Secretary of the Department of Defence and including senior Defence Department, ADF and DMO representatives—had ultimate authority for DPR implementation.

In addition, In January 2004, the then Government formed the Defence Procurement Advisory Board and made it responsible for:

- governance and oversight of the implementation;
- reporting its progress to the National Security Committee of Cabinet (NSC); and
- providing strategic direction to the Chief Executive Officer (CEO) of DMO.

The Board comprised three private sector representatives and senior members of the Defence Force, the Department of Defence, the Department of the Treasury and the then Department of Finance and Administration (Finance). It first met in March 2004 and met several times each year until its most recent meeting in February 2008. The Mortimer Review recommended that the Board continue with an increased focus on providing advice to the CEO of DMO. Defence advised the ANAO that the Government has agreed with the intent of the recommendation and intends to subsume the functions of the DPAB, as described in the response to the Mortimer Review, within a proposed Strategic Reform Advisory Board, which would draw its membership from both the public and private sectors.

officers who prepare the proposals and costings, and the directors who manage them. Similarly, CCDG is Chair of the DCC and a member of the DCIC, yet the advice provided by CIR Division to these committees is considered by Defence to be independent.

30. Defence advised the ANAO in response to the proposed audit report that it considered that the arrangements it has in place for CIR Division mean that the actual location of the division is not relevant.²⁶ The ANAO recognises the steps taken by Defence seeking to maximise the independence of the advice provided by CIR Division. However, there are limits to the degree of independence that can be achieved while CIR Division and the staff preparing capability proposals and costings are responsible to the same line manager.

31. The ANAO notes that, going forward, reforms outlined in the *Defence White Paper 2009* and the Government's response to the Mortimer Review will change how costings are developed. Defence advised the ANAO in June 2009 that:

CCDG will remain the coordinating authority for the development of submissions to Government; the Defence Materiel Organisation (DMO), supported by Defence Groups and Services, is responsible and accountable for developing military equipment costs and schedule estimates, risk analysis, and developing and implementing an acquisition strategy. In alignment with the revised approach, CEO DMO will also be required to attend all NSC meetings if capability acquisition decisions are being sought.

Finance's involvement

32. The 2003 DPR identified that:

Finance agreement to Cabinet submission costings is generally sought shortly before lodgement, and does not allow sufficient time for any in-depth analysis of capability, strategic, technical, legal or commercial issues associated with the costs and risks of major capital investments or other procurements.²⁷

²⁶ Defence advised in June 2009 that:

[The First Assistant Secretary of CIR Division] FASCIR has direct accountability and direct access to the Secretary and CDF. Even though the line manager is CCDG, agendum papers submitted to the DCC are drafted within CIR Division and authorised for release by FASCIR. CCDG is not involved in the development of these agendum papers, so independence of advice and issued raises at DCC and DCIC is maintained. The DCC and DCIC agendum papers are supported by independent analysis undertaken by both branches of CIR Division. Further, FASCIR attends both the DCC and DCIC and is able to provide his opinion and advice directly at these forums.

²⁷ Department of Prime Minister and Cabinet 2003, *Defence Procurement Review*, p.17.

33. The DPR Report emphasised the importance of the early and continuous involvement of Finance throughout the two-pass process to provide government with an independent evaluation of capability development proposal costings. Additionally, the DPR Report stated that 'ideally, Defence should provide [to government] well developed business cases for the proposed investments, based on sound costings models, for validation by Finance'.²⁸

34. In March 2004, Defence advised the then Government that appropriate working arrangements would be developed by Defence and Finance to ensure Finance received the information required to review cost risks associated with capability development proposals.

35. Defence advised the ANAO that it considers that this element of the DPR reforms has been implemented in terms of both process and outcome. However, no agreed, documented processes and procedures exist to facilitate Finance's early and ongoing engagement in the development of cost estimates for capability development proposals.

36. Finance is a permanently invited member²⁹ of the DCC and therefore has some engagement at this stage in the process of developing two-pass submissions through access to Defence papers and information presented to DCC members. Finance informed ANAO of its view that recent practice in Defence has seen the DCIC take the place of the DCC in considering the larger and more risky capital capability equipment proposals. Finance is not a member of the DCIC.³⁰ Finance informed the ANAO that it does not receive the relevant information early in the process, and often only receives a first look at the costing information and risks 30 days or less out from a submission being put to the NSC. Additionally, Finance informed the ANAO that the

²⁸ *ibid.*

²⁹ Permanent members are expected to attend or be represented at every meeting. Permanently invited members are expected to attend only for relevant items. Reference: Defence Capability Committee Governance Principles.

³⁰ The ANAO had sought Defence's advice during the audit as to the number of projects in recent years that had been considered by the DCIC rather than the DCC. In June 2009, Defence advised the ANAO as follows:

Since 2006 only three projects have been considered by the DCIC that were not also considered by the DCC. All other projects since 2006 have gone through the DCC, of which [the Branch Manager of the Defence Capability Assessment Branch at Finance] is a permanent member. These three projects were the AWD [SEA 4000 Phase 3 - Air Warfare Destroyer (AWD) build phase], LHD [JP 2048 Phase 4A/4B – Amphibious Ships] and NACC [AIR 6000 – New Air Combat Capability] projects, which given their size and complexity, were considered by the more senior committee.

information provided at this point is often limited and of questionable quality. Finance further advised that:

the information provided is often very detailed, but as subsequent events have shown, failed to identify correctly the areas of major risk and potential financial impacts. For some projects, Finance has no advance information from Defence, or engagement at a working level prior to the formal consideration process by Ministers.

37. Finance informed the ANAO that these issues limit Finance's ability to be involved and to provide adequate external verification of proposals early on in the capability development process.

38. Defence has a different perspective on how effectively its engagement with Finance is operating during the capability development process. Defence informed the ANAO that:

...suggestions that Finance and CDG are not closely linked in the early stages of Capability Development are inconsistent with CDG processes. Finance are engaged on large and complex projects to the Defence Capability Committee (DCC) much earlier than the 30 days or less mentioned in the ANAO report. The report also mentions that what Finance receives is often limited and of questionable quality. Again this is not consistent with the recognised and demonstrable level of Capability Investment and Resources (CIR) Division's engagement with [Finance].

39. It is important for Finance and Defence to develop a common understanding on the appropriate approach to engagement between the two agencies during the capability development process if the aims of the Government's procurement reforms are to be achieved. Currently, Defence and Finance have different perspectives on how effectively this relationship is currently working.

40. The Government continues to place significant emphasis on the need for Finance to be appropriately engaged in the capability development process. The Government's May 2009 response to the Mortimer Review advises that reforms to the Capability Development process will provide government with more reliable information on which to base judgements and a more efficient and effective capability development process.³¹ One of the initiatives outlined for achieving this outcome is 'ensuring early consultation with Finance on

³¹ *The Response to the Report of the Defence Procurement and Sustainment Review*, p. 9.

options, cost estimates and project risks'.³² Also as part of the Government's response to the Mortimer Review,³³ Defence intends to create opportunities to improve and align cost estimation techniques and training in cost estimation between Defence, the DMO and Finance in order to improve the level of common understanding and reduce conflicts due to the employment of different methodologies.³⁴

41. Currently, the absence of agreed processes and procedures, and of guidance for desk officers and their managers on the approach to be taken in engaging with Finance, means that government may not be consistently provided with the level of independent evaluation of capability development proposal costings envisaged by the DPR. Paragraph 8.14 of the *Cabinet Handbook* states that: 'each first and second pass submission or memorandum requires agreement with Finance on the detailed acquisition and operating costings and financial risk assessment.' Yet of the 23 submissions to government reviewed by the ANAO in this audit, four went to government containing cost estimates that Finance had been unable to agree to.

CDG desk officers and their support (Chapter 3)

42. One of the key principles underlying the DPR reforms was that 'skilled project managers, backed by accurate and reliable systems, are an essential prerequisite for being able to deliver projects on schedule and within budget'.³⁵

43. The majority of CDG desk officers, who are the project managers within the CDG, are military personnel. They are responsible for various aspects of the capability development process including the preparation of the relevant capability development documents,³⁶ and the provision of technical advice based on their military experience.

44. In a 'lessons learnt' review conducted by Defence in March 2007, and focus groups conducted by the ANAO in mid 2008, desk officers identified

³² *ibid.*, p. 10.

³³ In particular, Recommendation 2.9.

³⁴ *ibid.*, p. 24.

³⁵ Department of Prime Minister and Cabinet 2003, *Defence Procurement Review*, p. 48.

³⁶ Capability development documents specified in the DCDM and Process Map include the Operational Concept Document (OCD), Business Case (includes costing templates), Functional Performance Specification (FPS), Test Concept Document (TCD), Project Management Plan and the Acquisition Strategy. These are described further in Chapter 4.

similar issues affecting their capacity to carry out their role. These included: high staff turnover; lack of timely and relevant training; lack of appropriate skills in certain areas, particularly cost estimation; and inadequacy of supporting information management systems.

45. Defence major capital equipment projects can be long term, complex and often high-risk. The same applies to the development phase of these projects that is carried out by CDG. High turnover and inadequate support for staff in such an environment adds to the risk profile of a capability development proposal and increases the importance of having robust and accurate tools and systems to support the capability development process.

46. The ANAO identified a number of aspects of the management of CDG desk officers, their role and their support that need improvement. These include, in addition to a need to address issues such as high turnover, records management support, training (particularly in relation to cost estimation), process support tools, and the level of complexity associated with project costing for first pass approval.

47. During fieldwork, the ANAO was informed that the CDG cost estimation templates are complex, difficult and excessively time-consuming to use, and that the level of support and assistance provided is inadequate. It is not clear that this level of complexity is necessary or appropriate, particularly for first pass costings. The ANAO suggests that Defence, in consultation with Finance, review the appropriateness of the CDG costing templates, particularly in the context of first pass costing activities.

48. The military desk officers are posted to CDG in order to utilise their military experience and expertise. However, the majority of their day-to-day employment comprises general project management and administration, rather than developing and exercising specialist skills in capability needs and requirements analysis. The ANAO observed that no training needs analysis has been conducted for desk officers, and that timeliness and relevance of training are a matter of concern to them.

49. At the time of the audit, CDG was reviewing its staffing levels, structure and skills sets. The ANAO considers that there would be benefit in Defence extending this review work to encompass:

- a formal analysis of the training needs of desk officers, and developing strategies to ensure that adequate, relevant and timely training and support is provided;

- consideration of strategies for maximising the value gained from the specialist knowledge brought to CDG by military desk officers; and
- how best to ensure that staff with the appropriate skills and tools are undertaking the complex cost estimation work required to develop capability development proposals to the standards required at first and second pass approval by Government.

50. The Mortimer Review recommended³⁷ that CDG should be adequately resourced in terms of workforce numbers and skills to develop capability proposals and incorporate specialist advice from the DMO and the Defence Science and Technology Organisation (DSTO). The Government's response to the Mortimer Review in responding to this recommendation stated the following:

Appropriate training remains a critical factor in ensuring that the CDG workforce is able to undertake high-quality capability development projects. We acknowledge a continuing need to deepen expertise in cost and schedule estimation and project management. Since the 2003 Defence Procurement Review Defence has invested substantial effort in developing training programs for CDG and DMO staff. CCDG and CEO DMO will continue to explore how to deepen our capabilities to improve this training.³⁸

Requirements phase project documentation (Chapter 4)

51. Capability development proposals generally pass through two Government decision points: first pass and second pass approval. To support these decision points, Defence has identified³⁹ additional decision points and documentation requirements in the capability development process.

52. However, from time to time, Government has made decisions to expedite its consideration of certain Defence major capital equipment acquisition projects. Two of the projects in the ANAO's sample of 20 case study projects were excluded from the strengthened two-pass approval process, as outlined in the DCDM, at the direction of the then Government.⁴⁰

³⁷ Recommendation 2.8 of the Review.

³⁸ *The Response to the Report of the Defence Procurement and Sustainment Review*, p. 24.

³⁹ In the DCDM, Process Map and associated process documents and tools.

⁴⁰ AIR 5349 Phase 1 – Super Hornets (see paragraph 4.18) and AIR 8000 Phase 3 – Heavy Airlift – the C17 acquisition (see paragraph 4.23).

Another became an 'accelerated' acquisition at the direction of the then Government.⁴¹

53. A further four⁴² projects were developed during the transition period during which the then Government agreed that submissions could be presented with less rigorous requirements, as to the level of information provided, than under the full strengthened two-pass approval system, provided the level of information was, in the then Government's words, 'sufficiently robust'.

54. An eighth project, Sea 4000 Phase 3—Air Warfare Destroyers, was treated differently by Defence because of its complexity, duration and materiality. Defence advised ANAO that the DCDM did not contemplate the kind of approach that Defence and the then Government considered was required for this project, involving more frequent engagement between Defence and the then Government.⁴³

55. For the twelve remaining case study projects in the ANAO's audit sample, Defence was unable to demonstrate, through the provision of access to key project documents, that the procedures outlined in the DCDM and the Process Map have been consistently followed, or that alternative procedures were appropriately authorised, managed and documented.

56. CDG could not provide the ANAO with final versions of around half of the key project documents requested on the basis of the ANAO's analysis of

⁴¹ JP 2008 Phase 4 – Military Satellites Capability. Defence advised the ANAO that:

'as the result of an 'unsolicited approach ... by the U.S. Government to the Australian Government': JP 2008 Ph 4 became an accelerated acquisition that underwent a combined First and Second Pass approval in an extremely short time frame (approximately 6 months). All elements of the capability development process were streamlined and it was acknowledged that not all traditional documentation would be developed. The acquisition process was via sole source to the US Government through a Memorandum of Understanding. The planning was managed through an Integrated Project Team. The risk associated with adopting this approach was offset by the engagement of experienced staff to lead the project and the active involvement of stakeholders in the decision making from the time the opportunity arose to "buy-in" to the WGS [wideband global satellite] program.'

See section commencing at paragraph 4.32.

⁴² JP 126 Phase 2, Joint Theatre Distribution System; JP2080 Phase 2B.2, ROMAN Upgrade (also subject to a 'short form' second pass process); LAND 121 Phase 3, Field Vehicles and Trailers; and LAND 125 Phase 2B.

⁴³ Sea 4000 Phase 3 received first pass approval from the NSC in May 2005, and second pass approval in June 2007, at an estimated cost of \$6.6 billion. Overall, the approved phases of SEA 4000 have a budget of almost \$8 billion and will see three AWDs be built and delivered to the Navy. Defence's explanation of the approach to obtaining Government approval of the phases of the SEA 4000 is outlined in Chapter 4 at paragraph 4.58.

the key elements set out in the DCDM. For some of these documents, CDG was able to provide electronic versions that were either marked as draft or contained unaccepted changes but was not able to provide the final approved document. Examples of the key documents sought by the ANAO for the case study projects included the Capability Proposal First Pass (CPFP) and the Capability Proposal Second Pass (CPSP). The DCDM provides for the development of these overarching documents. However, CDG was unable to provide the CPFP for five of the twelve projects⁴⁴ in the ANAO's audit sample submitted for first pass approval or the CPSP for four of the eleven projects⁴⁵ submitted for second pass approval.

57. Other key documentation sought by the ANAO included that relating to formation and operation of Integrated Project Teams for each of the projects. The DCDM outlines that Integrated Project Teams:

are specific to each capability development project and provide guidance and technical expertise from key stakeholders in the process and/or outcomes of the capability development proposal. IPTs are usually formed at the very early stages of the project, and their importance cannot be overstated. Properly formed and managed, they provide a base for undertaking the capability development process in a thorough and systematic way, particularly the consideration of [fundamental inputs to capability (FIC)] issues, and for engaging in a meaningful and timely way with all capability development stakeholders. As in the case with lead up to First Pass approval, the project IPT is a key mechanism through which [Capability Systems Division] staff coordinate activities leading up to Second Pass consideration by Government.⁴⁶

58. Notwithstanding the importance attached by the DCDM to IPTs, CDG could not provide satisfactory documentary evidence that IPTs had been formed and operated for 6 of the 12 projects in the ANAO's audit sample that were submitted for first pass approval or for 6 of the 11 projects submitted for second pass approval.

⁴⁴ Does not include the AWD project or those projects excluded from the strengthened two-pass approval process at the direction of the then Government (see footnote 14).

⁴⁵ Does not include the AWD project or those projects excluded from the strengthened two-pass approval process at the direction of the then Government (see footnote 14). In addition, one project was submitted to Government for first pass approval but received combined first and second pass approval. Accordingly, the CPSP was not required to be developed.

⁴⁶ DCDM Chapter 3, Overview of the Requirements Phase, pp. 31-32 and 60.

59. The ANAO experienced considerable difficulty in obtaining key capability development documents. The process to establish, as far as possible, that all available records relating to the projects in the ANAO's audit sample had been provided by CDG was lengthy, taking more than ten months. This was because CDG's recordkeeping is inadequate, particularly with respect to key decisions and processes central to the strengthened two-pass approval process. In most cases, the ANAO was unable to determine whether Defence's inability to provide requested documents was a consequence of poor records management practices or because the documents had not been prepared. Defence does not have an adequate audit trail of key decisions and requirements in relation to the capability development process.

60. Rather than consistently following the clearly defined process outlined in the DCDM and Process Map, Defence advised the ANAO that it considers that the system is required to be flexible, and that it 'has used tailored products and processes rather than adhere to particular suites of documents for the sake of conformity'. In this context, as noted in paragraph 12, Defence advised that the system has evolved since the 2006 DCDM was promulgated, and that the intent of the Kinnaird reforms has been upheld, even though there has not necessarily been strict adherence to the DCDM. Defence further advised that deviations from the process outlined in the DCDM are the result of this evolution, rather than departures from the process, and that the DCDM was developed by Defence to provide generic guidance to desk officers, but in practice the process is tailored for each project.

61. The ANAO notes that the DPR stated that 'a strong mandatory two-pass system should provide a precise and understandable process for the procurement of defence capabilities, which would ensure that Government would be presented with robust proposals'.⁴⁷ Adopting a tailored approach, on a project by project basis, to the development of proposals to Government for first and/or second pass approval is not inconsistent with this goal but the approach to be taken to individual projects should be authorised at an appropriate level, and the authorisation recorded, to maintain the integrity of the capability development phase of procurement. In addition, as outlined in paragraph 13, it is still important to ensure that key elements required to produce sound proposals to Government at first and second pass are clearly identified and executed. Defence did not consistently apply this level of

⁴⁷ Department of the Prime Minister and Cabinet 2003, *Defence Procurement Review 2003*, p. 12.

discipline in relation to the approaches taken to developing the first and/or second pass approval submissions to Government for the projects in the ANAO's audit sample.

62. Accordingly, the ANAO considers that Defence should ensure that the revised DCDM that the department is currently preparing clearly identifies for CDG staff the key elements that are required to produce robust proposals to Government at first and second pass, and provides guidance on the process to be followed to obtain authorisation for the particular approach to be pursued in the context of an individual project.

Submissions to Government (Chapter 5)

63. The *Cabinet Handbook* articulates the principles and conventions by which the Cabinet system operates, and the procedures designed to ensure that the Cabinet process fulfils its central purposes. It also sets out the requirements applying to submissions and memoranda related to defence procurement. These rules are closely aligned to the DPR's recommendations in respect of a strengthened two-pass approval system.

64. The ANAO reviewed the 23 submissions, which had been provided to the NSC in relation to the projects in our sample, against the *Cabinet Handbook* requirements for submissions seeking first and/or second pass approval and noted a significant level of non-adherence, across the sample, to a number of *Cabinet Handbook* requirements. The most significant of these are to do with the assessment and description of technical risk, and the presentation of costs, associated with acquiring a new capability.

65. The ANAO observed that, in a number of cases, the description of technical risk did not provide sufficient guidance for decision-makers or provide confidence that an adequate assessment of risk had been conducted. For example, one first pass submission examined stated that, for one element, risk was 'relatively low' and that there was 'some risk' in respect of integration issues. Another submission, for a high-profile, expensive acquisition, stated that risks in respect of integration issues 'will need to be assessed and addressed in the acquisition phase'. Another submission presented a 'preliminary risk assessment'.

66. The *Cabinet Handbook* includes the requirement that, for second pass submission, each Acquisition Business is to include 'an analysis of the technology, cost and schedule risks and drivers (technology risk must be rated using 'Technology Readiness Level' (TRL) methodology)'. TRLs are assessed

on a nine-point scale in ascending order of technical maturity.⁴⁸ On that scale, a score of '4' indicates 'component and or basic sub-system technology valid in laboratory environment', while '8' indicates 'system technology qualified through test and demonstration'. Nevertheless, only one of the second pass submissions in the ANAO's sample adhered to the Handbook requirements. Of the remaining nine submissions: one used 'System Readiness Levels' – which Defence has not been able to explain to ANAO; one used TRLs for two options but not for the recommended option; and the remaining submissions in the sample used technical risk ratings such as 'low', 'high', 'medium' and 'medium-high'

67. The ANAO recognises that the assignment of technical risk is not straightforward. Nevertheless, as recognised in the DPR, it is vital that government be provided with consistent and accurate advice on technical risk to the extent possible under the particular circumstances.

68. The DPR states:⁴⁹

When taking decisions on capability options at first and second pass the whole-of-life costs must be presented to and understood by government. These not only comprise the cost of the prime equipment, but also infrastructure, equipment operating costs, through-life-support, and the resources required to manage acquisition.

69. The *Cabinet Handbook* reflects the DPR's recommendations on this. At first pass, submissions are required to include 'the indicative total acquisition and whole-of-life costs' for each option being explored. At second pass, each Acquisition Business Case is required to include 'the budget estimates of total acquisition and whole-of-life-costs'. However, only five of the fifteen first pass submissions⁵⁰ in the ANAO's sample provided an estimate of whole-of-life

⁴⁸ See p.19 of the DPR.

⁴⁹ Department of Prime Minister and Cabinet 2003, *Defence Procurement Review 2003*, p. 18.

⁵⁰ All but one of the first pass submissions in the sample provided indicative total acquisition costs. That submission also did not provide indicative whole-of-life costs. Of the remaining nine first pass submissions in the sample that did not adhere to this requirement: one provided an estimate of annual operating costs: seven provided estimates of Net Personnel and Operating Costs (NPOC); and another provided estimates that appear to be NPOC but which were variously described in the submission as 'estimated net operating costs', 'net through-life Personnel and Operating estimates' and '[estimated] annual net operating costs'.

costs and only four out of the ten second pass submissions.⁵¹ The majority of the submissions to Government in the ANAO's sample contained net personnel and operating costs (NPOC)⁵² estimates instead of estimated whole-of-life costs.

70. NPOC estimates are an important component of the costings for major capital equipment projects. They reflect the anticipated change in operating costs associated with replacing a capability (where applicable) or, alternatively, reflect an update of the estimate contained in the Defence Capability Plan for the operating cost of a new capability. They do not, however, provide the transparent, understandable whole-of-life cost information required for informed decision making. The importance of whole-of-life cost estimates has now been re-inforced by the *Defence White Paper 2009* which states:

The Government has also directed that greater attention be paid in the planning process to the whole-of-life cost dimensions of capability. This will be critical in providing Government with increased levels of confidence with respect to cost, schedule and technical risk when it considers major Defence projects. This will also assist in minimising scope variations in major acquisitions, and help drive down cost pressures.⁵³

Summary of agency responses

Department of Defence

71. Defence acknowledges the findings noted in this audit report, which assessed Defence's performance in the implementation of the strengthened Two-Pass process, as recommended in the 2003 Defence Procurement Review ('Kinnaird' Review), and agrees to each of the four recommendations made within the report. The report notes that Defence has made significant progress

⁵¹ All ten of the second pass submissions in the ANAO's sample did include the budget estimates of the total acquisition costs. The four second pass submissions that included budget estimates of the whole-of-life-costs provided comprehensive, transparent whole-of-life-costs. Of the six submissions that did not provide whole-of-life cost estimates: one provided no estimate of operating costs at all; one provided an estimate of annual operating costs; and four expressed operating costs in terms of Net Personnel and Operating Cost (NPOC).

⁵² The DCDM 2006, p. 111 defines NPOC as '...the difference between future and current mature operating costs associated with a capability, facility, system or specific item of equipment. It reflects the net difference between the cost estimates to operate a new, upgraded or replacement capability offset by the [Defence Management and Financial Plan funding] available to operate the current capability'.

⁵³ *Defence White Paper 2009*, paragraph 13.18.

in implementing the changes, as recommended by Kinnaird, but further improvement is needed.

72. Defence has already begun addressing the issues highlighted in the audit report through the Defence Strategic Reform Program, and reforms to the capability development process outlined in the Government's response to the Mortimer Review.

Department of Finance and Deregulation

73. Finance agrees with the recommendations made in the proposed report, and welcomes the opportunity to work with the Department of Defence to agree a suitable approach to capability development evaluation that engages Finance staff early in the process.

Recommendations

Recommendation No. 1

Paragraph 2.56

The ANAO recommends that Defence agree with Finance a suitable approach to allow Finance's early and ongoing involvement in the evaluation of capability development proposal costings.

Defence response: *Agree.*

Recommendation No. 2

Paragraph 4.64

The ANAO recommends that Defence develop, promulgate and implement a sound records management policy within CDG.

Defence response: *Agree.*

Recommendation No. 3

Paragraph 5.55

The ANAO recommends that Defence refine its methodology for assessing and describing technical risk for future acquisitions and ensure that submissions do not proceed without a clear statement of technical risk, consistent with the agreed methodology as set out in the *Cabinet Handbook*.

Defence response: *Agree.*

Recommendation No. 4

Paragraph 5.66

The ANAO recommends that Defence ensure that submissions to the NSC for first or second pass approval include explicit acquisition and whole-of-life cost estimates, agreed by Finance, as required by the *Cabinet Handbook*.

Defence response: *Agree.*

Audit Findings and Conclusions

1. Introduction

This chapter provides information on the background to the audit and on Defence's major capital equipment projects, together with an overview of the Defence Procurement Review 2003. It also provides the audit objective and approach and the report structure.

Background

1.1 In order to achieve its mission of defending Australia and its national interests, Defence requires, amongst other things, the ability to plan effectively the acquisition of the major weapon systems and platforms that form fundamental inputs to military capability. Defence defines a major capital equipment project as any project involving expenditure of \$20 million or more, or of less than \$20 million with strategic significance or with individual items of \$1 million or more.

1.2 The Defence Capability Plan (DCP) is the Government's costed ten year plan in which capability needs are identified as either an equipment solution or an operational effect. The Defence Portfolio Budget Statements (PBS) for 2008–09 report that the Government has approved approximately 230 major capital equipment projects or phases of projects worth around \$48.3 billion since the *Defence White Paper 2000*. The 2008–09 PBS also identify almost \$7 billion in funding for new major capital equipment projects, yet to be approved by Government, from the current DCP over the 2008–09 to 2011–12 financial years. On 2 May 2009, the Government released the *Defence White Paper 2009*⁵⁴ which forecasts expenditure of more than \$30 billion over the next decade including \$6 billion to remediate critical capability gaps.⁵⁵

1.3 The management of major capital equipment projects in Defence is complex and challenging. Defence's performance in this area has been the subject of a number of reports by the Joint Committee of Public Accounts and Audit (JCPAA), the Senate Committee on Foreign Affairs, Defence and Trade, and the ANAO. Over the years ANAO performance audits into acquisition

⁵⁴ *Defending Australia in the Asia Pacific Century: Force 2030*, Defence White Paper 2009.

⁵⁵ Media Release Minister for Defence, *Remediating Shortfalls and Underinvestment in the Defence Budget*, 2 May 2009.

projects⁵⁶ have identified significant weaknesses in project planning—including risk identification and management, as well as project costing issues—resulting in projects experiencing cost overruns, scope changes and delayed implementation.

1.4 The challenges faced by Defence in managing major capital equipment projects effectively, and the concerns over projects that do not meet expectations in terms of costs, schedule and capability, are not unique to Australia. Audit reports from, for example, the US, Canada, the UK and New Zealand also report similar concerns. Additionally, attempts at reforming the various acquisition systems in these countries have also been problematic.

1.5 The United Kingdom's National Audit Office's annual *Ministry of Defence Major Projects Reports*⁵⁷ and the United States Government Accountability Office's 2008 report on selected weapons programs⁵⁸ identify issues around significant cost growth and schedule slippages in major defence acquisition projects. A 2008 report on major defence acquisitions by the New Zealand Office of the Auditor General⁵⁹ reported similar issues.

The Defence Procurement Review

1.6 It was in response to concerns about the procurement process for major Defence acquisitions that the then Government announced, in December 2002, the Defence Procurement Review (DPR), to be conducted by a team led by Mr Malcolm Kinnaird AO, which was to examine and report on issues associated with major capital acquisitions in Defence. The 2003 DPR⁶⁰ found that the system for defining and assessing capability in existence at the time of the review lacked 'rigour and discipline'⁶¹ and was 'not based on any mandatory endorsement of key decisions by relevant stakeholders, nor was the

⁵⁶ For example see: ANAO Audit Report No.11 2007–08, *Management of the FFG Capability Upgrade*, ANAO Audit Report No.36 2005–06, *Management of the Tiger Armed Reconnaissance Helicopter Project-Air 87*, ANAO Audit Report No.5 2004–05, *Management of the Standard Defence Supply System Upgrade* and ANAO Audit Report No.3 2005–06, *Management of the M113 Armoured Personnel Carrier Upgrade Project*.

⁵⁷ National Audit Office 2007, *Ministry of Defence Major Projects Report 2007*.

⁵⁸ United States Government Accountability Office 2008, *Defense Acquisitions: Assessments of Selected Weapon Programs*.

⁵⁹ Controller and Auditor General 2008, *Reporting the progress of defence acquisition projects*.

⁶⁰ The DPR is also known as the Kinnaird Review.

⁶¹ Department of Prime Minister and Cabinet 2003, *Defence Procurement Review 2003*, p. 11.

opportunity for external scrutiny applied to significant proposals being put forward to Government'.⁶² As a result, the DPR concluded that:

Government has often been asked to sign off on acquisition proposals at a point where there has not been sufficient analysis within Defence to give confidence that financially and technically robust decisions are being made. Too often, poorly defined and inaccurately costed projects have been put to governments and passed to the DMO to acquire. This has given rise to unrealistic expectations regarding the delivery of defence capabilities.⁶³

1.7 The DPR report was published in August 2003. The report made ten major recommendations and a number of additional points for consideration. Nine of the ten major recommendations were accepted by the then Government in September 2003.

1.8 The purpose of the DPR recommendations was to provide a framework for Defence to implement reform that would enable it to provide Government with greater certainty that government-approved capabilities will be delivered on time and within budget.

1.9 The underlying principles of the DPR recommendations were:

- Government must remain in control of the process that identifies and then decides which capability gaps must be addressed.
- The concept that there must be 'no secrets and no surprises' has to be central to communication between Government and the agencies responsible for capability development. Government must remain confident that it has a current and accurate understanding of the progress of capability development at every stage of the cycle.
- Adequately defining and assessing capability is critically important to the success of the procurement process.
- There must be detailed analysis of the options to achieve a required military effect before adopting a platform-based solution.
- Management and reporting structures need to be clear, well understood, and, to the greatest extent possible, ensure that they align authority, responsibility and accountability.

⁶² *ibid.*

⁶³ *ibid.*, p. 9.

- A higher proportion of project funds spent on early analysis to improve project outcomes represents an investment that can return dividends in terms of greater certainty in regard to costs and a better understanding of project risks.
- Rigorous analysis of technology, cost and schedule risks, backed by external verification, is essential before any project is put to tender.
- Costs of a defence capability must be assessed on a whole-of-life basis.
- The development of a more businesslike culture will support the transformation of the DMO into a professional project management organisation.
- Skilled project managers, backed by accurate and reliable systems, are an essential prerequisite for being able to deliver projects on schedule and within budget.
- Military personnel must be able to participate appropriately in the acquisition of equipment that their Service will utilise.
- The introduction of private expertise to support the leadership of the procurement agency will accelerate reform.⁶⁴

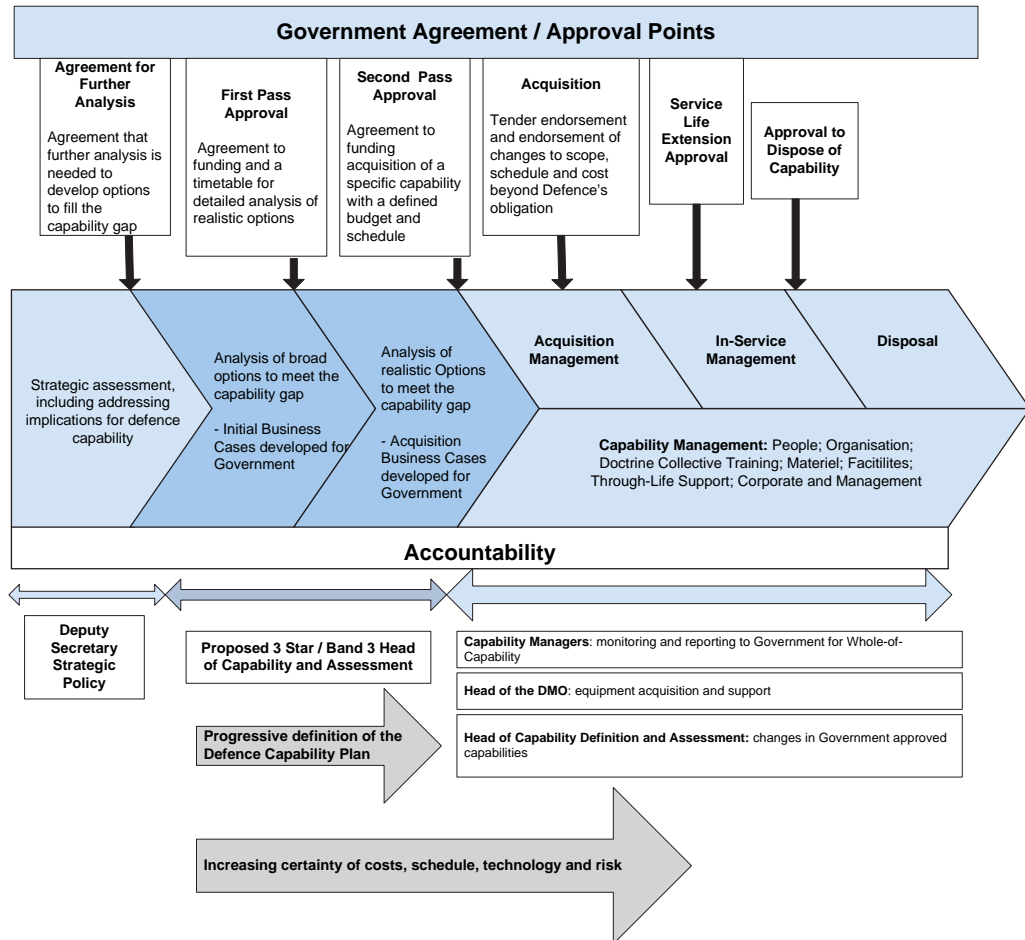
1.10 Recommendation No.3⁶⁵ of the DPR was aimed at strengthening the then existing two-pass approval process for Defence's major capital equipment acquisitions. The recommendation was that:

Government should mandate, and enforce via revised Cabinet rules, a rigorous two-pass system for new acquisitions with government considerations dependent on comprehensive analyses of technology, cost (prime and whole-of-life) and schedule risks subjected to external verification.

1.11 Figure 1.1 shows the strengthened two-pass approval process, as recommended by the DPR, in the context of Defence's capability life cycle. The process is described in more detail in Chapters 2 and 3.

⁶⁴ Department of Prime Minister and Cabinet 2003, *Defence Procurement Review 2003*, p. 48.

⁶⁵ *ibid.*, p. v.

Figure 1.1**Capability Life Cycle**

Source: Re-creation, Department of Prime Minister and Cabinet 2003, *Defence Procurement Review 2003*, p.14.

1.12 Ongoing Parliamentary reviews⁶⁶ of the DPR reforms indicate the importance placed on Defence achieving significant improvements in the cost, schedule and capability outcomes of its major capital equipment projects. In addition, the Government commissioned the Defence Procurement and

⁶⁶ For example, through the JCPAA inquiry into financial reporting and equipment acquisition at the Department of Defence and the Defence Material Organisation conducted during the period 2006-2008 and reported in JCPAA Report 411, *Progress on equipment acquisition and financial reporting in Defence*, August 2008.

Sustainment Review,⁶⁷ also known as the Mortimer Review. The Mortimer Review report provided to the Government in September 2008 made 46 recommendations to assist in achieving these outcomes. Both the *Defence White Paper 2009* and the Government's response to the Mortimer Review⁶⁸ reinforce further the importance of implementing reforms of the Capability Development process and achieving significant improvements in the cost, schedule and capability outcomes of its major capital equipment projects.

Audit objective and approach

1.13 The objective of this audit was to assess whether the strengthened two-pass approval process for major capital equipment projects is being implemented effectively.

1.14 The general criteria for the audit were:

- Government policy in relation to the strengthened two-pass system has been effectively promulgated.
 - The Defence Capability Development Manual (DCDM) and other departmental guidelines accurately, comprehensively and clearly reflect Government policy, and provide sufficient guidance to enable managers to ensure that all essential elements of the strengthened two-pass system are complied with.
- Departmental guidelines and relevant *Cabinet Handbook* requirements⁶⁹ have been followed in the development of proposals and the preparation of submissions.
 - Compliance with guidelines is documented in each case, or, if departure from the guidelines has occurred, the rationale is appropriately documented and is in accordance with Government policy;

⁶⁷ The then Parliamentary Secretary for Defence Procurement announced on 8 May 2008 that Mr David Mortimer AO would chair this review.

⁶⁸ *The Response to the Report of the Procurement and Sustainment Review*, 2 May 2009.

⁶⁹ The Department of the Prime Minister and Cabinet's *Cabinet Handbook* lays down the principles and conventions by which the Cabinet system operates, and the procedures designed to ensure that the Cabinet process fulfils its central purposes. It also contains the rules applying to submissions and memoranda related to defence procurement. These rules are closely aligned to the DPR's recommendations in respect of a strengthened two-pass approval system.

- Submissions to Government comply with the *Cabinet Handbook's* requirements for submissions for first and/or second pass approval.

Scope and methodology

1.15 The audit's scope included an examination of a sample of 20 projects drawn from the 84⁷⁰ that had received first pass, second pass or both first and second pass approval since the introduction of the strengthened two pass approval process. The sample included many of the highest value projects, balanced across the various environments (land, sea, air and joint projects) and reflected the diversity of types of major capital equipment acquisitions undertaken by Defence. The sample also included five projects nominated by Defence. The ANAO conducted:

- an analysis of the steps Defence has taken, and the processes it has put in place to implement the strengthened two-pass approval process; and
- an analysis of the submissions to government relating to the sample of 20 projects, providing an indication of the extent of Defence's compliance with the requirements of the *Cabinet Handbook*, and the incidence of project approvals outside the strengthened two-pass approval process; and

1.16 The ANAO also sought to collect key capability development documentation for the sample projects, compared the documentation provided by Defence to the guidance set out in the 2006 DCDM and associated Process Maps, and sought to identify how any variances were approved.

1.17 The audit approach also included:

- interviewing key personnel, and examining documents, manuals and guidelines used by Defence staff that implement the two-pass approval process;
- interviewing Department of Finance and Deregulation (Finance) officers regarding Finance's involvement in the strengthened two-pass approval process;

⁷⁰ As at 27 May 2008.

- reviewing CDG's management of the sample of 20 pre-second pass projects; and
- analysing CDG's Cabinet submissions for the sample of 20 projects that had received first pass, second pass or both first and second pass approval under the strengthened two pass approval process, and assessing these submissions against requirements set out in the Department of Prime Minister and Cabinet's *Cabinet Handbook*.

1.18 During the period this audit was undertaken, as noted in paragraph 1.12, the Government commissioned the Defence Procurement and Sustainment Review, also known as the Mortimer Review.⁷¹ Late in the course of this audit, Defence's response to the Review was released on 2 May 2009, the same day as the *Defence White Paper 2009* was released. *The Response to the Report of the Defence Procurement and Sustainment Review*, together with providing the Government's detailed responses to the Review report's 46 recommendations, also sets out the key elements of the reform program for the capability development areas in Defence, the DMO and for enhancing the DMO-Defence relationship as a whole.

1.19 This audit was conducted in accordance with ANAO auditing standards at a cost to the ANAO of some \$650 000.

Report structure

1.20 The remainder of this report is organised into four chapters:

- Chapter 2 describes the steps taken by Defence to implement the DPR recommendations and outlines the structure of CDG;
- Chapter 3 describes the personnel, systems and guidelines Defence has put in place to support the strengthened two-pass approval process;
- Chapter 4 presents the results of the ANAO's review of the capability development documentation relating to the sample of 20 projects that had received first pass, second pass or both first and second pass approval under the strengthened two pass approval process; and

⁷¹ The Review report, provided to the Government in September 2008, made 46 recommendations. The Government agreed to 42 recommendations, agreed in part to a further three recommendations and did not agree to one recommendation.

- Chapter 5 presents the results of the ANAO's analysis of submissions to government relating to the sample of 20 projects, and the extent to which the submissions adhered to the guidance contained in the *Cabinet Handbook*, as amended to reflect the DPR recommendations regarding the strengthened two-pass approval system.

2. The strengthened two-pass approval system

This chapter provides an overview of Defence's implementation of the 2003 Defence Procurement Review's recommendations related to strengthening the two-pass approval system.

Background

2.1 In September 2003, the then Government broadly accepted⁷² the DPR recommendations, including a recommendation that sought to strengthen, through revised Cabinet rules, the two-pass approval system for new Defence acquisitions. The Government also agreed that Defence should establish an implementation team to develop a draft implementation plan and timetable.

2.2 In October 2003, Defence established the DPR Implementation Team,⁷³ supported by a DPR Stakeholder Group⁷⁴ and a DPR Steering Group to implement the recommendations made in the DPR. In October 2003, Defence established a DPR Implementation Team,⁷⁵ a DPR Stakeholder Group⁷⁶ and a DPR Steering Group to support the implementation of the recommendations made in the DPR. The DPR Steering Group—chaired by the Secretary of the

⁷² Nine of the ten major recommendations were accepted, the exception being the establishment of the Defence Material Organisation (DMO) as an executive agency under the *Public Service Act 1999*. The then Government decided that DMO should become a prescribed agency. The Government has now affirmed this decision in Defence's response to the Mortimer Review, which had also recommended the establishment of the DMO as an executive agency.

⁷³ The establishment of the Implementation Team was directed by the then Government. The Team was responsible for coordinating the activity on DPR implementation. This team was replaced on 1 April 2004 by a Defence Procurement Review Monitoring and Reporting Team.

⁷⁴ The DPR Stakeholder Group was made up of Senior Executive Service Band 2 or military equivalent representatives from ADF Service Headquarters, DMO, Defence Corporate Services and Infrastructure Group, the Chief Finance Officer Group, Capability Staff, Defence Personnel Executive, Public Affairs and Corporate Communication, Joint Logistic Command, the Defence Science and Technology Organisation, the Department of the Prime Minister and Cabinet and the then Department of Finance and Administration. The Group was established to promote wide consultation and communication of DPR implementation activities and outcomes.

⁷⁵ Directed by Government. Responsible for coordinating the activity on DPR implementation. This team was replaced on 1 April 2004 by a Defence Procurement Review Monitoring and Reporting Team.

⁷⁶ To promote wide consultation and communication of DPR implementation activities.

Department of Defence and including senior Defence Department, ADF and DMO representatives⁷⁷—had ultimate authority for DPR implementation.

2.3 The DPR Report did not articulate how the recommended reforms, including the strengthened two-pass approval process, were to be put in place. In January 2004, the then Government formed the Defence Procurement Advisory Board and made it responsible for:

- governance and oversight of the implementation;
- reporting its progress to the National Security Committee of Cabinet (NSC); and
- providing strategic direction to the Chief Executive Officer of DMO.

2.4 The Board comprised three private sector representatives and senior members of the Defence Force, the Department of Defence, the Department of the Treasury and the then Department of Finance and Administration (Finance)⁷⁸. It first met in March 2004 and met several times each year until its most recent meeting in February 2008.⁷⁹

2.5 Table 2.1 provides a timeline of key steps in Defence's implementation of DPR Recommendations 2 and 3, from Government acceptance in September 2003 to the release of the current version of the DCDM in February 2006.

⁷⁷ Members of the Steering Group were: the Chief of the Defence Force, Vice Chief of the Defence Force, Head of the Defence Materiel Organisation, Head of Capability Group, Deputy Secretary Strategic Policy and Chief Finance Officer.

⁷⁸ Now the Department of Finance and Deregulation.

⁷⁹ The Mortimer Review recommended that the Board continue with an increased focus on providing advice to the CEO of DMO. Defence has agreed with the intent of the recommendation but intends, subject to Government agreement, to subsume the functions of the DPAB within a proposed Strategic Reform Advisory Board, which would draw its membership from both the public and private sectors. *The Response to the Report of Procurement and Sustainment Review*, pp. 41-42.

Table 2.1

Defence Procurement Review implementation

Date	Activity
Aug 2003	Defence Procurement Review Report presented to Government.
Sep 2003	Government broadly accepts the recommendations made in the Defence Procurement Review Report.
Oct 2003	Defence Procurement Review Implementation Team established.
Dec 2003	Chief, Capability Development Group appointed.
Feb 2004	Capability Development Group created.
Mar 2004	Government agrees to proposed implementation arrangements for two pass approval process. Cabinet Handbook amended to incorporate new requirements to support the strengthened two pass approval process. First meeting of the Defence Procurement Advisory Board.
Jun 2004	Capability Development Group Implementation Plan released (period Jul 04 to Dec 05).
Dec 2004	Version 1.0 of Capability Development Group Process Map released.
Feb 2005	Release of <i>Defence Capability Development Manual 2005</i> .
Feb 2006	Release of <i>Defence Capability Development Manual 2006</i> and release of Version 2.0 of CDG Process Map.

Source: ANAO

2.6 In March 2004, the then Government agreed:

- to revised Cabinet procedures for the implementation of the two-pass process for Defence major equipment acquisitions;
- to transitional approval arrangements for selected projects with a year of decision of 2003–04 and 2004–05;⁸⁰ and
- to apply the full two-pass system to all projects with a year of decision of 2005–06 and beyond.

2.7 In April 2004, the Defence Procurement Advisory Board reported to Government that Defence had completed a DPR Implementation Plan,

⁸⁰ The *Defence Capability Development Manual 2006* (p. 30) defines the year of decision (YOD) as the proposed timing of second pass approval. The YOD for each project is initially identified in the Defence Capability Plan (DCP). The YOD for the selected projects provided to the NSC for transitional approval arrangements were revised and may differ from those published in the 2003–04 DCP, current at the time of the decision.

Communications Plan and Risk Management Plan in November 2003 to guide the DPR implementation process.

Formation of the Capability Development Group

2.8 In December 2003 Defence, in response to the DPR's Recommendation No. 2,⁸¹ appointed a three star ADF officer as Chief of Capability Development Group (CCDG), with responsibility and accountability for Defence's capability development process.

2.9 The Capability Development Group (CDG)⁸² was then established in February 2004 with the responsibility of managing the process for developing capability development proposals from their entry into the DCP through to final approval by government. On 30 June 2004 the then CCDG released the CDG Implementation Plan, which identified key tasks to establish the CDG; priorities for each of the tasks; the task owners; and timeframes for each task. The final task in the Implementation Plan was due for completion in December 2005.

2.10 During the capability development process CDG carries overall responsibility for the coordination of the preparation of first and second pass proposals. However, for many projects, some capability development work is carried out by DMO under a Memorandum of Arrangement between CDG and DMO. DMO provides specialist engineering, project management and industry expertise that is required in developing capability development documents such as the overall project plan, the acquisition strategy and costing estimates.⁸³ According to the 2006 DCDM, DMO is one of the stakeholders that 'should, as a matter of course, be consulted, and invited to participate in an Integrated Project Team⁸⁴ in either a full- or part-time, or advisory, capacity'.

2.11 Figure 2.1 illustrates the current structure of CDG.

⁸¹ Department of Prime Minister and Cabinet 2003, *Defence Procurement Review 2003*, p. 11:

Recommendation 2: A three star officer, military or civilian, should be responsible and accountable for managing capability definition and assessment. This appointment should be on a full-time basis, with a defined tenure (minimum five years) to ensure a coherent, cohesive, holistic and disciplined approach.

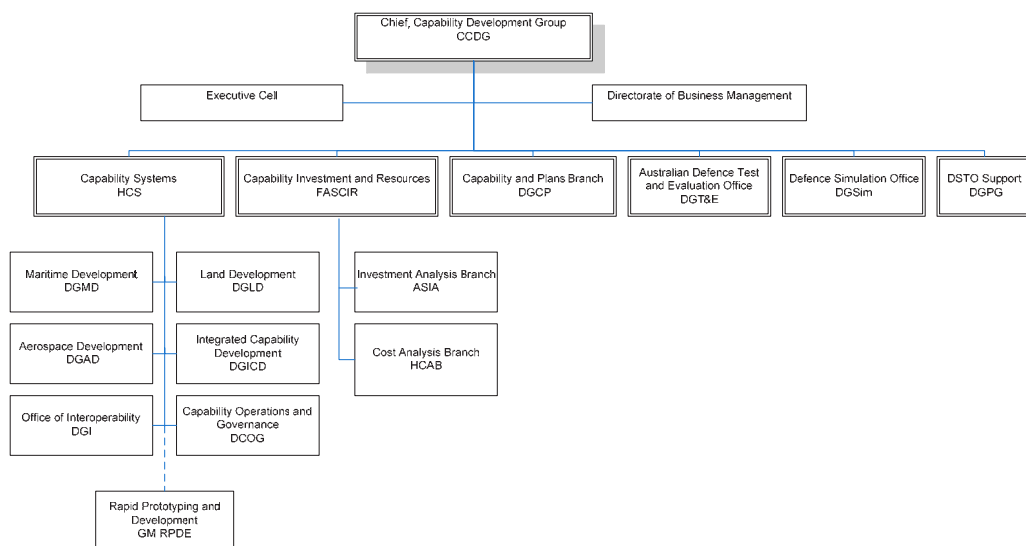
⁸² In July 2006 the Capability Development Group was renamed Capability Development Executive. In August 2007, Capability Development Executive was renamed Capability Development Group. Source: Defence Intranet, Capability Development Group, About Us, History.

⁸³ Defence advice in response to the ANAO's December 2008 issues papers.

⁸⁴ See paragraph 4.14 for an explanation of the role of Integrated Project Teams.

Figure 2.1

Capability Development Group



Source: Department of Defence

2.12 As at March 2009, CDG employed 143 civilian and 146 military personnel.

CDG's structure

2.13 The Capability Systems Division 'manages the development of future capability options to assist Government decision making on investment' in Defence major capital equipment;⁸⁵ that is, it manages the DCP and develops acquisition proposals through the strengthened two-pass approval process. The Division is also responsible for 'development of departmental processes and procedures associated with [Recommendations 2 and 3] of the [DPR]'.⁸⁶

2.14 Within Capability Systems Division is the Capability Operations and Governance Directorate, which is responsible for 'cost estimation and process support for desk officers and decision support and knowledge management'.⁸⁷

⁸⁵ Department of Defence 2006, *Defence Capability Development Manual 2006*, p. 9.

⁸⁶ Department of Defence 2006, *Capability Development Orientation Booklet* p. 5.

⁸⁷ *ibid.*, p. 6 – the Directorate's name changed from Capability Operations and Plans during 2008.

2.15 The role of the Capability Investment and Resources (CIR) Division is described by CDG as to:

- provide independent advice to the Defence Capability and Investment Committee (DCIC) and Defence Capability Committee (DCC) on capability priorities, resources and balances, in particular relating to the Major Capital Investment Program;
- advise on the adequacy, alignment, costing and risks associated with individual new Major Capital Equipment (MCE) proposals and key Major Capital Facilities (MCF) proposals;
- develop an affordable and achievable forward unapproved MCE Program to underpin the Defence Capability Plan (DCP), based on articulated capability priorities; and
- produce the Ministerial and Cabinet submissions for MCE project approvals.⁸⁸

2.16 The role of the Cost Analysis Branch within the CIR Division is to:

- provide advice on the financial resource aspects, both capital and operating, and associated risks relating to major investment proposals considered by the DCC or DCIC;
- conduct independent analysis and review of the costing of proposals and may generate independent cost estimates for key ones;
- generate process and guidance on cost estimation in CDG;
- provide the interface with the Department of Finance and Administration on major equipment costing issues; and
- conduct the annual review of the capital and operating cost estimates of DCP projects.⁸⁹

2.17 The role of the Investment Analysis Branch within the CIR Division is to:

- provide independent analysis and review of capability issues, including the overall balance of investment in current and future

⁸⁸ *ibid.*, p. 4-5.

⁸⁹ *ibid.*, p. 5.

capability; the future structure of the ADF; major investment proposals; preparedness; and priorities;

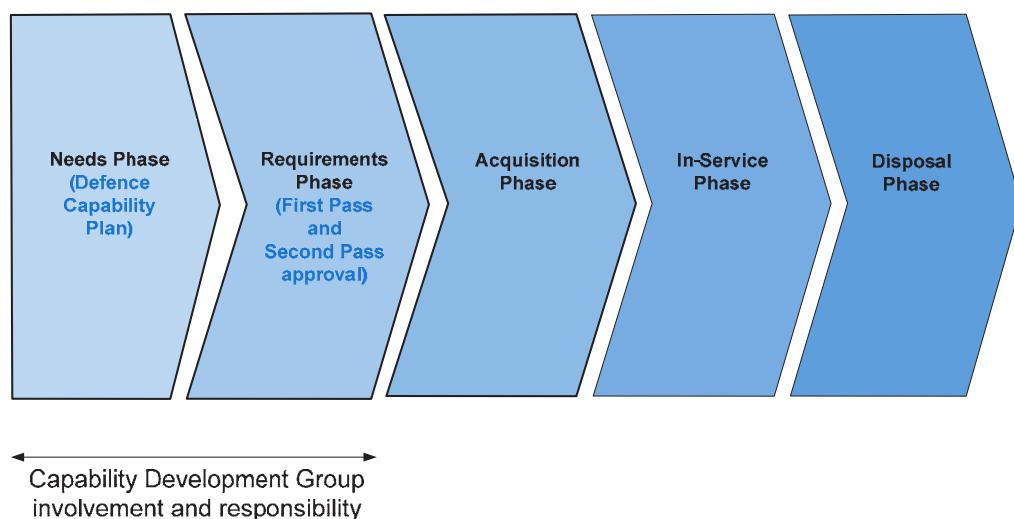
- prepare the agenda papers for the DCC; and
- produce the Ministerial and Cabinet submissions for Major Capital Equipment project approvals.⁹⁰

Capability process and the role of CDG

2.18 Figure 2.2 illustrates the various phases of Defence's Capability Life Cycle and identifies CDG's key areas of involvement and responsibility.

Figure 2.2

Defence Capability Process



Source: Adapted from Department of Defence Capability Development Group Process Map

2.19 The Needs Phase of Defence's Capability Life Cycle involves the identification of capability gaps through an annual assessment of the ADF's performance against capability goals, and results in the development of the Defence Capability Plan (DCP). Responsibility for the Needs Phase is shared between the Deputy Secretary Strategy⁹¹ and CCDG⁹². The DCP expresses capability needs in terms of either a broadly defined equipment solution or a

⁹⁰ Department of Defence 2006, *Capability Development Orientation Booklet* pp. 4-5.

⁹¹ For the development and articulation of the strategic guidance and military strategic priorities.

⁹² For the capability gap analysis and development of the DCP.

desired operational effect. The DCP is approved by the NSC and identifies the major capital equipment projects to be undertaken by Defence over the next ten years.⁹³

2.20 The Requirements Phase involves taking the capability gaps identified in the Needs Phase, developing proposals for options to fill those gaps and presenting those options to government for approval. Capability development proposals pass through two government decision points⁹⁴—first pass and second pass approval.

The strengthened two-pass approval process

2.21 As noted in paragraph 1.10, one of the nine DPR recommendations accepted by the then Government was Recommendation No. 3⁹⁵:

Government should mandate, and enforce via revised Cabinet rules, a rigorous two-pass system for new acquisitions with government considerations dependent on comprehensive analyses of technology, cost (prime and whole-of-life) and schedule risks subjected to external verification.

2.22 The *Cabinet Handbook* sets out procedures, principles and conventions for the operation of Cabinet. In March 2004, in response to this recommendation, the *Cabinet Handbook* was amended to include new requirements around the submissions and memoranda relating to the acquisition of Defence capabilities considered by the NSC. These are contained in Chapter 8 of the Handbook.

First Pass approval

2.23 The first pass approval stage of the two-pass process can be defined as the stage during which Defence analyses and identifies a number of options which meet the agreed capability gap identified in the DCP and then presents

⁹³ The DCP is published in both classified and unclassified versions. Three DCPs have been made publicly available since the publication of the Defence White Paper in 2000: 2001-10 DCP, 2004-14 DCP and 2006-16 DCP.

⁹⁴ The Cabinet Handbook (p. 36) states capability proposals 'must be presented to Government through a "two-pass" process'; although (p. 38) 'for less complex projects, where formal project definition phases have been completed, and for follow-on activity under contract options, it may be acceptable for Defence to bring forward a proposal for second pass approval to be agreed at the first pass consideration'. The DCDM (p. 28) describes first and second pass as 'essential decision points' and also (p. 31) provides for what it describes as 'combined pass approvals'.

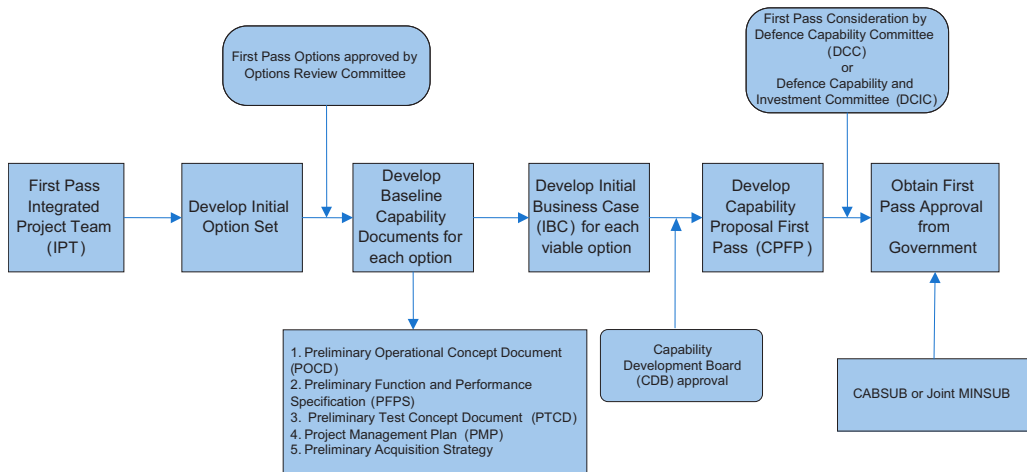
⁹⁵ Department of Prime Minister and Cabinet 2003, *Defence Procurement Review*, p. v.

these options to government in the form of separate Initial Business Cases. The DPR states that:

...each Initial Business Case would identify the option to be explored, the indicative schedule and cost of implementation (both the acquisition and whole-of-life costs) and the methodology for further assessment including the necessary funding to do the work. Together, the Initial Business Cases should provide a variety of realistic capability, cost, schedule, and risk trade-offs for government to consider. At least one off-the-shelf option must be included. Any option that proposed the 'Australianisation' of capability would need to fully outline the rationale and associated costs and risks.⁹⁶

2.24 In 2006, CDG developed and promulgated an updated manual-the 2006 DCDM-and a related Process Map, to support staff in executing the strengthened two-pass approval process. For first pass approval, the DCDM identified additional decision points and documentation requirements in the capability development process considered necessary to manage the first pass approval process. Figure 2.3 illustrates the key activities and decision points, as identified by the 2006 DCDM and the CDG Process Map, required to obtain first pass approval from government.

⁹⁶ Department of Prime Minister and Cabinet 2003, *Defence Procurement Review 2003*, p.15.

Figure 2.3**CDG first pass approval activities as set out in CDG 2006 DCDM and Process Map**

Source: Adapted from CDG 2006 DCDM and Process Map

2.25 After achieving first pass approval by government of a project, Defence has government approval to proceed with more detailed development and analysis of a set of options intended to meet the agreed capability gap.

Second Pass approval

2.26 The second pass approval stage involves Defence carrying out more detailed and rigorous analysis and assessment of the range of capability solution options approved at first pass. In preparing for a submission to Government seeking second pass approval, Defence is required to develop and present a separate Acquisition Business Case for each option approved at first pass. According to the DPR, each Acquisition Business Case 'and accompanying recommendations should have external verification before being submitted to Government'⁹⁷.

2.27 The DCDM states that 'second pass approval is formal approval by Government of a specific capability solution to an identified capability development need'⁹⁸. Second pass approval by government authorises Defence

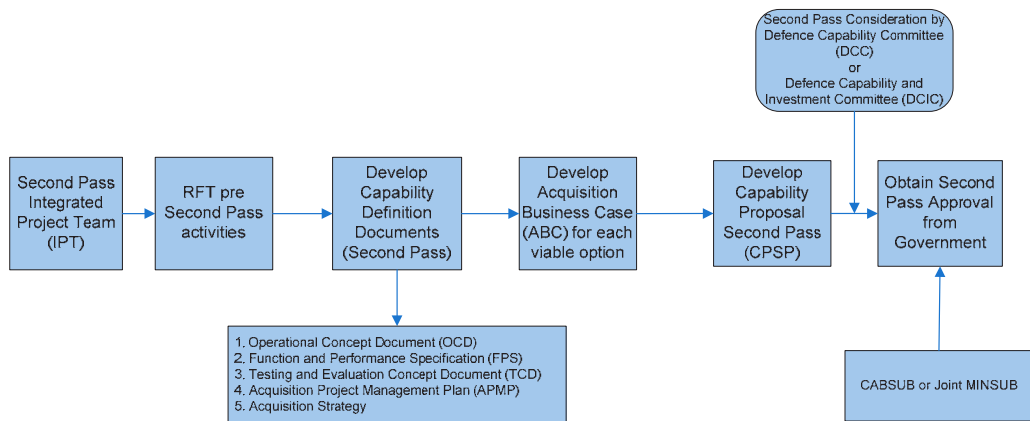
⁹⁷ Department of Prime Minister and Cabinet 2003, *Defence Procurement Review 2003*, p. 16.

⁹⁸ Department of Defence 2006, *Defence Capability Development Manual 2006*, p. 30.

to proceed to acquire the agreed solution. Figure 2.4 illustrates the key activities and decision points, as identified by the 2006 DCDM and the CDG Process Map, required to obtain second pass approval from government.

Figure 2.4

CDG second pass approval activities as set out in CDG 2006 DCDM and Process Map



Source: Adapted from CDG 2006 DCDM and Process Map.

Transitional arrangements

2.28 In March 2004, the then Government agreed to transitional approval arrangements for projects with a year of decision of 2003–04 or 2004–05. Because of this decision by the then Government, some projects were specifically exempted from the requirement for first pass approval by the NSC.

2.29 The NSC also agreed that proposals for the remaining projects with a year of decision of 2003–04 or 2004–05 could be submitted for approval despite not meeting all requirements of the new process, provided the level of information was ‘sufficiently robust’.

2.30 Defence did not formulate any specific instructions, guidelines or advice to desk officers in CDG on the process to be followed in preparing capability development proposals for these projects.

2.31 The ANAO observed that some uncertainty exists within CDG about the transition status of projects under the strengthened two-pass approval process. This became apparent when the ANAO received conflicting advice from different areas within CDG on the transition status of certain projects within the audit sample. Defence advised the ANAO that transition

arrangements were determined on a case-by-case basis by the Options Review Committee (ORC).

Defence capability related committees

2.32 Defence's 2006 DCDM describes a process whereby capability development proposals pass through the following committees:⁹⁹

- a. any relevant Single Service committee;
- b. the ORC;
- c. the Capability Development Board (CDB); and
- d. the Defence Capability Committee (DCC) and/or, depending on the size of the project, the Defence Capability and Investment Committee (DCIC).

2.33 Capability development proposals may also pass through a number of other committees, depending on the nature of the proposal. For full details of Defence capability related committees and boards, see Appendix 1.

2.34 The ANAO found that high-level processes associated with the establishment of CDG¹⁰⁰ were essentially sound. It also considers that the processes outlined in the 2006 DCDM to operationalise the strengthened two-pass approval system have the potential to be largely effective, provided they

⁹⁹ Department of Defence 2006, *Defence Capability Development Manual 2006*, p. 55.

¹⁰⁰ In October 2003, Defence established the DPR Implementation Team, supported by a DPR Stakeholder Group and a DPR Steering Group to implement the recommendations made in the DPR. The DPR Steering Group—chaired by the Secretary of the Department of Defence and including senior Defence Department, ADF and DMO representatives—had ultimate authority for DPR implementation.

In addition, In January 2004, the then Government formed the Defence Procurement Advisory Board and made it responsible for:

- Governance and oversight of the implementation;
- reporting its progress to the National Security Committee of Cabinet (NSC); and
- providing strategic direction to the Chief Executive Officer (CEO) of DMO.

The Board comprised three private sector representatives, the Defence Secretary and Chief Defence Force, and senior members of the Department of Defence, the Department of the Treasury and the then Department of Finance and Administration (Finance). It first met in March 2004 and met several times each year until its most recent meeting in February 2008. The Mortimer Review recommended that the Board continue with an increased focus on providing advice to the CEO of DMO. Defence has agreed with the intent of the recommendation but intends, subject to Government agreement, to subsume the functions of the DPAB within a proposed Strategic Reform Advisory Board, which would draw its membership from both the public and private sectors.

are adhered to and underpinned by adequate and appropriate resourcing, support and training for CDG staff.

2009 Reforms to the Capability Development process

2.35 The Government's response to the Mortimer Review sets out the approach Defence intends to take to strengthen the Capability Development process:

Reforms to the Capability Development process will provide Government with more reliable information on which to base judgements and a more efficient and effective capability development process. This will be achieved by:

- The development of regular Defence White papers and an overhauled and strengthened Defence Planning Guidance to ensure tighter alignment between strategic guidance, capability decisions and resources.
- Clarifying the roles and responsibilities of each part of the Defence Organisation in capability development terms, with Capability Development Group (CDG) remaining the coordinating authority for developing submissions to Government.
- Better defining the roles and memberships of key capability committees.
- Confirming that DMO is responsible and accountable for developing military equipment costs and schedule estimates and risk analysis and developing and implementing an acquisition strategy. DMO will also be responsible for analysing industry's capacity to deliver the required capability.
- Clarifying the roles of each Group and Service in developing Fundamental Inputs to Capability (FIC).
- Strengthening the roles of Capability Managers in coordination and integration of all FIC.
- Establishing better planning connections between Capability Development and key enabling Groups such as the Defence Science and Technology Organisation and the Chief Information Officer Group.
- Ensuring that capability and commercial advice are developed in tandem through the project.

- Ensuring early consultation with the Department of Finance and Deregulation on options, cost estimates and project risks.¹⁰¹

Independent review of costings

CIR Division

2.36 Paragraph 2.15 sets out CDG's description of the role of the CIR Division, which includes to:

- provide independent advice to the DCIC and DCC on capability priorities, resources and balances, in particular relating to the Major Capital Investment Program; and
- advise on the adequacy, alignment, costing and risks associated with individual new Major Capital Equipment proposals and key Major Capital Facilities proposals.¹⁰²

2.37 However, the ANAO found that the governance arrangements under which CIR Division operates are not conducive to the provision of independent analysis and review of costings, or to the provision of independent advice to the committees considering whether, and in what form, to progress capability proposals. Rather than providing an independent viewpoint, CIR Division staff are accountable to CCDG—as are the desk officers who prepare the proposals and costings, and the directors who manage them. Similarly, CCDG is Chair of the DCC and a member of the DCIC, yet the advice provided by CIR Division to these committees is considered by Defence to be independent.

2.38 Defence advised the ANAO in response to the proposed audit report that it considered that the arrangements it has in place for CIR Division mean that the actual location of the division is not relevant. These arrangements are:

First Assistant Secretary CIR has direct accountability and direct access to the Secretary and CDF. Even though the line manager is CCDG, agenda papers submitted to the DCC are drafted within CIR Division and authorised for release by FASCIR. CCDG is not involved in the development of these agenda papers, so independence of advice and issued raises at DCC and DCIC is maintained. The DCC and DCIC agenda papers are supported by

¹⁰¹ *The Response to the Report of the Defence Procurement and Sustainment Review*, pp. 9-10.

¹⁰² Department of Defence 2006, *Capability Development Orientation Booklet*, pp. 4-5.

independent analysis undertaken by both branches of CIR Division. Further, FASCIR attends both the DCC and DCIC and is able to provide his opinion and advice directly at these forums.

2.39 The ANAO recognises the steps taken by Defence seeking to maximise the independence of the advice provided by CIR Division. However, there are limits to the degree of independence that can be achieved while CIR Division and the staff preparing capability proposals and costings are responsible to the same line manager.

2.40 The ANAO notes that, going forward, reforms outlined in the *Defence White Paper 2009* and the Government's response to the Mortimer Review will change how costings are developed. Defence advised the ANAO in June 2009 that:

CCDG will remain the coordinating authority for the development of submissions to Government; the Defence Materiel Organisation (DMO), supported by Defence Groups and Services, is responsible and accountable for developing military equipment costs and schedule estimates, risk analysis, and developing and implementing an acquisition strategy. In alignment with the revised approach, CEO DMO will also be required to attend all NSC meetings if capability acquisition decisions are being sought.

Finance

2.41 The 2003 DPR identified that:

Finance agreement to Cabinet submission costings is generally sought shortly before lodgement, and does not allow sufficient time for any in-depth analysis of capability, strategic, technical, legal or commercial issues associated with the costs and risks of major capital investments or other procurements.¹⁰³

2.42 The DPR Report emphasised the importance of the early and continuous involvement of Finance throughout the two-pass process to provide government with an independent evaluation of capability development proposal costings. Additionally, the DPR Report stated that 'ideally, Defence should provide [to government] well developed business cases for the proposed investments, based on sound costings models, for validation by Finance'¹⁰⁴.

¹⁰³ Department of Prime Minister and Cabinet 2003, *Defence Procurement Review*, p. 17.

¹⁰⁴ *ibid.*

2.43 In March 2004, Defence advised the then Government that appropriate working arrangements would be developed by Defence and Finance to ensure Finance received the information required to review cost risks associated with capability development proposals.

2.44 Defence advised the ANAO that it considers that this element of the DPR reforms has been implemented in terms of both process and outcome. However, no agreed, documented processes and procedures exist to facilitate Finance's early and ongoing engagement in the development of cost estimates for capability development proposals.

2.45 The DCDM states that Finance provides 'an additional level of scrutiny and advice on capability development proposals, from a whole-of-Government perspective'¹⁰⁵ but provides no additional information or guidance on the nature and extent of this involvement. The CDG Process Reference page on the Process Map site provides a high-level guideline document on interaction with central agencies and a draft document outlining the role of Finance. However, the documents are dated August 2005 and, as noted above, no documented working arrangements have been agreed with Finance.

2.46 In November 2005, CCDG commissioned an internal review of the Group's performance in delivering the DCP. The report noted that late engagement was a consistent complaint of the Department of the Treasury (Treasury), the Department of Prime Minister and Cabinet (PM&C) and Finance.

2.47 In March 2007, Defence conducted a study of 13 major capital equipment projects that had progressed through first or second pass approval during 2006 to identify lessons learnt by Capability Systems desk officers and Directors. In the resulting report, *CS Desk Officers: Lessons Learnt 2007*, desk officers expressed the view that it is difficult to maintain an open relationship with counterparts in Finance as all communications with Finance are directed through other areas within CDG. During fieldwork for this audit the ANAO conducted a series of focus groups with CDG desk officers. In these meetings, some desk officers advised the ANAO that they considered that they had no engagement with Finance at all; others indicated they had some, but were uncertain as to when, and at what level of detail, Finance should be involved.

¹⁰⁵ Department of Defence 2006, *Defence Capability Development Manual 2006*, p. 32.

2.48 Finance is a permanently invited member¹⁰⁶ of the DCC and therefore has some engagement at this stage in the process of developing two-pass submissions through access to Defence papers and information presented to DCC members. Finance informed ANAO of its view that recent practice in Defence has seen the DCIC take the place of the DCC in considering the larger and more risky capital capability equipment proposals. Finance is not a member of the DCIC. Finance informed the ANAO that it does not receive the relevant information early in the process, and often only receives a first look at the costing information and risks 30 days or less out from a submission being put to the NSC. Additionally, Finance informed the ANAO that the information provided at this point is often limited and of questionable quality. Finance further advised that:

the information provided is often very detailed, but as subsequent events have shown, failed to identify correctly the areas of major risk and potential financial impacts. For some projects, Finance has no advance information from Defence, or engagement at a working level prior to the formal consideration process by Ministers.

2.49 Finance considers that these issues limit Finance's ability to be involved and to provide adequate external verification of proposals early on in the capability development process.

2.50 Defence has a different perspective on how effectively its engagement with Finance is operating during the capability development process. Defence informed the ANAO in June 2009 that:

....suggestions that Finance and CDG are not closely linked in the early stages of Capability Development are inconsistent with CDG processes. Finance are engaged on large and complex projects to the Defence Capability Committee (DCC) much earlier than the 30 days or less mentioned in the ANAO report. The report also mentions that what Finance receives is often limited and of questionable quality. Again this is not consistent with the recognised and demonstrable level of Capability Investment and Resources (CIR) Division's engagement with [Finance].

2.51 Defence further advised the ANAO as follows:

¹⁰⁶ Permanent members are expected to attend or be represented at every meeting. Permanently invited members are expected to only attend for relevant items. Reference: Defence Capability Committee Governance Principles.

Defence typically convenes the DCC at least three months before meetings of the National Security Committee of Cabinet. Defence has permanently invited [the] Branch Manager of the Defence Capability Assessment Branch at [Finance] to attend all meetings of the DCC. All members of the DCC receive the relevant papers at least ten days and up to five weeks in advance of the meeting, which included the related cost models. Permanent [Finance] membership of the DCC allows a sufficiently senior [Finance] representative to actively contribute to project development activities and to raise concerns on behalf of the Central Agencies in a formal context, so that they can be appropriately resolved, prior to Government consideration.

In addition, Defence holds regular meetings of representatives from the Central Agencies to discuss all projects as the business cases are being developed, well before consideration by the DCC. Typical representation at such meetings includes relevant Directors from CIR Division, Assistant Secretary Investment Analysis, [the Branch Manager of the Defence Capability Assessment Branch as Finance], PM&C and Treasury officials of comparable levels. High-level engagement and information sharing includes regular dialogue between the First Assistant Secretary Capability Investment and Resources and his counterpart in [Finance] who heads the Government and Defence Division.

Defence also provides early exposure drafts of all Cabinet Submissions to the Central Agencies, through the CABNET system.

2.52 The ANAO had sought Defence's advice during the audit as to the number of projects in recent years that had been considered by the DCIC rather than the DCC. In June 2009, Defence advised the ANAO as follows:

Since 2006 only three projects have been considered by the DCIC that were not also considered by the DCC. All other projects since 2006 have gone through the DCC, of which [the Branch Manager of the Defence Capability Assessment Branch at Finance] is a permanent member. These three projects were the AWD [SEA 4000 Phase 3 – Air Warfare Destroyer (AWD) build phase, LHD [JP 2048 Phase 4A/4B – Amphibious Ships] and NACC [AIR 6000 – New Air Combat Capability] projects, which given their size and complexity, were considered by the more senior committee.

2.53 It is important for Finance and Defence to develop a common understanding on the appropriate approach to engagement between the two agencies during the capability development process if the aims of the Government's procurement reforms are to be achieved. Currently, Defence and Finance have different perspectives on how effectively this relationship is currently working.

2.54 The Government continues to place significant emphasis on the need for Finance to be appropriately engaged in the capability development process. The Government's May 2009 response to the Mortimer Review advises that reforms to the Capability Development process will provide government with more reliable information on which to base judgements and a more efficient and effective capability development process.¹⁰⁷ One of the initiatives outlined for achieving this outcome is 'ensuring early consultation with Finance on options, cost estimates and project risks.'¹⁰⁸ Also as part of the Government's response to the Mortimer Review,¹⁰⁹ Defence intends to create opportunities to improve and align cost estimation techniques and training in cost estimation between Defence, the DMO and Finance in order to improve the level of common understanding and reduce conflicts due to the employment of different methodologies.¹¹⁰

2.55 The absence of agreed processes and procedures, and of guidance for desk officers and their managers on the approach to be taken in engaging with Finance, means that government may not be consistently provided with the level of independent evaluation of capability development proposal costings envisaged by the DPR. In practice, this has meant that of the 23 submissions to government reviewed by the ANAO in this audit, four went to government containing cost estimates that Finance had been unable to agree to.

¹⁰⁷ *The Response to the Report of the Defence Procurement and Sustainment Review*, p.9.

¹⁰⁸ *ibid.*, p.10.

¹⁰⁹ In particular, Recommendation 2.9.

¹¹⁰ *ibid.*, p. 24.

Recommendation No.1

2.56 The ANAO recommends that Defence agree with Finance a suitable approach to allow Finance's early and ongoing involvement in the evaluation of capability development proposal costings.

Defence response

2.57 Defence agreed to the recommendation and stated as follows:

Defence already consistently engages with DoFD at the Band 1 level to allow access to cost data early in the capability development process for every DCP project. Access is provided to cost source data such as tender and market survey data early on in the process. Defence will work to formalise the process for engagement with DoFD (and PM&C and Treasury).

3. CDG desk officers and their support

This chapter describes the capability development process including project management of capability development proposals by CDG's desk officers and the guidance and support provided to desk officers, including training, reference material, tools and CDG's records management system.

Capability development desk officers

3.1 One of the key principles underlying the DPR reforms was that 'skilled project managers, backed by accurate and reliable systems, are an essential prerequisite for being able to deliver projects on schedule and within budget'.¹¹¹ The requirement for skilled project managers applies just as importantly to projects during their development in CDG as it does to their management by DMO once the Government has given second pass approval to go ahead with a particular acquisition solution. In CDG the project manager role is undertaken by the capability development desk officers.

3.2 Capability development desk officers are responsible for various aspects of the capability development process for a project including the preparation of the relevant capability development documents.¹¹² Desk officers can be responsible for multiple projects at any one time.

3.3 The majority of CDG desk officers are military personnel and their responsibilities include the provision of technical advice based on their military experience.¹¹³ However, the bulk of the capability development desk officers' day-to-day employment comprises general project management and administration.

Issues affecting capability development desk officers' capacity to carry out their role effectively

3.4 In March 2007, Defence conducted a series of interviews with CDG desk officers and the directors who manage them to capture their experience

¹¹¹ Department of Prime Minister and Cabinet 2003, *Defence Procurement Review*, p. 48.

¹¹² Capability development documents specified in the 2006 DCDM and Process Map include the Operational Concept Document (OCD), Business Case (includes costing templates), Functional Performance Specification (FPS), Test Concept Document (TCD), Project Management Plan and the Acquisition Strategy (AS).

¹¹³ The ANAO was advised, however, that one particular project was without a desk officer for two years.

with the strengthened two-pass approval process.¹¹⁴ This ‘lessons learnt’ review identified a number of issues including high staff turnover; lack of administrative support; apparent lack of authority to ‘maintain an open and honest relationship with their counterparts at [the then] DoFA’;¹¹⁵ uncertainty around desk officers’ authority to modify CDG processes; and lack of appropriate training, skills and tools.

3.5 As part of fieldwork for this audit, the ANAO conducted a number of focus group sessions with CDG desk officers between June and August 2008. The feedback provided to the ANAO through these focus group sessions included observations, in the view of the participating desk officers, that many of the issues identified in Defence’s March 2007 review remained unresolved. During the focus group sessions, attending desk officers consistently raised the following as issues continuing to affect them:

- high staff turnover;¹¹⁶
- lack of timely and relevant training;
- lack of appropriate skills in certain areas, particularly cost estimation; and
- the inadequacy of supporting information management systems that impeded their capacity to manage the information management requirements of capability development activities under the strengthened two-pass approval process.

3.6 These issues are covered in more detail later in this chapter.

Capability development desk officer training

3.7 The military desk officers are posted to CDG in order to utilise their military experience and expertise. However, as noted in paragraph 3.2, the majority of their day-to-day employment comprises general project management and administration, rather than developing and exercising specialist skills in capability needs and requirements analysis. In particular, desk officers are responsible for the development of the cost estimates that are

¹¹⁴ Department of Defence, ‘CS Desk Officers: Lessons Learnt 2007’ report.

¹¹⁵ *ibid.*, Executive Summary, p. 13

¹¹⁶ In 2008, the turnover rate for all CDG desk officers was 41 per cent; for CDG military desk officers it was 49 per cent.

an essential component of the capability development proposals when they are put forward to Government at first and second pass.

3.8 Defence has developed various capability development related training programs for CDG staff. These include CDG induction training, TARDIS¹¹⁷ training and specific training related to developing fundamental capability development documents such as Operational Concept Documents (OCDs)¹¹⁸. However, Defence advised the ANAO that no training needs analysis has been undertaken in relation to CDG staff.

3.9 The posting cycle for military personnel within CDG ranges from two years for Navy and Army personnel to three years for Air Force personnel. The often long timeframes involved in the capability development process¹¹⁹, coupled with the complexity of the process, which results in a steep learning curve for incoming CDG desk officers, means that CDG desk officers could be expected to perform their role effectively for only a short time before they are posted out of CDG. Defence advised the ANAO that the department recognises that Defence's posting cycle means that CDG desk officers need access to specialist support for certain CDG activities such as cost estimation.

3.10 At the time of the audit, CDG was reviewing its staffing levels, structure and skills sets. The ANAO considers that there would be benefit in Defence extending this review work to encompass consideration of how it might maximise the value gained from the specialist knowledge brought to CDG by military desk officers, while also ensuring that staff with the appropriate skills and tools are undertaking the complex cost estimation work required to develop capability development proposals to the standards required at first and second pass approval by Government.

¹¹⁷ TARDIS is an information and knowledge framework consisting of eight components (with a number of sub-components) including data and document management, stakeholder management, financials and reports. Reference: Department of Defence, 'TARDIS Training Notes, New Starter Course', January 2007, Part 02, Slide 15.

¹¹⁸ The OCD is the prime document capturing the intent for the proposed capability and communicates the needs of the warfighter, describes the characteristics of the required capability from an operational perspective, facilitates an understanding of the overall system goals, details missions and scenarios, provides a reference for determining 'fitness for purpose' and provides a justifiable basis for the formal requirements.

¹¹⁹ The 2006 DCDM notes that projects can take up to 10 years between a project's inclusion in the DCP to second pass approval by government.

Capability development tools and resources

3.11 Defence major capital equipment projects can be long term, complex and often high-risk. The same applies to the development phase of these projects that is carried out by CDG. High turnover, and under-resourcing, of staff in such an environment adds to the risk profile of a capability development proposal and increases the importance of having robust and accurate tools and systems to support the capability development process.

3.12 Defence's aspiration, as set out in the 2006 DCDM, is for the system supporting defence capability planning decisions by Government to do so 'in a way that is rational and robust, yet simple and manageable'¹²⁰. Defence has developed a number of resources, tools and systems to support desk officers in administering the strengthened two-pass approval system and the key ones are discussed in this section.

2006 Defence Capability Development Manual (DCDM)

3.13 The DCDM was developed to provide high-level guidance on the capability development process within Defence. In February 2005, Defence released the first version of the DCDM to support the implementation of the strengthened two-pass approval process. A further version of the DCDM, released in February 2006, remains the current version available to CDG staff although Defence advises that it is in the process of developing a revised DCDM.

3.14 Under the System of Defence Instructions, the system of policy and procedural instruments which regulates the administration of Defence, compliance with the directions in Defence Manuals is 'mandatory and enforceable'. Defence Manuals are distinguished from other manuals within Defence by their authorisation or endorsement. Defence Manuals are either signed by the Secretary of Defence and the Chief of the Defence Force (CDF), or are endorsed through a Defence Instruction General DI(G) signed by the Secretary and the CDF.¹²¹ Neither version of the DCDM issued thus far is signed by the Secretary or CDF nor are they endorsed by a DI(G), they are signed by the Chief, Capability Development Group. The DCDM is therefore

¹²⁰ Department of Defence 2006, *Defence Capability Development Manual 2006*, p. 8.

¹²¹ Department of Defence Intranet, Governance Division, 'Defence Manuals', accessed 26-05-08.

not a Defence Manual in the sense that compliance with it is mandatory and enforceable.

3.15 Nevertheless, the 2006 DCDM states that it is 'authoritative guidance to CDG staff' for the development of capability proposals.¹²²

3.16 The ANAO's analysis of the processes followed and the documentation prepared in respect of a sample of 20 projects that have been through first and/or second pass approval under the post-2003 DPR strengthened system identified a range of deviations from the guidance in the 2006 DCDM. These are discussed in detail in Chapter 4.

3.17 CCDG advised the ANAO that the system has evolved since the 2006 DCDM was promulgated, and that the intent of the Kinnaird reforms has been upheld, even though there has not necessarily been strict adherence to the 2006 DCDM. He further advised that deviations from the process outlined in the DCDM are the result of this evolution, rather than departures from the process, and that the DCDM was developed by Defence to provide generic guidance to desk officers, but in practice the process is tailored for each project.

3.18 Defence provided the ANAO with a draft paragraph it intends to include in the revised DCDM currently being developed in the context of the *Defence White Paper 2009* and the capability development process reforms outlined in the Government's response to the Mortimer review:

The processes outlined in this manual are presented as guidance only. These processes will need to be tailored for specific projects. This manual is not intended as a "one size fits all" approach, as Defence has a wide range of complexities in its projects and requires the reader to apply context and understanding to individual projects.

3.19 The DPR stated that 'a strong mandatory two-pass system should provide a precise and understandable process for the procurement of defence capabilities, which would ensure that government would be presented with robust proposals'.¹²³ Adopting a tailored approach, on a project by project basis, to the development of proposals to government for first and/or second pass approval is not inconsistent with this goal but the approach to be taken to individual projects should be authorised at an appropriate level, and the

¹²² Department of Defence 2006, *Defence 'Capability Development Manual 2006*, p. v.

¹²³ Department of the Prime Minister and Cabinet 2003, *Defence Procurement Review 2003*, p. 12.

authorisation recorded, to maintain the integrity of the capability development phase of procurement. In addition, where a tailored approach is to be adopted, it is still important to ensure that key elements required to produce sound proposals to Government at first and second pass are clearly identified and executed. Accordingly, the ANAO considers that Defence should ensure that the revised DCDM clearly identifies for CDG staff the key elements that are required to produce robust proposals to Government at first and second pass, and provides guidance on the process to be followed to obtain authorisation for the particular approach to be pursued in the context of an individual project.

Capability Development Process Map

3.20 CDG also developed a Process Map which is intended to provide 'detailed guidance and templates' to CDG staff on capability development to 'enable the key capability products (and supporting products) to be developed, suitably endorsed and then navigated through the required approval gates at all levels'.¹²⁴

3.21 The first version (Version Zero) of the Process Map was released in December 2004, and a second version (Version One) in July 2005. Version One comprised a series of PowerPoint slides. CDG staff advised the ANAO that Version One of the Process Map was not widely promulgated. A further version (Version Two) was released in February 2006, and this is the current version available to CDG staff. The Process Map is supported by a number of guidance documents, such as Data Item Descriptions (DIDs), guides and guidance papers, intended to provide further detail on specific elements of the capability development process.

3.22 In April 2008, CCDG advised the ANAO that the Process Map is the authoritative source of instruction for desk officers but that desk officers are not expected to document a detailed explanation of deviations from the instructions where they consider them to be not applicable in the context of a particular project.

3.23 The Process Map is made up of 300-400 web pages with in excess of 3 500 links. The tool used to develop the current version of the Process Map is a web development application that, according to CDG staff, is not ideally

¹²⁴ Department of Defence, CDG Intranet, 'CDG Process Map', accessed 22 May 2008.

suited to the way the Process Map is being used. This makes the Process Map difficult to maintain as processing updates is a very time consuming manual process and, as a result, the Process Map is not updated regularly.

3.24 The report on Defence's March 2007 'lessons learnt' review of the implementation of the strengthened two pass approval process indicated that some desk officers found the Process Map complex and difficult to follow. However, there is no dedicated support available for desk officers in relation to the use of the Process Map.

3.25 The ANAO identified instances where the guidance documents supporting the Process Map referred to out of date material, in some cases material that pre-dates the acceptance of the DPR recommendations¹²⁵. This suggests the documents may not have been updated for some time, and casts doubt on whether all the instructions and guidance they contain is relevant to the strengthened two-pass approval process. Additionally, the ANAO observed some examples of guidance documents available through the links within the Process Map that were not dated, signed off or endorsed.¹²⁶ This increases the risk that desk officers will proceed on the basis of guidance which is not authoritative and/or the current version.

3.26 The ANAO also observed an example where different versions of a DID were obtained depending from where in the Process Map the document was accessed, and also found instances where links within the Process Map did not work.

3.27 In addition, the Process Map and supporting documents do not provide clear advice or direction to users about document management requirements. CDG's recordkeeping practices are discussed in this report in the section commencing at paragraph 3.45.

3.28 These issues limit the usefulness of the Process Map and supporting documents to CDG staff as their primary source of guidance and for accessing

¹²⁵ For example, The 'Defence Capability Definition Documents Guide', v1.3, March 2005 (retrieved from CDG Process Map site 15 May 2008). This version of the document is pre the release of the DCDM 2006 manual and refers to the DCDM 2005. Additionally, the DID for the Operational Concept Document (retrieved from CDG Process Map site 15 May 2008) refers to the 'Capability Systems Life Cycle Management Guide 2001' which was superseded by a 2002 version of this guide (both pre dating DPR reforms) which was subsequently superseded by the 2005 and 2006 DCDM.

¹²⁶ For example, the 'Defence Capability Definition Documents Guide', v1.3, March 2005 (retrieved from CDG Process Map intranet site May 2008). The version available through the Process Map link is not a signed or endorsed version.

templates and navigating the capability development process and should be addressed to maintain the Process Map at a high standard of usability, currency and accuracy.

CDG Costing Templates

3.29 The DPR identified the need for Defence capability proposal costings to be more accurate¹²⁷, based on a more rigorous analysis of cost risks¹²⁸. The DPR also identified the ‘need to focus adequate attention on managing and costing defence capabilities on a whole-of-life basis’.¹²⁹ In this respect, the DPR Report notes that:

...Defence spends approximately as much on maintenance and consumables each year as it spends on purchasing new equipment. Over two thirds of the whole-of-life cost of defence platforms or weapon systems is incurred after the system is introduced into service.¹³⁰

3.30 Whole-of-life costs, according to the DPR, consist of ‘the cost of the prime equipment, infrastructure, equipment operating costs, through-life-support, and the resources required to manage acquisition’¹³¹ and the DPR envisaged that, under the strengthened two-pass approval process:

- these costs would be clearly identified before second pass approval as part of the whole-of-life cost estimate; and
- Defence and Finance will need to develop specific skills and methodology to ensure that more accurate whole-of-life costs are produced and analysed.¹³²

3.31 The 2006 DCDM includes the requirement for all capability proposals to include estimates of total acquisition and whole-of-life costs. Cost estimates are held on CDG Two Pass Approval Templates¹³³ which comprise a series of detailed worksheets capturing cost basis and quantity information for acquisition, net personnel and operating costs (NPOC), and capability

¹²⁷ Department of Prime Minister and Cabinet 2003, *Defence Procurement Review*, p. iv.

¹²⁸ *ibid.*, p. v.

¹²⁹ *ibid.*, p. 3.

¹³⁰ *ibid.*, p. 6.

¹³¹ *ibid.*, p. 18.

¹³² *ibid.*, p.18.

¹³³ A Microsoft Excel workbook.

development costs. The costing spreadsheets are key supporting documents to the business cases developed for each capability option progressed through the strengthened two-pass approval process.

3.32 CDG desk officers in attendance at focus group sessions conducted by the ANAO raised cost estimation, and the use of the CDG costing templates, as a significant source of frustration and difficulty, and indicated that they found the CDG costing templates complex and difficult to use. As indicated in paragraphs 3.4 and 3.5, there is a lack of cost estimation training provided to CDG desk officers and few of them have experience in cost estimation. There is also little support available to CDG desk officers for undertaking cost estimation, including use of the CDG costing templates. The complexity of the spreadsheets comprising the costing templates, lack of cost estimation training and experience among CDG desk officers and a lack of support available to desk officers in this field limits the templates' usefulness in contributing to the more accurate and robust cost estimates envisaged by the DPR.

3.33 Defence advised the ANAO in June 2009 in response to the proposed audit report as follows:

It is agreed that additional training is required on the CDG Cost Template for desk officers and Defence is in the process of setting up a formalised coaching and mentoring approach to the problem. It should be noted though that a large number of cost estimates (especially for larger projects) are not undertaken by the CDG desk officers but rather the DMO or consultants. The use of the standardised Cost Template with a tailorable cost element breakdown structure has been of great benefit to the understanding of the costs compared to the ad-hoc cost presentations prior to its introduction. CDG aims to simplify the standard template.

3.34 During fieldwork for this audit, Finance advised that the key to better capability cost estimates is identifying the main cost drivers and the material risks and trade-offs around those cost drivers. Finance also noted that Defence's financial reporting systems make it difficult for Defence to identify whole-of-life costs for existing capabilities, and that this in turn makes it difficult to estimate the net impact on the Defence budget of the proposed replacement capability.

3.35 The cost estimation processes in use in CDG involve a highly detailed, reductive approach that has the advantage of prompting desk officers to consider everything involved in a capability acquisition. However, seeking to refine cost estimates by striving to break systems down into their constituent elements at fine levels of granularity will not necessarily produce a robust

estimate, particularly when an estimate for a particular element of a proposed acquisition is inflated by a contingency provision of—for example—43 per cent, as was the case in one of Defence's submissions to Government reviewed by the ANAO. This issue is summarised well in a disclaimer Defence used on at least one occasion to explain the reliability of its estimates to Government, namely: 'the apparent precision does not reflect the true level of uncertainty'.

3.36 The ANAO suggests that Defence, in consultation with Finance, review the appropriateness of the CDG costing templates, particularly in the context of first pass costing activities as it is not clear that the level of complexity—as opposed to comprehensiveness—currently associated with CDG costing is necessary. This review should also focus on assessing the level of training and support required to enable desk officers to develop the required costings effectively and efficiently. Defence informed the ANAO in June 2009 that it will continue to work with DoFD to refine cost methodology.

3.37 In this context, the Mortimer Review recommended¹³⁴ that CDG should be adequately resourced in terms of workforce numbers and skills to develop capability proposal and incorporate specialist advice from the DMO and the Defence Science and Technology Organisation (DSTO). The Government's response to the Mortimer Review in responding to this recommendation stated the following:

Appropriate training remains a critical factor in ensuring that the CDG workforce is able to undertake high-quality capability development projects. We acknowledge a continuing need to deepen expertise in cost and schedule estimation and project management. Since the 2003 Defence Procurement Review Defence has invested substantial effort in developing training programs for CDG and DMO staff. CCDG and CEO DMO will continue to explore how to deepen our capabilities to improve this training.¹³⁵

3.38 However, also in this context, Finance advised the ANAO as follows:

While training and support are issues to be worked on, the real issue is costing methodology and why Defence estimates so regularly undershoot the eventual reality. Well trained analysts executing faithfully a flawed or inappropriate costing methodology is not going to achieve a great deal. Finance would like to see a more fundamental review of costing methodology, and an approach

¹³⁴ Recommendation 2.8 of the Review.

¹³⁵ *The Response to the Report of the Defence Procurement and Sustainment Review*, p. 24.

which gives greater weight to the uncertainties at first pass and factors this into ranged cost estimates.

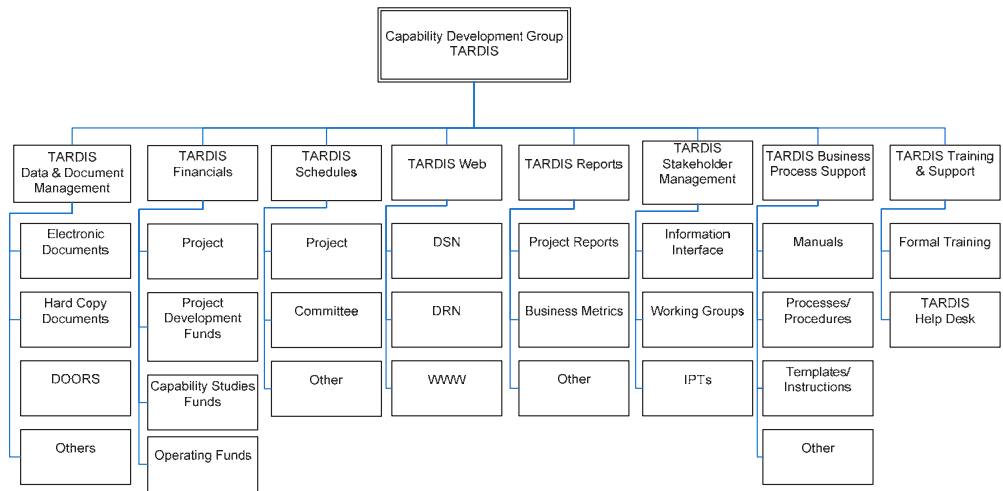
TARDIS

3.39 TARDIS is an information and knowledge framework consisting of eight components (with a number of sub-components) including data and document management, stakeholder management, financials and reports.

3.40 Figure 3.1 illustrates the eight components of the CDG’s TARDIS framework and some of the key sub-components.

Figure 3.1

CDG TARDIS Framework



Source: Department of Defence

3.41 The purpose of TARDIS is to provide ‘the framework and mechanisms for managing all information artefacts generated by or provided to CDG no matter what their form or type and all data associated with CDG operations’.¹³⁶ DOORS, a commercial requirements management application designed to manage large sets of requirements, is one of these mechanisms.

3.42 Defence has developed a TARDIS training program. The TARDIS training material states that it is mandatory for desk officers to maintain the

¹³⁶ Commonwealth of Australia and HolisTech Pty Ltd 2005, ‘Development and Implementation of the CDG Knowledge and Information Management System (TARDIS)’, p. 9.

capability requirements that they use to produce key capability documents—such as the Operational Concept Document (OCD) and Function and Performance Specification (FPS)—within one of the sub-components of TARDIS (DOORS). Defence advised the ANAO that use of the system within CDG is mandatory.

3.43 However, there has been no directive to this effect promulgated to CDG staff and, in mid 2006, a survey of staff, initiated by CDG and conducted by an external consultant, showed that a significant number of respondents reported low or no use of the various components of TARDIS. For example, 35 per cent of respondents said they had never used DOORS, 20 per cent said they had never used Defence Restricted Network (DRN) files, 23 per cent said they had never used Defence Secret Network (DSN) files and 48 per cent said they had never accessed TARDIS training.

3.44 This circumstance has significant implications for the accuracy and completeness of the CDG's records of its capability development activities.

CDG records management

3.45 The ANAO sought to obtain from Defence the key capability development related documents prepared in respect of the 20 capital equipment projects¹³⁷ in the ANAO's sample. To identify the likely relevant documents, ANAO first analysed the requirements set out in the 2006 DCDM and related Process Maps and discussed our approach with CDG. ANAO's information request was then framed around the documents that could reasonably be expected to have been maintained at key decision points within the strengthened two-pass approval process as identified in the 2006 DCDM and related Process Maps. Where departures from the documented process had occurred, the ANAO sought documentation of how these had been authorised.

3.46 ANAO worked closely with the key CDG staff identified by Defence to try to ensure that the documentation secured by ANAO in relation to the 20 projects in our sample was as complete as possible. However, Defence encountered significant difficulties in identifying and supplying to ANAO relevant documentation, and the task was time-consuming for both parties.

¹³⁷ Projects that had received either first pass approval, second pass approval or both first and second pass approval under the strengthened two-pass approval process.

This was because deficiencies in Defence's recordkeeping practices, procedures and systems meant that the department was not able to provide the ANAO with the information requested in a timely and coherent way.

3.47 These deficiencies include:

- a lack of consistent version control over key documents, making it difficult for Defence staff to locate the relevant version and resulting in the ANAO receiving various versions of the same document without any indication of which was the definitive one;
- the absence of appropriate endorsement or approval of key documents, making it difficult for the ANAO to assess whether the document provided was the definitive one;
- many documents provided were marked as drafts and or had track changes still activated, making it difficult to assess whether the document provided was intended to be the definitive one;
- lack of meaningful file naming conventions, making it difficult for Defence staff to locate the relevant documents and for the ANAO to determine that a particular document was what it purported to be and in what context it had been provided;
- lack of consistent directory structures, making it difficult for Defence staff to locate the relevant documents; and
- unsigned minutes from senior Defence committees (DCC/DCIC) containing key decisions regarding First and Second pass approval.

3.48 A 2003 Capability Systems survey found that more than 85 per cent of staff rated the management of information within Capability Systems as fair or worse than fair. The difficulty Defence had in providing the ANAO with the requested documents suggests that significant improvements to Defence's management of capability development information are still required. Further discussion of this issue, together with a recommendation, is contained in Chapter 4.

4. Requirements phase project documentation

This chapter presents the results of the ANAO's examination of key capability development documents produced to support the strengthened two-pass approval system for a sample of 20 projects.

Introduction

4.1 The Requirements phase of Defence's Capability Life Cycle involves developing proposals for options to fill identified capability gaps and presenting those options to government for first and second pass approval. As outlined in Chapter 3, the DCDM provides high-level guidance, within Defence and to industry, on this process. Detailed guidance is provided to CDG staff in the Process Map.

4.2 The ANAO analysed the DCDM and Process Map to identify key activities and deliverables¹³⁸ that would provide evidence of Defence's implementation of the strengthened two-pass approval process. The ANAO then selected a sample of 20 projects for use as case studies to determine if the management processes contained within the DCDM and CDG's Process Map were adequate and of sufficient quality. Table 4.1 sets out the project name and the status of each of the 20 case study projects. For more detailed descriptions of each of these 20 projects see Appendix 3.

4.3 The original methodology for this part of the audit included an assessment of the adequacy of the key documentation prepared for each of the sample projects. However, this proved not to be feasible within the time available for the audit, because of the extended delays in gaining access to the requested documents resulting from the shortcomings in CDG's records management described in Chapter 3. The process to refine the ANAO's document request for the documentation relating to the 20 case study projects in the ANAO's audit sample took some two months. It then took a further eight months to receive the last of the documents that CDG considered were

¹³⁸ Listed at Appendix 2. The ANAO originally identified the DCDM requirement for sign-off of proposals by the relevant single service committee/s as a key activity in the capability development process. However, Defence advised the ANAO that the decision to take a project to the single service committee is a matter for the Service Chief to decide. Consequently, the ANAO has excluded this requirement from its analysis.

relevant to the ANAO's document request. Consequently, the ANAO was required to reduce the scope of this analysis to that of a basic review to determine whether the relevant key documents had been prepared as part of the two-pass approval process for each of the 20 projects in the ANAO's sample.

4.4 The ANAO expected that the capability development activities undertaken, and the documentation produced, by CDG personnel in respect of the projects in the ANAO's sample would be those outlined in the 2006 DCDM and the CDG Process Map. Accordingly, the ANAO compared the documentation provided by Defence to the guidance set out in the DCDM and Process Map, and sought to identify how any variances were authorised.

4.5 Defence informed the ANAO in response to issues papers prepared by the ANAO following the conduct of fieldwork and analysis that it considers that the system is required to be flexible, and that it 'has used tailored products and processes rather than adhere to particular suites of documents for the sake of conformity'. However, as set out in paragraph 3.19, where a flexible, tailored approach is adopted on a project by project basis it is still important to ensure that key elements required to produce sound proposals to government at first and second pass are clearly identified and executed and that the rationale for, and the elements of, the approach to be applied in a particular process are authorised at an appropriate level and recorded in order to maintain the integrity of the capability development phase of procurement. Accordingly, the ANAO considers that Defence should ensure that the revised DCDM that the department is currently preparing informs CDG staff of what these key elements include and provides guidance on the process to be followed to obtain authorisation for the approach to be pursued for a particular project.

4.6 It should be noted that in many cases the ANAO had difficulty in determining the status of documents provided by Defence. In accordance with current records management practices applicable in Defence, almost all of the documents ANAO requested in relation to our sample of 20 projects were stored electronically by Defence in the department's electronic records management system and provided to ANAO in electronic format. Many of the documents provided were unsigned, were labelled 'draft', and/or had unaccepted tracked changes. For the purpose of this audit the ANAO did not reject unsigned documents, but considered documents labelled as 'draft', documents dated after the relevant first and/or second pass approval had been given by Government, and documents with substantive unaccepted tracked changes to be unreliable evidence.¹³⁹

¹³⁹ Defence also provided a number of documents with version numbers less than 1 (for example, v 0.0 and v 0.3). The ANAO considered these documents to have draft status.

Case study population

Table 4.1

ANAO's case study projects and their status as at May 2008.

Project name and phase	1 st pass status	2 nd pass status
AIR 5349 Phase 1 - Super Hornets	Approved outside the 2-pass process	
AIR 6000 Phase 2A/2B - New Air Combat Capability	Nov 2006	Approval not yet received
AIR 7000 Phase 1B - Multi-mission Unmanned Aerial Vehicle (MUAV)	July 2006	Approval not yet received
AIR 8000 Phase 3 - Heavy Airlift – the C-17 Acquisition	Combined – Mar 2006	
AIR 9000 Phase 4 - Black Hawk Midlife Upgrade/ Replacement	Combined – Apr 2006	
JP126 Phase 2 - Joint Theatre Distribution System	Apr 2005	Jul 2007
JP 2008 Phase 3F - Military Sat Capability	Apr 2006	Approval not yet received
JP 2008 Phase 4 - Military Sat Capability	Jun 2007	Sep 2007
JP 2048 Phase 4A/4B - Amphibious Ships	Aug 2005	Jun 2007
JP 2080 Phase 2B.2 - Defence Management Systems Improvement - ROMAN Upgrade	Jul 2005	Nov 2006
JP 2095 Phase 1 - Aviation Fire Truck	Combined – Dec 2005	
LAND 75 Phase 3.4 - JP 2099 Phase 1 - Identity Management - Project CERTE	Apr 2006	Approval not yet received
LAND 75 Phase 3.4 - Battlefield Command Support System	Dec 2005	Approval not yet received
LAND 112 Phase 4 - ASLAV Enhancement	Oct 2006	Approval not yet received
LAND 121 Phase 3 - Field Vehicles and Trailers	Jun 2004	Aug 2007
LAND 125 Phase 2B - Soldier Enhancement V.1 – Acquisition	Exempt	Feb 2005
SEA 1428 Phase 4 - Evolved Sea Sparrow Missiles	Combined – Jul 2006	
SEA 1448 Phase 2B - ANZAC ASMD Upgrade - Fire Control Radar	Exempt	Sep 2005
SEA 1654 Phase 2A - WESTRALIA Replacement	Exempt	Mar 2004
SEA 4000 Phase 3 - Air Warfare Destroyer ¹⁴⁰	May 2005	Jun 2007

¹⁴⁰ Excluded from the analysis in this chapter (see paragraph 4.60).

4.7 From time to time, government has made decisions to expedite its consideration of certain Defence major capital equipment acquisition projects. Two of the projects in the ANAO's sample of 20 case study projects were excluded from the strengthened two-pass approval process, as outlined in the DCDM, at the direction of the then Government.¹⁴¹ Another became an 'accelerated' acquisition at the direction of the then Government¹⁴².

4.8 A further four¹⁴³ projects were developed during the transition period during which the then Government agreed that submissions could be presented with less rigorous requirements, as to the level of information provided, than under the full strengthened two-pass approval system, provided the level of information was, in the then Government's words, 'sufficiently robust'.

4.9 An eighth project, Sea 4000 Phase 3—Air Warfare Destroyers—was treated differently by Defence because of its complexity, duration and materiality¹⁴⁴. Defence advised the ANAO that the DCDM did not contemplate the kind of approach that Defence and the then Government considered was required for this project, involving more frequent engagement between Defence and the then Government. Defence's explanation of the approach to obtaining Government approval of the phases of the SEA 4000 is explained commencing at paragraph 4.58.

4.10 As shown in Table 4.1, three of the 20 sample projects were exempted from the requirement to obtain first pass approval under transitional arrangements approved by the NSC (see paragraph 2.27). In relation to these projects, therefore, only second pass documentation was included in this audit.

4.11 The *Cabinet Handbook* states that

For less complex projects, where formal project definition phases have been completed, and for follow-on activity under contract options, it may be

¹⁴¹ AIR 5349 Phase 1 – Super Hornets (see paragraph 4.18) and AIR 8000 Phase 3 – Heavy Airlift – the C17 acquisition (see paragraph 4.23).

¹⁴² JP 2008 Phase 4 – Military Satellites Capability. See section commencing at paragraph 4.32.

¹⁴³ JP 126 Phase 2, Joint Theatre Distribution System; JP2080 Phase 2B.2, ROMAN Upgrade (also subject to a 'short form' second pass process); LAND 121 Phase 3, Field Vehicles and Trailers; and LAND 125 Phase 2B.

¹⁴⁴ Sea 4000 Phase 3 received first pass approval from the NSC in May 2005, and second pass approval in June 2007, at an estimated cost of \$6.6 billion. Overall, the approved phases of SEA 4000 have a budget of almost \$8 billion and will see three AWDs be built and delivered to the Navy.

acceptable for Defence to bring forward a proposal for second pass approval to be agreed at the first pass consideration.¹⁴⁵

The DCDM does not, however, elaborate on this broad advice and provide guidance on the process to be followed within CDG to develop such proposals. Two projects were each presented to the NSC as combined first and second pass submissions¹⁴⁶. The ANAO compared the documentation provided by Defence for these two projects to the requirements for second pass, as the requirements at second pass are the more advanced.

Overall results of ANAO's analysis of the project documentation for the case study projects

4.12 Defence was unable to demonstrate, through the provision of access to key project documents, that the procedures outlined in the DCDM and the Process Map have been consistently followed in the case study projects in the ANAO's audit sample, or that alternative procedures were appropriately authorised, managed and documented.

4.13 CDG could not provide the ANAO with final versions of around half¹⁴⁷ of the key project documents requested on the basis of the ANAO's analysis of the key elements set out in the DCDM. For some of these documents, CDG was able to provide electronic versions that were either marked as draft or contained unaccepted changes but was not able to provide the final approved document. Examples of the key documents sought by the ANAO for the case study projects included the Capability Proposal First Pass (CPFP) and the Capability Proposal Second Pass (CPSP). The DCDM provides for the development of these overarching documents. However, CDG was unable to provide the CPFP for five of the twelve projects¹⁴⁸ in the ANAO's audit sample

¹⁴⁵ Commonwealth of Australia 2004, *Cabinet Handbook*, fifth edition, p. 38.

¹⁴⁶ A further two projects received combined first and second pass approval, but not as the result of combined submissions to NSC. These were JP 2095 Phase 1, Aviation Fire Trucks and AIR 8000 Phase 3, the C-17 acquisition.

¹⁴⁷ CDG provided some 52 per cent of requested documents overall, with some 44 per cent of documents provided for projects submitted during the transition period (see paragraph 4.8) and 57 per cent of documents provided for other projects.

¹⁴⁸ Does not include the AWD project or those projects excluded from the strengthened two-pass approval process at the direction of the then Government (see footnote 14).

submitted for first pass approval or the CPSP for four of the eleven projects¹⁴⁹ submitted for second pass approval.

4.14 Other key documentation sought by the ANAO included that relating to formation and operation of Integrated Project Teams for each of the projects. The DCDM outlines that Integrated Project Teams:

are specific to each capability development project and provide guidance and technical expertise from key stakeholders in the process and/or outcomes of the capability development proposal. IPTs are usually formed at the very early stages of the project, and their importance cannot be overstated. Properly formed and managed, they provide a base for undertaking the capability development process in a thorough and systematic way, particularly the consideration of [fundamental inputs to capability (FIC)] issues, and for engaging in a meaningful and timely way with all capability development stakeholders. As in the case with lead up to First Pass approval, the project IPT is a key mechanism through which [Capability Systems Division] staff coordinate activities leading up to Second Pass consideration by Government.¹⁵⁰

4.15 Notwithstanding the importance attached by the DCDM to IPTs, CDG could not provide satisfactory documentary evidence that IPTs had been formed and operated for six of the 12 projects in the ANAO's audit sample that were submitted for first pass approval or for the 11 projects submitted for second pass approval.

4.16 In most cases, the ANAO was unable to determine whether Defence's inability to provide requested documents was a consequence of poor records management practices or because the documents had not been prepared. Defence does not have an adequate audit trail of key decisions and requirements in relation to the capability development process.

¹⁴⁹ Does not include the AWD project or those projects excluded from the strengthened two-pass approval process at the direction of the then Government (see footnote 14). In addition, one project was submitted to Government for first pass approval but received combined first and second pass approval. Accordingly, the CPSP was not required to be developed.

¹⁵⁰ DCDM Chapter 3, Overview of the Requirements Phase, pp. 31-32 and 60.

Results of ANAO's analysis of the project documentation for the individual case study projects

4.17 The results of the ANAO's analysis of the project documentation provided by Defence for each of the 20 case study projects is set out in this section, project by project.

AIR 5349 Phase 1 - the Super Hornet acquisition

4.18 This project is not listed in the 2004–14 or 2006–16 DCP. Rather, it was brought forward at the request of the then Government as a New Policy Proposal in the 2007–08 Budget and subsequently funded in that Budget. Defence advised the ANAO that the then Government did not require the project to undergo the strengthened two-pass approval process and so there was not the requirement to prepare documentation in accordance with the DCDM.

AIR 6000 Phase 2A/2B - New Air Combat Capability (the Joint Strike Fighter project)

4.19 This project, as identified in the 2006-16 DCP, 'is intended to acquire the first tranche of new multi-role combat aircraft to replace F/A-18 Hornets and the F-111 aircraft fleet as they are withdrawn from service'.¹⁵¹ It received first pass approval from the NSC in November 2006. The Government stated, in the Defence White Paper 2009, that it will acquire around 100 F-35 Joint Strike Fighters (JSFs), along with supporting systems and weapons.¹⁵²

4.20 The process for the identification and approval of the broad option set submitted for first pass consideration of the project followed a different path from that outlined in the DCDM and Process Map. Defence advised the ANAO that:

a broad range of options had been considered prior to First Pass but the option set had been reduced to one option by Government direction.

In Nov 2001 the AIR 6000 project office released a Market Survey to ensure the broadest possible range of force mix options would be considered. Then in Dec

¹⁵¹ 2006–16 DCP, p. 31.

¹⁵² Department of Defence, *Defending Australia in the Asia Pacific Century: Force 2030 – Defence White Paper 2009*, p. 78.

2001 a Request for Information was also released seeking additional information on nine potential Air Combat options.

In early 2002 an opportunity existed for Australia to join the Joint Strike Fighter System Development and Demonstration (JSF SDD) program and Defence sought Ministerial approval to prepare a business case. In Jun 2002 the NSC considered the business case and authorised Defence to enter into negotiations to enter the JSF partnership.

In Oct 2002 following successful negotiations NSC approved entry by Australia into the JSF SDD program and at the same time formally terminated any further consideration of other combat platforms. Notwithstanding, ongoing monitoring of the wide option set was maintained by DSTO.

4.21 Defence provided copies of most of the key documents for this project requested by the ANAO, but was not able to provide a copy of the Capability Proposal First Pass (CPFP). Defence advised the ANAO that

the existence of a CPFP for AIR 6000 is evidenced by approval to proceed to 2nd Pass and Australia's further commitment to the JSF program through entry into the PSFD [Production, Sustainment, and Follow-on Development] MoU.

AIR 7000 Phase 1B - Multi-mission Unmanned Aerial Vehicle

4.22 The 2006-16 DCP identifies this as a project 'intended to acquire high altitude long endurance unmanned aerial systems for maritime patrol and other surveillance'.¹⁵³ The project received first pass approval from the NSC in July 2006. Defence provided copies of most of the key project documents requested by the ANAO, but was not able to provide details of the options that were considered by the Options Review Committee (ORC).¹⁵⁴ Defence did not provide evidence of the formation and operation of an Integrated Project Team (IPT)¹⁵⁵, but nonetheless stated that one was formed and operated for this project. Defence provided a document which it advised was a copy of the

¹⁵³ 2006-16 DCP, p. 33.

¹⁵⁴ The Options Review Committee (ORC) is a management committee within CDG with permanent membership consisting of CCDG (chair), First Assistant Secretary Capability Investment and Resources (FASCIR) and Head Capability Systems (HCS). The main role of the ORC is to consider initial proposed capability solutions and to guide the capability options set to be presented to Government for first pass approval.

¹⁵⁵ An IPT comprises representatives of the various stakeholders, such as DMO, CDG and the relevant Capability Manager. Its role is to facilitate and guide the capability development proposal through the Requirements Phase.

Function and Performance Specification¹⁵⁶ (FPS) for the project, but it was marked 'version 0.0'.

AIR 8000 Phase 3 - the C-17 acquisition

4.23 The C-17 acquisition is not listed in either the 2004-14 or 2006-16 DCPs. The then Government directed Defence to provide a first pass submission to the NSC in November 2006. The NSC gave combined first and second pass approval for the project on the basis of this submission. Defence subsequently prepared a number of the first and second-pass documents required under the strengthened two-pass approval system as described in the DCDM. However, as these documents were developed after second pass approval had been given, the decision to approve the project can not be said to have been informed by the process to develop these documents.

AIR 9000 Phase 4 - Black Hawk Mid-Life Upgrade/Replacement

4.24 AIR 9000 Phase 4, Black Hawk Mid-Life Upgrade/Replacement, is identified in the 2004–14 DCP as a project to 'address the modernisation or replacement of the Australian Army's fleet' of Black Hawk helicopters.¹⁵⁷ Defence advised the ANAO that

A1R9000 Ph 4/6 was established by a contract change to [an existing contract] CAPO 338444 (AIR 9000 Ph 2) and therefore formed part of the broader AIR9000 Program; i.e. an additional 34 helicopters were added to the initial contract for 12 aircraft.

4.25 Nevertheless, as the project was approved by the then Government as the result of a combined first and second pass submission to the NSC in April 2006, the ANAO requested Defence to provide copies of the key project documents used to develop that submission. Defence provided copies of most of the key documents requested, but the Acquisition Strategy had draft status. In addition, Defence advised the ANAO that an IPT was not required for the project because the project 'resulted from a contract change'.

¹⁵⁶ The FPS specifies the requirements for the system and provides the basis for its design and qualification testing.

¹⁵⁷ 2004–14 DCP, p. 59.

JP 126 Phase 2 - Joint Theatre Distribution System,

4.26 According to the 2006-16 DCP, this project 'will acquire equipment to improve the ADF capability to deliver support to forces on operations'.¹⁵⁸ The project received first pass approval from the NSC in April 2005, and second pass approval in July 2007.

4.27 First pass approval of this project was given by the NSC during the transition period to the strengthened two-pass approval system during which less stringent requirements for submissions applied, and Defence advised the ANAO that

in the lead up to First Pass the Kinnaird recommendations had not yet been fully implemented. The staff work for first pass involved documents prepared under the previous system, therefore many of the documents for first pass were not in the Kinnaird style.

4.28 Defence provided the ANAO with copies of the Initial Options Set, Capability Proposal First Pass (CPFP),¹⁵⁹ Initial Business Case (IBC), FPS and evidence of Defence Capability Committee (DCC) or Defence Capability and Investment Committee (DCIC) sign-off for this project; therefore there is evidence that many of the first pass activities described in the DCDM were carried out.

4.29 Defence also provided copies of the majority of second pass documents for JP 126 Phase 2 requested by the ANAO, with the significant exception of either a consolidated FPS or individual FPSs for the majority of the modules. The FPS is important because, according to the DCDM, it should contain the 'detailed technical analysis and understanding (depth) to support the capability, cost, schedule and risk assessments required for Second Pass'¹⁶⁰.

JP 2008 Phase 3F - Military Satellite Capability

4.30 According to the 2006-16 DCP, this project 'is intended to upgrade the existing terrestrial infrastructure to improve the operational performance of

¹⁵⁸ 2006-16 DCP, p. 55.

¹⁵⁹ The CPFP incorporates and summarises the key points of the Initial Business Cases for each option and recommends preferred options for further investigation after First Pass.

¹⁶⁰ 2006 DCDM, p. 66.

the ADF satellite network'.¹⁶¹ The project received first pass approval from the NSC in April 2006.

4.31 After extensive delays, Defence provided all of the first pass documents requested by the ANAO with the exception of the initial Project Management Plan and documentary evidence of ORC endorsement of the Initial Options Set. As noted in Table 4.1, at the time the ANAO conducted fieldwork for this audit this project had yet to receive second pass approval.

JP 2008 Phase 4 - Military Satellite Capability¹⁶²

4.32 This project is listed in the 2006–16 DCP as a project 'intended to implement the next generation ADF Satellite Communications architecture and is intended to cover both the space and ground segments'.¹⁶³ Defence advised the ANAO that, as the result of an 'unsolicited approach ... by the U.S. Government to the Australian Government':

JP 2008 Ph 4 became an accelerated acquisition¹⁶⁴ that underwent a combined First and Second Pass approval in an extremely short time frame (approx. 6 months). All elements of the capability development process were streamlined and it was acknowledged that not all traditional documentation would be developed. The acquisition process was via sole source to the US Government through a Memorandum Of Understanding. The planning was managed through an IPT. The risk associated with adopting this approach was offset by the engagement of experienced staff to lead the project and the active involvement of stakeholders in the decision making from the time the opportunity arose to "buy-in" to the WGS [wideband global satellite] program.

4.33 The project was given first pass approval by the NSC in June 2007 and second pass approval by the then Prime Minister in September 2007. Defence was unable to provide the ANAO with documentation indicating how the 'accelerated acquisition' was authorised or directed by the then Government. The department provided the ANAO with six of the 13 first pass project

¹⁶¹ 2006–16 DCP, p. 59.

¹⁶² Submitted to the NSC under the project name 'WGS Satellites'. Note that the Cabinet Handbook (paragraph 8.13) prescribes that 'the second-pass stage will occur for each acquisition phase of a multi-phased project'.

¹⁶³ *ibid.*, p. 59.

¹⁶⁴ The Cabinet Handbook (p. 38) provides that 'in exceptional circumstances the Prime Minister may approve an accelerated rapid acquisition process'. The 2006 DCDM does not provide guidance on how to manage or conduct an 'accelerated acquisition'.

documents, but none of the 12 second pass project documents (including costing, specification and risk assessment information) requested by the ANAO. Defence was not able to provide other documents to those requested that served the same functions and also could not provide evidence of how the approach to the two-pass approval process adopted by the department for this project, which differed to that described in the DCDM and Process Map, was authorised.

4.34 The ANAO notes that Finance did not agree the second pass costings for this project.

Amphibious Ships - JP 2048 (Phases 4A and 4B)

4.35 This project appears in the 2006-16 DCP¹⁶⁵ and involves the acquisition of two amphibious ships. The NSC gave first pass approval for the project in August 2005, and second pass approval in June 2007.

4.36 Defence provided six of the 13 first pass capability development documents requested by the ANAO, and most of the second pass documents, with the exception of authority to issue a Request for Tender and an Operational Concept Document (OCD).

4.37 Defence advised the ANAO that documents detailing the initial options set, and first pass cost estimates, could not be found. Other significant first pass documents that Defence was not able to provide to the ANAO include the CPFP, the Preliminary FPS,¹⁶⁶ and DCC/DCIC sign-off for the project.

JP2080 Phase 2B - ROMAN¹⁶⁷ Upgrade

4.38 This project is listed in the 2004-14 DCP¹⁶⁸ as part of a project to improve Defence's management information systems. The specific objectives of Phase 2B are to upgrade Defence's core financial and personnel computer systems, including the integration of the military pay system into the overall personnel system. The ANAO requested Defence to provide capability development documents relating to Phase 2B.2 of the project. This phase was

¹⁶⁵ 2006-16 DCP, p. 67.

¹⁶⁶ However, Defence did provide a document called an 'Outline Functional and Performance Specification Version 2' but this document was watermarked as draft.

¹⁶⁷ Resource Output Management and Accounting Network.

¹⁶⁸ 2004-14 DCP, p. 103.

given first pass approval by the NSC in July 2005, and second pass approval by exchange of letters between the then Ministers for Defence and Finance and Administration in November 2006.

4.39 Defence provided only two of the 13 first pass documents requested by the ANAO, and advised that the first pass submission was developed during the transition period (see paragraph 2.28) by staff in the CFO Group and ROMAN sustainment staff, and ‘as such, may not have complied with later documentation requirements’. Defence also advised the ANAO that the project utilised a ‘short form’ proposal and an ‘abbreviated’ submission, but could not provide the ANAO with documentation indicating how this process was authorised or managed. The DCDM does not contain guidance on what processes are to be followed in preparing a ‘short form’ proposal, or what documentation should be produced to support an ‘abbreviated’ submission.

4.40 Defence provided most of the 12 second pass documents requested, but could not provide evidence that a second pass IPT had been established, authority to issue a Request for Tender, or a copy of the second pass FPS or Test Concept Document (TCD).

JP 2095 Phase 1 - Aviation Fire Trucks

4.41 This project is listed in the 2004-14 DCP.¹⁶⁹ The project was included in the list of transition projects exempted, by the then Government, from the requirement for first pass approval (see paragraph 2.27). However, subsequently, the project was given combined first and second pass approval, by an exchange of letters between the then Ministers for Defence and Finance and Administration in December 2005, as it fell below the \$50 million threshold beyond which NSC approval is required. Defence provided all of the second pass capability development documents requested by the ANAO, with the significant exception of documents indicating authorisation to proceed to tender.

JP 2099 Phase 1 - Project CERTE

4.42 JP 2099 Phase 1 is listed in the 2006-16 DCP¹⁷⁰ as the first stage in the development of a Defence-wide identity management capability. First pass

¹⁶⁹ 2004-14 DCP, p. 111.

¹⁷⁰ 2006-16 DCP, p. 96.

approval for the project was given by the NSC in April 2006. At the time the ANAO conducted fieldwork for this audit this project had yet to receive second pass approval.

4.43 Defence provided the ANAO with copies of most of the requested first pass capability development documents, but was not able to provide a copy of the initial Project Management Plan, and provided only a draft version of the CFPF. Defence informed the ANAO in response to the proposed audit report that 'during First Pass consideration by the DCC in September 2005, the format requirement was to label the documentation as a "DRAFT" submission'.

Battlefield Command Support System - LAND 75 Phase 3.4

4.44 LAND 75 Phase 3.4 is listed in the 2004-14 DCP as a project to 'provide further rollout of the Battlefield Command System to Land Force units'.¹⁷¹ The project received first pass approval in November 2005 and had not received second pass approval at the time that the ANAO conducted fieldwork for this audit. Defence provided copies of all the documents requested by the ANAO.

LAND 112 Phase 4 - ASLAV Enhancement

4.45 LAND 112 Phase 4 'is a survivability enhancement and mid-life upgrade of the fleet of Australian Light Armoured Vehicles'.¹⁷² The project received first pass approval from the NSC in October 2006 and had not received second pass approval at the time that the ANAO conducted fieldwork for this audit.

4.46 Defence provided the ANAO with copies of most of the capability development documents requested; however, documents relating to one option were incomplete. The Preliminary FPS and the First to Second Pass Project Management Plan provided by Defence were dated post first pass approval of the project.

LAND 121 Phase 3 - Field Vehicles and Trailers

4.47 LAND 121 Phase 3 is listed in the 2006-16 DCP with Phase 3A proposed to commence the replacement of the Army's field vehicles and trailers, and 3B providing replacement field vehicles and trailers for the

¹⁷¹ 2004-14 DCP, p. 127.

¹⁷² 2006-16 DCP, p. 111.

remainder of the ADF.¹⁷³ The project received first pass approval from the NSC in June 2004, and second pass approval in August 2007.

4.48 First pass approval for this project was given during the transition period (see paragraph 2.28). Defence was not able to provide any of the first pass capability development documents requested by the ANAO and advised the ANAO that:

in the lead up to first pass the Kinnaird recommendations had not yet been fully implemented. The staff work for first pass involved documents prepared under the previous system, therefore many of the documents for first pass were not in the Kinnaird style.

4.49 Defence provided most of the second pass capability development documents requested by the ANAO, but could not provide evidence of the formation and operation of the second pass IPT; authority to release a request for tenders; or the Acquisition Strategy document.

LAND 125 Phase 2B - Soldier Enhancement Version 1

4.50 LAND 125 Phase 2B is listed in the 2004–14 DCP as the design phase of a project to develop and acquire enhanced capabilities for combat soldiers.¹⁷⁴ It was exempted, by the then Government, from first pass approval under the transition arrangements described in paragraph 2.27. It received second pass approval in February 2005, and was subject to the transition arrangements described in paragraph 2.28 during which less stringent requirements for submissions applied.

4.51 Defence was unable to provide the ANAO with evidence that a second pass IPT was formed and operated, authority to issue a Request for Tender, the outcome of the tender process, or a Capability Proposal Second Pass (CPSP) for this project. The Acquisition Project Management Plan provided by Defence was dated some four and a half years prior to second pass approval of the project, and the FPS and Acquisition Strategy provided had draft status.

¹⁷³ 2006–16 DCP, p. 113.

¹⁷⁴ 2004–14 DCP, p. 135.

SEA 1428 Phase 4 – Evolved Sea Sparrow Missiles

4.52 SEA 1428 Phase 4, which is listed in the 2006-16 DCP as a project to acquire Evolved Sea Sparrow Missiles,¹⁷⁵ was a follow-on purchase under an existing contract. It received combined first and second-pass approval from the NSC in July 2006.

4.53 Defence provided copies of most of the key second pass documents, for this project, requested by the ANAO. However, the Acquisition Project Management Plan provided was dated almost six years before project approval, and Defence was not able to provide a copy of the FPS.

SEA 1448 Phase 2B – ANZAC ASMD Upgrade – Fire Control Radar

4.54 SEA 1448 Phase 2B is listed in the 2004-14 DCP as a project to acquire fire control radars to complete the ANZAC Ship Anti-Ship Missile Defence upgrade¹⁷⁶. It was exempted, by the then Government, from first pass approval under the transition arrangements described in paragraph 2.27. The project received second pass approval in September 2005.

4.55 Defence provided the ANAO with copies of most of the key second pass documents requested; however, the Acquisition Project Management Plan provided had draft status, and the evidence of DCC sign-off provided contained unaccepted tracked changes.

SEA 1654 Phase 2A – Westralia Replacement

4.56 SEA 1654 Phase 2A is identified in the 2004-14 DCP as a project to replace HMAS WESTRALIA with a commercial, second-hand auxiliary oiler to be modified in Australia. This project also was exempted from first pass approval under the transition arrangements described in paragraph 2.27. It received second pass approval from the NSC in March 2004—that is, the same month as the strengthened two-pass approval system was introduced with the publication of the revised *Cabinet Handbook*.

4.57 Defence was unable to provide the ANAO with a copy of the CPSP, and evidence of higher committee sign-off, for this project. Defence provided the ANAO with two versions of the Acquisition Strategy, but both were dated after second pass approval had been given.

¹⁷⁵ 2006-16 DCP, p. 125.

¹⁷⁶ 2004-14 DCP, p. 153.

SEA 4000 Phase 3 - Air Warfare Destroyer (AWD) build phase

4.58 SEA 4000 Phase 3, Air Warfare Destroyer (AWD) build phase, is listed in the 2006-16 DCP.¹⁷⁷ This phase received first pass approval from the NSC in May 2005, and second pass approval in June 2007, at an estimated cost of \$6.6 billion. Overall, the approved phases of SEA 4000 have a budget of almost \$8 billion and will see three AWDs be built and delivered to the Navy.

4.59 However, the processes employed in engaging with Government in respect of the AWD project have not followed the guidance set out in the 2006 DCDM and the Process Map. Chiefly, this has been because of the size, complexity, materiality and duration of this project. There was close engagement with the then Government during the development of the project. Defence advised that for SEA 4000 Phase 3 the first and second pass capability development documents, requested by the ANAO had not been prepared, and advised that:

The AWD Program comprises all phases of SEA 4000. SEA 4000 Phase 3 is the current phase in which the Government's decision at first and second pass, for the delivery of three AWDs and their support system, are being executed. SEA 4000 Phase 3 does not stand alone, with discrete two pass process requirements of its own but, rather, the requirements of the two-pass process are met for the AWD Program as a whole, during SEA 4000 Phases 1 and 2, and the resulting processes and decisions thus apply across SEA 4000 as a whole and, particularly, to SEA 4000 Phase 3.

Noting that the DCDM was released in 2006, well into the execution of SEA 4000 Phase 2 and a year after the first pass and the project definition activities undertaken during and after SEA 4000 Phase 1, not all aspects of the strengthened two-pass process can have been met in the form subsequently prescribed in the DCDM.

Throughout the definition and decision activities in SEA 4000 Phases 1 and 2, the AWD Program, because of its size, complexity and cost, was the subject of close and ongoing engagement, direction and scrutiny from Government. For example, the paradigm for progressing from first pass to second pass and defining the options for Government decision at second pass were the product of specific direction from Government at first pass approval.

Understanding these facts is essential to a valid assessment of how the AWD Program has satisfied the requirements of the strengthened two-pass process.

¹⁷⁷ 2006-16 DCP, p. 137.

With that understanding, it can be seen that the AWD Program has applied the principles articulated in the 2003 Kinnaird review, and has fully met the outcomes intended in the Kinnaird recommendations, as well as, subsequently, in the DCDM. This fact applies equally to the phases and sub-phases of SEA 4000 which fall outside the timeframe of the Kinnaird review or the subsequent development of the DCDM and, more importantly, outside the specific scope of SEA 4000 Phase 3.

4.60 The *Cabinet Handbook* states that ‘the second pass stage will occur for each acquisition phase of a multi-phased project’. Nevertheless, as described above, much of the first and second pass capability development activities described in the DCDM were undertaken in previous phases of this project, some pre-dating the publication of the DCDM. Consequently, the ANAO has excluded SEA 4000 Phase 3 from the analysis of project documentation described in this chapter. The project is, however, included in the review of Cabinet documents in Chapter 5.

Records management

4.61 As discussed in paragraph 4.13, the ANAO found CDG’s document management and recordkeeping practices to be inadequate. In most cases, the ANAO was unable to determine whether Defence’s inability to provide requested documents was a consequence of poor records management practices or because the documents had not been prepared to inform the planning process and subsequent government decisions. The lack of rigour applied to document naming, versioning and storage by CDG staff of key capability development documents in Defence’s electronic records management systems makes it difficult or impossible to retrieve key documents.

4.62 The National Archives of Australia issues guidelines to Australian Public Service agencies on records management. These guidelines include the following:

As well as creating records, it is essential that staff in your agency capture or save them into your agency’s records management systems. This action will ensure that records:

- can be proven to be genuine;
- are accurate and can be trusted;
- are complete and unaltered;
- are secure from unauthorised access, alteration and deletion;

- can be found when needed; and
- are related to other relevant records.¹⁷⁸

4.63 ANAO Report No.6 2006–07, *Recordkeeping including the Management of Electronic Records*, in identifying a number of factors likely to enhance entities' capacity to manage their recordkeeping responsibilities, pointed to the need for agencies to 'recognise recordkeeping as an integral part of "doing business", requiring a sustained and visible commitment from senior management'.

Recommendation No.2

4.64 The ANAO recommends that Defence develop, promulgate and implement a sound records management policy within CDG.

Defence response

4.65 Defence agreed to the recommendation and stated as follows:

This will be done in parallel with a broader Defence portfolio wide activity on records management which is part of the Strategic Reform Program.

¹⁷⁸ National Archives of Australia, Check-up: A Tool for Assessing Your Agency's Information and Records Management, <<http://www.naa.gov.au/records-management/create-capture-describe/index.aspx>> [accessed 27 November 2008]

5. Submissions to government

This chapter presents the results of the ANAO's analysis of submissions to government relating to the 20 case study projects reviewed by the ANAO.

Introduction

5.1 As noted in paragraph 1.10, the DPR recommended that Cabinet rules be revised to 'enforce' the two-pass system.¹⁷⁹ A revised version of the *Cabinet Handbook* was published in March 2004.

5.2 The *Cabinet Handbook* articulates the principles and conventions by which the Cabinet system operates, and the procedures designed to ensure that the Cabinet process fulfils its central purposes.¹⁸⁰ It also sets out the requirements applying to submissions and memoranda related to defence procurement.¹⁸¹ These rules are closely aligned to the DPR's recommendations in respect of a strengthened two-pass approval system.

5.3 To inform our assessment of the degree to which the processes followed for the 20 projects in the ANAO's sample¹⁸² adhered to the Cabinet Handbook requirements, the ANAO examined copies of the submissions to government in relation to these projects.

Overall case study results

5.4 The ANAO found that 15 of the 20 sample projects followed the documented path for NSC approval set out in the *Cabinet Handbook*. Of these 15, at the time of the audit:

- six had received first pass approval only;
- three had received second pass approval only; and
- six had received both first and second-pass approval.

¹⁷⁹ Department of Prime Minister and Cabinet 2003, *Defence Procurement Review*, p. v.

¹⁸⁰ Department of Prime Minister and Cabinet, *Cabinet Handbook*, Fifth Edition, Amended March 2004 p. iii.

¹⁸¹ *ibid*, p.36. In March 2004, the NSC approved an increase, from \$20 million to \$50 million, in the threshold above which second pass approval must be given by the NSC. Projects valued between \$8 million and \$50 million can be approved jointly by the Minister for Defence and the Minister for Finance and Deregulation.

¹⁸² These projects are listed in Table 4.1 and more detailed descriptions of each project can be found at Appendix 3.

5.5 Defence was not required to develop submissions to government for two of the case study projects. The Super Hornet acquisition project, AIR5349 Phase 1, was approved as a New Policy Proposal in the 2007–08 Budget (see paragraph 4.18) with the then Government making this decision outside the two-pass approval process. In accordance with the *Cabinet Handbook*, the second project, Aviation Fire Trucks - JP2095 Phase 1, was not required to be submitted to the NSC for consideration because its value was below \$50 million. This project received combined first and second-pass approval through an exchange of letters between the Ministers of Defence and Finance.

5.6 The remaining three sample projects received second pass approval following the introduction of the strengthened two-pass approval process, but not as the result of a second pass submission to the NSC. JP2080 Phase 2B.2 - ROMAN Upgrade received first pass approval from the NSC, and subsequently received second pass approval by the relevant Ministers, because its value was below \$50 million.¹⁸³ JP2008 Phase 4 - Military Satellite Capability received first pass approval by the NSC, and subsequently received second pass approval by the then Prime Minister.¹⁸⁴ AIR 8000 Phase 3 - C-17s, received combined first and second-pass approval from the NSC in March 2006 despite having been submitted by Defence for first pass approval only.

5.7 As stated in paragraph 2.11 of the *Cabinet Handbook*, Cabinet documents and discussions are strictly confidential; consequently this audit does not disclose the submissions' contents as they relate to specific projects. Rather, we report in general terms on the extent to which the 23 submissions relating to the 20 sample projects adhere to the guidance contained in Chapter Eight of the Handbook. That guidance, together with the results of our analysis, is presented below.

5.8 Because of the difficulties encountered in obtaining key internal Defence documentation described in Chapter 4, the ANAO was not able to assess the quality of the documentation supporting the information provided in the sample submissions; in this chapter 'adhered' means that the ANAO

¹⁸³ Defence provided copies of the second pass submissions for the two sample projects that received second pass approval by Ministers. However, the ANAO was not able to assess their compliance with guidelines for submissions to Ministers, as such guidelines do not exist. See paragraph 5.73

¹⁸⁴ The Cabinet Handbook (paragraph 8.19) states that 'in exceptional circumstances the Prime Minister may approve an accelerated rapid acquisition process'.

observed that information that appeared to satisfy a requirement of the *Cabinet Handbook* had been included in the submission.

Adherence to specific *Cabinet Handbook* guidance

First pass

5.9 The ANAO assessed the first pass submissions for 15 projects. These were the 12 projects that received first pass approval as described in paragraph 5.4 and the three projects that received first pass approval as described in paragraph 5.6.

*Requirement - Each first pass submission or memorandum must identify the NSC-agreed capability gap to be addressed*¹⁸⁵

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
14	-	1	-

5.10 All first pass submissions in the sample identified the capability gap the project proposed to address. One submission contained limited information on the capability gap and the desired level of capability to be acquired. However, this submission was considered during the transition period, agreed by NSC, when submissions could be presented with less rigorous requirements as to the level of information provided. The transition arrangements applied to projects with a planned year of decision of 2003-04 or 2004-05 and the NSC agreed that proposals for these projects could be submitted, provided the level of information was sufficiently robust, despite not meeting all requirements of the new process.

*... and attach an 'Initial Business Case' for each realistic broad solution that addresses the capability gap*¹⁸⁶

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
14	-	1	-

¹⁸⁵ Department of Prime Minister and Cabinet, *Cabinet Handbook*, Fifth Edition, Amended March 2004, paragraph 8.6.

¹⁸⁶ *ibid.*

5.11 All of the first pass submissions in the sample included an Initial Business Case or, for combined first and second-pass submissions, an Acquisition Business Case. Fourteen of the sample first pass submissions had initial business cases attached. In one proposal (a 'transition' project as defined in paragraph 2.27) the initial business case was not identified as such, but most of the required information was included in the body of the submission.

Requirement - The options must include at least one off-the-shelf¹⁸⁷ option, where such an option exists, and where it is judged not to exist, this must be explained in the first pass approval submission

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
14	1	-	-

5.12 Fourteen submissions in the sample included an off-the-shelf option, or explained the non-inclusion of one, though in one case this explanation was limited to one line. In another submission, the shortcomings of alternatives currently in service with other countries' forces were listed in one paragraph, but none of these alternatives was included as an option.

Requirement - Any option that proposes the 'Australianisation' or modification of equipment must detail the rationale and associated costs and risks¹⁸⁸

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
5	2	-	8

5.13 Five submissions in the sample proposed, and provided a rationale for, modification of equipment to suit Australian requirements. Eight of the submissions that did not propose modifications were for acquisitions where such modifications might not be expected to be required. However, in two cases the need for modifications seemed likely but was not addressed in the submission.

¹⁸⁷ An off-the-shelf option is 'one that is available for purchase, and will have been delivered to another military or Government body or commercial enterprise in a similar form to that being purchased at the time of the approval being sought'. Source: DCDM, 2006, p. 41.

¹⁸⁸ Department of Prime Minister and Cabinet, *Cabinet Handbook*, Fifth Edition, Amended March 2004, paragraph 8.6.

*Requirement - The body of each submission or memorandum must include a discussion of the rationale for undertaking further analysis of some of the options*¹⁸⁹

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
11	2	-	2

5.14 Eleven submissions in the sample adhered to the Handbook guidance. In two cases the requirement was not applicable, as the submissions sought combined first and second-pass approval. In two cases, although the need for further analysis was evident, it was not discussed.

*... and, at a high level, the cost, capability, schedule and risk trade-offs between the different options identified*¹⁹⁰

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
1	5	7	2

5.15 It is essential that decision-makers in the Government have ready access to information about the cost, capability, schedule and risk trade-offs between the different options identified to address a capability gap. Accordingly, the ANAO expected to see this information displayed in a standardised tabular format; however, there was little consistency of presentation across the sample.

5.16 Of the seven submissions that partially adhered to the Handbook guidance, one compared capabilities and costs of the alternatives, but not schedules and risks, two compared capabilities, costs and schedules but not risks; two compared costs, capabilities and risks, but not schedules; one compared capabilities, risks and schedules, but not costs; and one compared costs, risks and schedules, but not capabilities. Two submissions in the sample each offered only one option, so this requirement was not applicable.

¹⁸⁹ *ibid.*

¹⁹⁰ *ibid.*

5.17 The submission that did adhere to the Handbook guidance provided the required information in a single, easy-to-read table. Five submissions did not include a discussion of trade-offs at all.

Requirement - Each Initial Business Case is to identify:

(a) the capability option being explored¹⁹¹

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
15	-		-

5.18 Each of the first pass submissions in the sample identified the capability option being explored.

(b) the indicative schedule¹⁹²

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
14	-	1	-

5.19 Each of the first pass submissions in the sample provided some indication of the proposed acquisition schedule. However, one submission contained only minimal information on the proposed acquisition schedule, providing estimates for the completion of the Request for Tender evaluation and for second pass approval (within a one year range) and stating that an in-service date late in a particular year 'is considered achievable'.

(c) the indicative total acquisition and whole-of-life costs¹⁹³

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
5	10	-	-

5.20 All but one of the first pass submissions in the sample provided indicative total acquisition costs, but only five provided an estimate of whole-of-life costs.

5.21 Of the remaining nine first pass submissions in the sample that did not adhere to this guidance, one provided an estimate of annual operating costs

¹⁹¹ *ibid.*

¹⁹² *ibid.*

¹⁹³ *ibid.*

rather than an estimate of whole-of-life costs. Seven provided estimates of Net Personnel and Operating Costs (NPOC). Another provided estimates that appear to be NPOC, but were variously described in the submission as ‘estimated net operating costs’, ‘net through-life Personnel and Operating estimates’ and ‘[estimated] annual net operating costs’.

*(d) the methodology for further assessment of the option, including any necessary funding to further assess the option, including the extent of industry solicitation*¹⁹⁴

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
8	3	2	2

5.22 Eight of the sample submissions provided this information. Two submissions sought combined first and second-pass approval, so this requirement was not applicable. A further two projects partially adhered to the Handbook guidance: one provided the information for several options, but not all. The other, relating to a very large acquisition, contained estimated costs for further assessment of each option, but the methodology was described as a set of high-level activities, providing no detail on what was actually proposed to be undertaken.

5.23 The three projects where this requirement was applicable but for which no methodology for further assessment was outlined included major, high-profile acquisitions.

*(e) an assessment of technical risk*¹⁹⁵

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
14	-	1	-

5.24 The ANAO observed a variety of approaches to the assessment of technical risk across the sample. While all of the first pass submissions in the sample mentioned technical risk, one did so in the body of the submission rather than in an initial business case, and the discussion was so imprecise it may have been of limited use decision-makers. For example, it stated that—for one element—risk was ‘relatively low’, and that there was ‘some risk’ in respect

¹⁹⁴ *ibid.*

¹⁹⁵ *ibid.*

of integration issues. Another submission, for a high-profile, expensive acquisition, stated that risks in respect of integration issues ‘will need to be assessed and addressed in the acquisition phase’. Another submission presented a ‘preliminary’ risk assessment.

5.25 Although some submissions in the sample characterised technical risk in imprecise terms such as low-medium or medium-high, two used Technical Readiness Levels (TRLs) as required for second pass submissions (see paragraph 5.34). One of these, however, rated the TRL for two elements as 4 to 8¹⁹⁶, providing very little guidance to decision-makers.

*(f) any implications for Australian industry, including potential suppliers and funded studies*¹⁹⁷

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
14	1	-	-

5.26 All but one of the first pass submissions in the sample adhered to the Handbook guidance on the requirement to identify any implications for Australian industry, including potential suppliers and funded studies.

Second pass

5.27 In the ANAO’s sample of 20 projects, Defence had prepared second pass submissions for 10. These are the nine projects that received second pass approval as described in paragraph 5.4, plus a project for which a second pass submission was prepared, but not approved by NSC.

¹⁹⁶ TRLs, as illustrated on p. 19 of the DPR Report, are assessed on a nine-point scale in ascending order of technical maturity. On that scale, 4 indicates ‘component and or basic sub-system technology valid in laboratory environment’, while 8 indicates ‘system technology qualified through test and demonstration’.

¹⁹⁷ *ibid.*, paragraph 8.10

Requirement - Each submission or memorandum must attach a detailed and rigorous 'Acquisition Business Case' for each capability option approved at first pass¹⁹⁸

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
6	2	-	2

5.28 Six of the second pass submissions in the sample adhered to the Handbook guidance. Of the two second pass submissions in the sample that did not adhere to this guidance, one did not include an acquisition business case at all. In the other, acquisition business cases were provided, but the options differed from those approved at first pass. In two cases the requirement was not applicable—as the proposed acquisitions had been exempted from the requirement for first pass approval, no options had been previously approved.

Requirement - The body of the submission or memorandum must include a discussion of the rationale for selection of the preferred option, including the cost capability, schedule and risk trade-offs between the different options identified¹⁹⁹

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
10	-	-	-

5.29 All second pass submissions in the sample adhered to the Handbook guidance.

Requirement - Each Acquisition Business Case is to include:

(a) the expected function or effect of the capability to be acquired²⁰⁰

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
10	-	-	-

¹⁹⁸ *ibid.*

¹⁹⁹ *ibid.*

²⁰⁰ *ibid.*, paragraph 8.11

5.30 All second pass submissions in the sample described the expected function or effect of the capability to be acquired.

(b) the budget estimates of total acquisition and whole-of-life costs²⁰¹

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
4	6	-	-

5.31 All second pass submissions in the sample provided estimated total acquisition costs. Four of them provided comprehensive, transparent whole-of-life cost estimates.

5.32 Six of the sample submissions did not provide whole-of-life cost estimates. Of these, one provided no estimate of operating costs at all; one provided an estimate of annual operating costs; and four expressed operating costs in terms of Net Personnel and Operating Cost (NPOC).

(c) the delivery schedule²⁰²

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
10	-	-	-

5.33 All second pass submissions in the sample provided an estimated delivery schedule.

(d) an analysis of the technology, cost and schedule risks and drivers (technology risk must be rated using the 'Technology Readiness Level' methodology)²⁰³

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
1	9	-	-

5.34 Paragraph 8.17 of the Cabinet Handbook states that

²⁰¹ *ibid.*

²⁰² *ibid.*

²⁰³ *ibid.* The DPR Report, in recommending the use of TRLs in second pass submissions to NSC, states that 'the system enables technology risk for each capability option to be identified early as they progress through the two-pass system. Implementation of such a system enables non-technical readers to better understand the level of technological risk of particular proposals and therefore facilitating a better assessment of their merits'.

Standardised Technology Readiness Levels (TRL) should be used to assess the technology maturity of equipment at various stages of development. Capability options without a TRL rating would not proceed for NSC consideration.

5.35 Nevertheless, only one of the second pass submissions in the sample adhered to the Handbook guidance. Of the remaining nine submissions, one used System Readiness Levels²⁰⁴. One used TRLs for two options (albeit with an imprecise rating assigned of 3-7), but not for the recommended option. The remaining submissions in the sample used technical risk ratings such as 'low', 'high', 'medium' and 'medium-high'.

(e) discussion of any implications for Australian industry²⁰⁵

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
9	1	-	-

5.36 All but one of the second pass submissions in the sample discussed Australian industry implications.

(f) the recommended mechanism for reporting progress to NSC²⁰⁶

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
5	5	-	-

5.37 Five of the second pass submissions in the sample adhered to the Handbook guidance by outlining a recommended mechanism for reporting progress to NSC; five did not.

Requirements applicable at both first and second pass

5.38 The ANAO examined 23 submissions relating to 18 of the 20 case study projects²⁰⁷.

²⁰⁴ Defence has not provided the ANAO with a definitive explanation of SRLs.

²⁰⁵ Department of Prime Minister and Cabinet, *Cabinet Handbook*, Fifth Edition, Amended March 2004, paragraph 8.11.

²⁰⁶ *ibid.*

²⁰⁷ As noted at paragraph 5.5, Defence was not required to develop Cabinet submissions for AIR 5349 Phase 1 or JP 2095 Phase 1.

*Requirement - Submissions or Memoranda must be labelled as first or second pass in the title*²⁰⁸

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
20	3	-	-

5.39 Twenty of the submissions the ANAO reviewed adhered to this requirement; three did not.

*Requirement - Each first and second pass submission or memorandum requires agreement with the Department of Finance and Administration*²⁰⁹ (Finance) on the detailed acquisition and operating costings and financial risk assessment²¹⁰

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
19	4	-	-

5.40 Nineteen of the submissions the ANAO reviewed adhered to the Handbook guidance; four did not.

5.41 In the case of one first pass proposal, Finance considered the cost and risk information supplied by Defence to be 'below the standard usually accepted for First Pass'. Finance indicated support for another first pass proposal, but did not state its agreement with Defence's costings, stating that the acquisition cost estimates were 'optimistic', and the operating cost estimates were 'immature', with one aspect of these not having been adequately analysed. Finance also disagreed with one component of Defence's costings for another second pass proposal, and stated that 'it is likely that final costings may vary'. Despite these caveats, Defence's submission stated that Finance—together with a number of other departments—had been consulted and that 'there is agreement'.

²⁰⁸ Department of Prime Minister and Cabinet, *Cabinet Handbook*, Fifth Edition, Amended March 2004, paragraph 8.4

²⁰⁹ Subsequently renamed the Department of Finance and Deregulation

²¹⁰ *ibid.*, paragraph 8.14

5.42 In the case of one submission in the sample, Finance's disagreement with Defence's costings led to the NSC deferring consideration of the proposal.

Requirement - A brief comment from Finance on cost and financial risk will be included in the cover page of each submission or memorandum²¹¹ ...

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
22	1	-	-

5.43 All but one of the submissions adhered to the Handbook guidance and included the required comment from Finance on cost and financial risk in the cover page. The non-compliant submission was presented shortly after the publication of the revised Cabinet Handbook in March 2004.

... along with a paragraph of comment [from Finance] in the body of the submission or memorandum²¹²

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
20	3	-	-

5.44 Twenty of the sample submissions adhered to the Handbook guidance and included a paragraph of comment from Finance on cost and financial risk in the body. However, three submissions did not include such a paragraph.

Requirement - Finance will provide material advising its sign off, any qualifications to that sign off and its perspective on the costings²¹³

5.45 ANAO did not review compliance with this requirement as it was outside the scope of the audit.

²¹¹ *ibid.*

²¹² *ibid.*

²¹³ *ibid.*

Requirement - Finance will also provide an attachment to its coordination comments for each Submission setting out in detail the basis for its sign off, issues identified and proposed treatments and remedies²¹⁴

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
-	23	-	-

5.46 None of the submissions in the sample had such an attachment, and Finance advised the ANAO that it has never provided them. In response to the proposed audit report, Finance advised the ANAO as follows:

this comment should be balanced by the fact that Finance includes comments in both the front of Cabinet submissions and in the body of the submissions, which makes Finance Comments more prominent than they would be in an attachment.

Further, Finance also provides an independent Blue Brief for members of the National Security Committee, introduced by the previous Government, which addresses the issues associated with cost and risk for major capital projects that are discussed by the Committee. In providing the Blue Brief, Finance provides greater information to assist the decision making process by the Committee, and meets with the intentions of the existing Cabinet Handbook.

Finally in light of both the above points, we understand that the next update of the handbook will delete the now unnecessary requirement for the attachment.

Requirement - All costings provided by Defence in Submissions are to be on an out-turned basis²¹⁵

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
22	1	-	-

5.47 All but one of the submissions in the sample contained at least one costing on an out-turned basis, but the majority of costings in the sample submissions were on a constant prices and foreign exchange²¹⁶ basis. Defence

²¹⁴ *ibid.*

²¹⁵ *ibid.*, paragraph 8.14. 'Out-turned prices' are estimates adjusted to incorporate the expected rate of inflation.

²¹⁶ That is, a constant foreign exchange rate for the Australian dollar against relevant foreign currencies was assumed.

informed the ANAO in June 2009 that all costs are now presented on an out-turned basis and that ‘this is now standard practice and embedded in standard tables in CABSUBs and associated cost models’.

Requirement - Within Defence there is to be sign off from the appropriate areas on the information provided in submissions, including costings, infrastructure aspects, acquisition strategy, risk assessment and mitigation, and technology maturity and risk²¹⁷

No. that adhered to guidance	No. that did not adhere	Partially adhered	Not applicable
-	23	-	-

5.48 The ANAO expected to see a standardised sign-off block in each submission, certifying approval by the heads of the areas within Defence responsible for each of the aspects listed above. The sample submissions do not contain this information. Many submissions in the sample assert that the Defence Science and Technology Organisation (DSTO) has provided the technical risk assessment, and the Defence Materiel Organisation (DMO) has assessed project maturity and provided a project maturity level, but no sign-off by these areas, or by those responsible for costings or infrastructure, was observed in the sample.

5.49 Defence advised the ANAO in response to the proposed audit report that ‘all CABSUBS are circulated within Defence and signed off at the two star and three star level. Defence has implemented a process of recording the sign off by each authoritative person.’

Approvals outside the two-pass process

A strong mandatory two-pass system should provide a precise and understandable process for the procurement of defence capabilities²¹⁸.

5.50 The ANAO selected its 20 sample projects on the basis of information–provided by Defence–and reported in its annual reports–that the projects had achieved first pass approval, second pass approval or both since the introduction of the strengthened two-pass approval process. However, the

²¹⁷ *ibid.*, paragraph 8.15.

²¹⁸ Department of Prime Minister and Cabinet 2003, *Defence Procurement Review 2003*, p. v.

ANAO observed that five of the sample projects received second pass approval outside the intended discipline of that process, as the result of decisions by the then Government.

Assessment of technical risk

5.51 The DPR stated that:

Standardised Technology Readiness Levels should be used to assess the technology maturity of equipment, including sub-systems, at various stages of development. Proposals lacking technology risk ratings would not proceed for government consideration.²¹⁹

5.52 As noted in paragraphs 5.24 and 5.35, the assessment and description of technical risk in the submissions in the ANAO's audit sample was inconsistent; in some cases, was vague; and, in many cases, did not adhere to the *Cabinet Handbook* requirement that TRLs should be used to assess the technology maturity of equipment at various stages of development. The ANAO found that, in many cases, the description of technical risk did not reflect an adequate assessment and did not provide sufficient guidance for decision-makers.

5.53 The ANAO recognises that the assignment of technical risk is not straightforward. Most acquisitions, even off-the-shelf items, involve integration with new and existing systems, and assessing the technical risks associated with the individual elements—and with the integration itself—is highly challenging. Nevertheless, it is vital that Government be provided with consistent and accurate advice on technical risk to the extent possible under the particular circumstances.

5.54 As identified by the DPR, the use of Technology Readiness Levels (TRLs) has the potential to assist in providing this advice; but care needs to be taken to ensure that the ratings are informative for decision makers and are used consistently in all submissions.

Recommendation No.3

5.55 The ANAO recommends that Defence refine its methodology for assessing and describing technical risk for future acquisitions and ensure that

²¹⁹ *ibid.*

submissions should not proceed without a clear statement of technical risk, consistent with the agreed methodology as set out in the *Cabinet Handbook*.

Defence response

5.56 Defence agreed to the recommendation and stated as follows:

All DCP Cabinet Submissions already contain a Technical Risk Statement. Defence will refine the methodology as part of the Capability Development stream of the Strategic Reform Program.

Costings

5.57 In relation to the issue of costings, the DPR stated:

When taking decisions on capability options at first and second pass the whole-of-life costs must be presented to and understood by government. These not only comprise the cost of the prime equipment, but also infrastructure, equipment operating costs, through-life-support, and the resources required to manage acquisition.²²⁰

5.58 Only nine of the 23 submissions the ANAO reviewed contained estimates of whole-of-life costs. Rather, the majority of operating costs were expressed as NPOC estimates. NPOC estimates reflect the anticipated change in operating costs associated with replacing a capability (where applicable) or, alternatively, reflect an update of the estimate contained in the DCP for the operating cost of a new capability. They do not, however, show decision-makers what the whole-of-life cost of the capability is estimated to be.

5.59 While NPOC and annual running cost estimates have their uses in other contexts, they do not provide the transparent, understandable whole-of-life cost information required for informed decision making on major capital acquisition projects. In this context, the DPR Review states that:

Currently, Defence spends approximately as much on maintenance and consumables each year as it spends on purchasing new equipment. Over two thirds of the whole-of-life cost of defence platforms or weapon systems is incurred after the system is introduced into service.²²¹

5.60 The DPR also states:

²²⁰ Department of Prime Minister and Cabinet 2003, *Defence Procurement Review 2003*, p. 18.

²²¹ *ibid.*, p. 6.

When taking decisions on capability options at first and second pass the whole-of-life costs must be presented to and understood by government. These not only comprise the cost of the prime equipment, but also infrastructure, equipment operating costs, through-life-support, and the resources required to manage acquisition²²².

5.61 The magnitude of cost associated with the whole-of-life costs of a capability option is not reflected in an NPOC estimate, which may be a small number, or even zero, depending on the estimated cost relative to that of the capability proposed to be replaced, or relative to the existing DCP provision for the capability.

5.62 The importance of whole-of-life cost estimates has now been reinforced by the *Defence White Paper 2009* which states:

The Government has also directed that greater attention be paid in the planning process to the whole-of-life cost dimensions of capability. This will be critical in providing Government with increased levels of confidence with respect to cost, schedule and technical risk when it considers major Defence projects. This will also assist in minimising scope variations in major acquisitions, and help drive down cost pressures.

Finance's involvement

5.63 The DPR report stated that:

'Finance ... should be involved much earlier, and on a continuous basis, throughout the two-pass approval process so that they can contribute to effective quality assurance in relation to costings ...'²²³

5.64 As detailed at paragraph 5.41, four submissions in the sample were submitted without agreement from Finance on their costings. Along with evidence presented in the discussion beginning at paragraph 2.40, this suggests that the expectation of the DPR that Finance be involved early and continuously throughout the two-pass approval process is not consistently being met.

5.65 *The Response to the Report of the Defence Procurement and Sustainment Review* indicates that one of the actions by which reforms to the Capability Development process will achieve the provision to Government of more

²²² *ibid.*, p. 18.

²²³ Department of Prime Minister and Cabinet 2003, *Defence Procurement Review 2003*, p. v.

reliable information on which to base judgements, and a more efficient and effective capability process, will be through ensuring early consultation with Finance on options, cost estimates and project risks.

Recommendation No.4

5.66 The ANAO recommends that Defence ensure that submissions to the NSC for first or second pass approval include explicit acquisition and whole-of-life cost estimates, agreed by Finance, as required by the *Cabinet Handbook*.

Defence response

5.67 Defence agreed to the recommendation and stated as follows:

All DCP Cabinet Submissions already contain this information but Defence will standardise the methodology and form of presentation.

Discussion of trade-offs

5.68 The DPR report also stated that:

Government must have information in a form that will allow it to assess the consequences of strategic decisions for defence capability.²²⁴

5.69 As noted at 5.17, only one of the sample submissions reviewed by the ANAO fully adhered to the *Cabinet Handbook* guidance regarding the provision of a high-level discussion of cost, capability, schedule and risk trade-offs. This discussion was accompanied by a simple yet comprehensive table, allowing ready comparison of the options against these criteria.

5.70 The ANAO suggests that Defence ensure that all future first and second-pass submissions, where more than one option is presented, include the required discussion of cost, capability, schedule and risk trade-offs between the options, accompanied by a one-page summary table to facilitate comparison.

²²⁴ *ibid.*, p. 18.

Other requirements

5.71 The ANAO noted a significant level of non-compliance, across the sample, in regard to a number of other *Cabinet Handbook* requirements. These include:

- rationale and associated costs and risks of 'Australianisation';²²⁵
- methodology for further assessment of the option;
- the proposed mechanisms to report progress to NSC;
- attachment from Finance setting out in detail the basis for its sign off; and
- record of sign-off from the appropriate area in Defence on costings, infrastructure aspects, acquisition strategy, risk assessment and mitigation, and technology maturity and risk.

5.72 The ANAO suggests that Defence seek clarification, from the NSC, of the Committee's requirements in regard to these issues. Where particular information is not required by the NSC, Defence should seek consequential amendments to the *Cabinet Handbook*.

²²⁵ In this context, 'Australianisation' means where a capability solution is sourced from an offshore original equipment manufacturer but is modified during the acquisition process to meet ADF requirements and is therefore materially different to the versions of the equipment in operation in other defence forces.

Ministerial submissions

5.73 Defence has not promulgated guidelines on information to be included in submissions to Ministers for first or second pass approval of major capital equipment acquisitions. The ANAO considers that, in order to make informed decisions in relation to such projects, Ministers require a level of information equivalent to that provided in submissions to the NSC. Advice in respect of Finance's views throughout the capability development process for these projects would also be valuable. The ANAO considers that there would be benefit in Defence reflecting these requirements in future editions of the DCDM and the Process Map.



Ian McPhee

Auditor-General

Canberra ACT

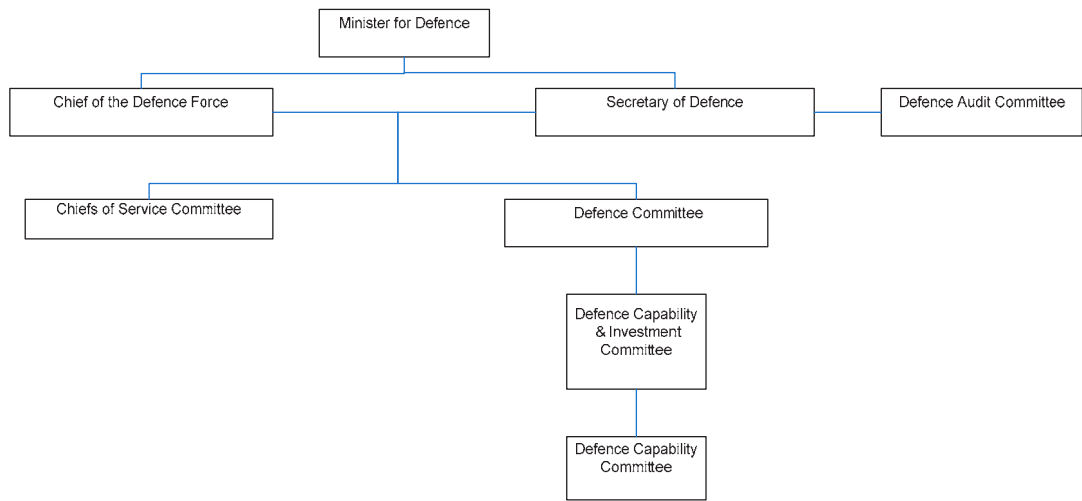
30 June 2009

Appendices

Appendix 1: Defence capability-related committees and boards

1. Within the senior Defence committee structure, there are two committees with specific roles related to the management of capability development and approval. The Defence Capability and Investment Committee (DCIC) considers the projects of high-value or significant strategic importance, and the Defence Capability Committee (DCC) considers the remaining projects. Sometimes the DCC assists the DCIC with selected strategically important or high-value projects.²²⁶
2. Figure 1 shows the relationship between Minister, Defence’s most senior management and the senior Defence committees that consider capability development proposals.

Figure 1
Structure of senior Defence capability-related committees



Source: Adapted from Dept. of Defence, Defence Annual Report 2006-07, Volume 1, Section 3, p.193

3. The DCIC is a sub-committee of the Defence Committee, which supports the Secretary of the Department of Defence (Secretary) and the Chief

²²⁶ Department of Defence 2006, *Defence Capability Development Manual 2006*, p. 32.

of the Defence Force (CDF) in meeting their obligations under the Ministerial Directive²²⁷. The DCIC's role is to 'strengthen independent review by seeking to ensure that resourcing, including capital investment and operation costs, is consistent with Defence's strategic priorities and resourcing strategy'.²²⁸ The DCIC is chaired by the Secretary and membership comprises the CDF, Chief Executive Officer of DMO, CCDG and the Chiefs of Navy, Army and Air Force.²²⁹ The DCIC is an advisory committee with the chair exercising executive authority.

4. The DCC's role, under the guidance of the DCIC, is to 'consider and develop options for current and future capability'.²³⁰ The CCDG chairs the DCC, which consists of permanent members and permanently invited members.²³¹ The DCC is an advisory committee with the chair exercising executive authority. Finance is a permanently invited member of the DCC.

5. Supporting these senior committees are the three Single Service Capability committees that, according to the DCDM, are required to formally consider capability proposals at first pass and second pass approval stage.

Management committees within CDG

6. The Options Review Committee (ORC)²³² is a management committee within CDG with permanent membership consisting of CCDG (chair), First Assistant Secretary Capability Investment and Resources (FASCIR) and Head Capability Systems (HCS). The main role of the ORC is to consider initial proposed capability solutions and to guide the capability options set to be presented to Government for first pass approval.

7. The Capability Development Board (CDB) is a management committee within the Capability Systems Division of CDG intended to provide 'guidance and direction to project directors' and to 'test, review and clear capability

²²⁷ The Ministerial Directive specifies key accountabilities and results for the Secretary and CDF.

²²⁸ Department of Defence, Defence Capability and Investment Committee Governance Principles, 17 October 2002, accessed on Defence Intranet, 30 April 2008.

²²⁹ *ibid.*

²³⁰ Department of Defence, Defence Capability Committee Governance Principles, n.d., accessed on Defence Intranet, 30 April 2008.

²³¹ Permanent members are expected to attend or be represented at every meeting. Permanently invited members are expected to only attend for relevant items.

²³² Formerly known as TROIKA.

proposals and supporting documentation' before they are presented to higher Defence committees such as the DCC.²³³

8. The ANAO notes that the DPR recommended that Defence review the committee system around capability development to improve accountability and reduce the burden of administrative process involved with multiple committee layers. The ANAO understands that such a review was conducted as part of the White Paper Companion Review process.

²³³ Department of Defence, Capability Development Board Business Rules, accessed on Defence Intranet, 30 April 2008.

Appendix 2: Project documentation

The ANAO requested Defence to provide the following documentation for each of the sample projects that had achieved first pass approval. Descriptions are from the DCDM.

First pass

Documentation confirming the formation and operation of the first pass IPT (Section 4.2)²³⁴

The formation of an IPT is an important step in the Requirements Phase for all capability development projects. The IPT is established by the capability development branch with CS Div responsible to the project, and should include membership suitable for facilitating and guiding the capability development proposal through the Requirements Phase, as the decision-making process in Defence on capability development issues necessarily involves consultation with a range of stakeholders. IPT membership will generally include a core membership of the supplier (DMO or CIOG), sponsor (CDG) and CM.

First pass project management plan (Section 4.3)

The PMP is a high-level planning document that provides a summary of the project and how it is to be managed. The PMP states what is to be done, when, by whom, at what cost (budget), and the risk associated with the activities. The PMP should also identify the different project processes and how they fit together to form a complete, integrated management system for the project phase.

Initial option set (Section 4.4)

The Requirements Phase involves a lengthy and detailed process of investigation of alternative ways of meeting a previously identified and agreed capability need. Early in the Requirements Phase, it will be necessary to identify and agree a set of broad options that will form the basis for more detailed investigation by Defence and consideration by Government. Getting this set of broad options right is crucial to the project's success, as the initial options set will drive the directions in which subsequent investigative effort is concentrated to achieve First Pass approval. First pass approval will in turn set the capability boundaries for solutions considered at Second Pass, and without further change, for the life of the asset.

²³⁴ Section and paragraph numbers refer to the relevant section of the 2006 DCDM.

Evidence of consideration and approval, by the Options Review Committee, of the option set to be considered (Section 4.4)

Once the IPT has undertaken some identification and investigation of possible options, the project should prepare a paper for consideration by the Troika.²³⁵ This paper, summarises the possible options for meeting a capability need, and recommends the prospective options for consideration at First Pass approval.

Capability Proposal First Pass ... (Section 4.5)

Once options have been investigated and refined to the point of submitting them for First Pass approval, CS Div personnel prepare a detailed package of covering and supporting documents. These documents consist of a 'Capability Proposal First Pass' (CPFP) and its supporting documents.

... and supporting documents (Section 4.5)

Initial Business Case for each option

First Pass Capability Cost Estimates

Preliminary Capability Definition Documents

The CDD will provide the basis for agreeing the technical requirements of the proposed capability between CDG and the DMO following Second Pass approval, when these documents will provide the Capability Baseline. The CDD consist of the following documents:

- a. Operational Concept Document (OCD);
- b. Function and Performance Specification (FPS); and
- c. Test Concept Document (TCD).

First to Second Pass Project Management Plan

Acquisition Strategy

Defence Committee Reviews (Section 4.6)

Once the CPFP and supporting documentation for a particular capability proposal are complete, they are considered by a number of Defence committees to achieve an agreed departmental position.

²³⁵ Also known as the Options Review Committee.

Documentation indicating sign-off by the relevant single service committee²³⁶

As the [Capability Manager] is the eventual owner/operator of the capability and related specialist military equipment in that environment, it is essential that their headquarters are consulted on the proposals that will ultimately affect them. This consultation will already be under way through the inclusion of Single Service representatives in IPTs from the beginning of the capability development project. However, it is also appropriate that there be formal Single Service consideration of the capability proposal at the First Pass approval stage (and later, too, at the Second Pass approval stage) ... in some cases, it may be appropriate for a particular proposal to be considered by more than one Single Service committee, depending on the nature of the proposed capability.

Documents indicating sign-off by either the DCC or the DCIC

The higher Defence committees relevant to capability proposals will normally be the DCC [Defence Capability Committee] and may also be considered by [other Defence committees]. For more strategic or sensitive capabilities, however, the DCIC [Defence Capability and Investment Committee] may review the proposal prior to it being considered by Government.

Second pass

Documentation confirming the formation and operation of the second pass IPT (Section 5.1)

As in the case with lead up to First Pass approval, the project IPT is a key mechanism through which [Capability Systems Division] staff coordinate activities leading up to Second Pass consideration by Government..

Documentation authorising the release of solicitation requests (Section 5.2)

The DMO is the authoritative agency for the development and release of solicitation requests.

Documentation indicating the outcome of tender evaluation (Section 5.2)

The tender evaluation approach is to be based on reducing the cost of tendering, maintaining competition and facilitating the rapid extraction of cost-capability issues and other significant considerations that enable

²³⁶ The ANAO excluded this requirement from its analysis on Defence advice that the requirement is not mandatory.

development of Second Pass submissions to Government. RFTs should be structured to facilitate this.²³⁷

Capability Proposal Second Pass ... (Section 5.3)

This step is broadly similar to that of developing the Capability Proposal First Pass. The proposals to be considered by Government at Second Pass are described in a Capability Proposal Second Pass (CPSP) and its supporting documentation.

... and supporting documents (Section 5.3)

Acquisition Business Case for each option

Second Pass Capability Cost Estimates

Capability Definition Documents

As discussed in Chapter 4 [of the DCDM], preliminary CDD documents will be developed for First Pass approval. These documents need to be refined and further developed for the specific options endorsed at First Pass.

Operational Concept Document

The OCD builds on the POCD developed during the First Pass stage (see Section 4-5 [of the DCDM]). The OCD must support the detailed cost, schedule and risk assessments and any final cost capability tradeoffs presented to Government. The OCD will therefore be much more detailed than the POCD presented at First Pass.

Function and Performance Specification

Test Concept Document

Acquisition Project Management Plan

Acquisition Strategy

Defence Committee Reviews (Section 5.4)

Once the Capability Proposal Second Pass and supporting documentation are completed, CS Div passes these papers through the same approval process by Defence committees as occurs at First Pass approval.

Documentation indicating sign-off by the relevant single service committee²³⁸

Documents indicating sign-off by either the DCC or the DCIC

²³⁷ This is the only guidance provided, in the DCDM, on tender evaluation.

²³⁸ The ANAO originally identified the DCDM requirement for sign-off of proposals by the relevant single service committee/s as a key activity in the capability development process. However, Defence advised the ANAO that the decision to take a project to the single service committee is a matter for the Service Chief to decide. Consequently, the ANAO has excluded this requirement from its analysis.

Appendix 3: The case study projects

AIR 5349 - Super Hornets

Twenty-four Boeing F/A-18F Block II Super Hornet aircraft will be acquired to give the ADF a bridging air combat capability. The first four aircraft are scheduled for delivery in the second quarter of 2010.

The acquisition of the Super Hornet under Project 5349 Phases 1 and 2 is being expedited due to the Government direction to establish an initial operating capability by the end of 2010. An accelerated schedule is possible due to the 'off the shelf' nature of the acquisition.

AIR 6000 Phase 2A/2B - New Air Combat Capability

The Government has decided that it will acquire around 100 F-35 Joint Strike Fighters, along with supporting systems and weapons. The first stage of this acquisition will acquire three operational squadrons comprising not fewer than 72 aircraft. The acquisition of the remaining aircraft will be conducted in conjunction with the withdrawal of the F/A-18F Super Hornet fleet, and will be timed to ensure that no gap in our overall air combat capability occurs.

Australia's future air combat capability will be based on four operational air combat squadrons consisting initially of three JSF squadrons and a squadron of Super Hornet aircraft, which will be replaced by a fourth JSF squadron.

AIR 7000 Phase 1B - Multi-mission Unmanned Aerial Vehicle (MUAV)

The life-of-type for the AP-3C Orion maritime patrol aircraft is being driven by the increasing cost of addressing airframe fatigue and corrosion, aircraft system supportability and mission system obsolescence. The Government will acquire eight new maritime patrol aircraft to replace the current AP-3C Orion fleet.

Phase 1B is intended to consider and further develop options leading to the acquisition of a high altitude long endurance unmanned aerial system that can perform all-weather, long endurance surveillance and reconnaissance tasks over maritime and land environments. The Phase 1 capability is an essential adjunct to the manned capability acquired under Air 7000 Phase 2B.

AIR 8000 Phase 3 - Heavy Airlift (C-17)

This project provides a global heavy airlift capability based around four Boeing C-17 Globemaster III aircraft and related provisions. The C-17 significantly enhances the Australian Defence Force's ability to support national and international operations and major disaster rescue and relief efforts.

Initial operational capability was achieved in September 2007, and following the arrival of the last aircraft in March 2008, all four aircraft have been operating in an air logistics support role (for purposes such as personnel and cargo transport). Expansion to other roles including Air Drop and high-dependency patient Aero-Medical Evacuation will occur progressively in 2008-09 as specialist equipment is procured, personnel trained and airworthiness accreditation obtained.

AIR 9000 Phase 4 - Black Hawk Midlife Upgrade/ Replacement

Project Air 9000 seeks to provide the ADF with the most appropriate force mix of helicopters. Fundamental to this is a strategic plan for the efficient management of all ADF helicopter fleets, in order to meet operational requirements in a range of roles (airmobile, armed reconnaissance, medium lift, maritime support, anti-submarine, anti-surface warfare, training and support to special forces).

Phase 4 of the project involves the acquisition of an additional 34 MRH-90 helicopters to replace the current Black Hawk and Sea King helicopter fleets.

JP126 Phase 2 - Joint Theatre Distribution System

JP 126 will provide for the synchronised delivery of equipment, materiel and personnel within joint theatres of operations, at the required time and in the required quantities and condition in order to support the joint commander's missions.

The scope of JP 126 includes all distribution activities conducted throughout the joint theatre of operations, from and within the points of disembarkation, to unit echelons. It includes those activities generally referred to as supply, transportation and movement, associated logistic command, and control and distribution information systems. The scope includes the distribution of all classes of supply and personnel in-theatre through all phases of operations.

Phase 2 involves the acquisition of rough terrain container handlers, materiel handling equipment—light, Beachmaster shelters, small load units, mobile cranes, and container sideloaders.

JP 2008 Phase 3F - Military Satellite Capability

This project is intended to upgrade the existing terrestrial infrastructure to improve the operational performance of the ADF satellite network. The two major initiatives are a second satellite ground station and advanced satellite communications modems.

JP 2008 Phase 4 - Wideband Global Satellites

This Project seeks to deliver high priority components of the next generation satellite communication system. The project will address the ADF's wideband satellite communications requirements through Australian involvement in the US Wideband Global Satellite Communication System program.

The US had an approved program for a five wideband satellite constellation and offered Australia the opportunity of partnering in the program through a contribution equivalent to the cost and sustainment of a sixth satellite. This will enable the expansion of the constellation to six satellites with benefits for both nations.

JP 2048 Phase 4A/4B - Amphibious Ships

The project will replace the heavy lift ship HMAS Tobruk and the amphibious landing ships HMAS Manoora and HMAS Kanimbla with two large amphibious ships.

The project centres on two Navantia-designed amphibious ships, each with landing space for six helicopters, hangar accommodation, garaging for heavy and light vehicles, a well dock capable of taking four large watercraft, 1403 personnel bunks and a fully integrated SAAB 9LV 454 Mk3E combat management system with onboard interfaces to external operational and support elements.

JP 2080 Phase 2B.2 - Defence Management Systems Improvement - ROMAN Upgrade

JP 2080 seeks to improve the range and quality of information available to managers, deliver business efficiencies and improve the interchange of management information within Defence's command support systems. It also provides an opportunity for the coordination of existing management information initiatives from individual programs and will incorporate a range of architectures, policies, procedures and standards to guide the provision of management information.

Phases 2B, 3, and 4 are intended to upgrade the core financial and personnel information systems to accommodate changes in user requirements, technical platforms and upgrades to the commercial application on which they are based. This will ensure the ongoing sustainability of the Defence Enterprise Resource Planning Systems to support Defence capability and decision making requirements.

Phase 2B is intended to finalise the integration of the military pay system into the overall personnel system.

JP 2095 Phase 1 - Aviation Fire Trucks

JP 2095 Phase 1 involves the acquisition of 16 new vehicles, compliant with international safety standards, to replace the existing Royal Australian Air Force capability provided by the current fleet of Trident fire trucks. These vehicles will be capable of providing aircraft rescue and fire fighting services at those bases where the RAAF provides its own ongoing aircraft rescue and fire fighting services (Amberley, Tindal, Williamstown and Richmond), and will also have the potential to deploy on expeditionary operations.

A contract for the supply of these vehicles was signed in February 2007, with deliveries scheduled to occur between April 2008 and May 2009.

JP 2099 Phase 1 - Project CERTE

JP 2099 proposes a Defence-wide identity management capability to manage the verification and control of Defence Identities. This capability will provide personnel and systems with trusted, reliable, timely and authoritative confirmation of the electronic identity of personnel and network-aware resources, including computing devices, sensors and weapon systems, operating across fixed and deployed components of Defence's information environment.

This phase is intended to deliver policy, governance and assurance processes, and standards to manage Defence Identity information throughout its life cycle; deliver a governance structure to manage and control Defence Identity; and implement the necessary technical infrastructure to deliver the service.

LAND 75 Phase 3.4 - Battlefield Command Support System

LAND 75 is a multi-phased project to provide the Australian Army with a Battlefield Command Support System and Battle Management System. These

systems will allow the transfer, processing and management of tactical level information necessary for the command and control of land operations.

Phase 3.4 is intended to provide further rollout of the Battlefield Command Support System and acquire an interim Battle Management System (BMS) capability to equip a Battle Group.

LAND 112 Phase 4 - ASLAV Enhancement

LAND 112 is a multi-phased proposal to provide a fleet of Australian Light Armoured Vehicles (ASLAV) for the Australian Army. Phase 4 is a survivability enhancement and mid-life upgrade of the fleet.

This phase may include mine protection; ballistic protection; battlefield management system integration; signature management; a defensive aid suite; offsetting weight increases to the vehicle caused by the above survivability enhancements in order to maintain current amphibious and land mobility; upgrading or replacing the power pack; and enhancing the crew procedural trainer.

LAND 121 Phase 3 - Field Vehicles and Trailers

LAND 121 is a multi-phased project that will provide the field vehicles, modules and trailers and associated support items that the ADF requires beyond the life-of-type of the current assets in order to meet ADF mobility requirements. This large project will deliver several thousand vehicles, modules and trailers over the next decade.

Field vehicles, modules and trailers transport personnel, munitions, replacement combat systems, fuel and critical supplies and, when necessary, evacuate casualties. The fleet also provides the platforms and prime movers for command, control, communications, computer and intelligence systems and numerous weapon systems. Vehicle characteristics therefore are tailored to suit the units and equipment they support, as well as the conditions under which they are required to operate.

LAND 121 Phase 3 seeks to commence the replacement of the current fleet.

LAND 125 Phase 2B - Soldier Enhancement Version 1

LAND 125 is a multi-phased, developmental project to optimise the capabilities for dismounted close combat at the individual and section level, including linkages to the combat unit. An integrated system will improve the

ability of the combat soldier and team to see, hear, move, react and engage on the future battlefield. This capability will also enhance the combat soldier's ability to train effectively for this future battlefield by enhancing their command/control and information exchange capability, improving lethality, survivability, sustainability and mobility in the conduct of dismounted combat.

Phase 2B seeks to introduce incremental enhancements to the ADF's close combat capability through limited integration of capabilities on the soldier.

SEA 1428 Phase 4 - Evolved Sea Sparrow Missiles

The Evolved Seasparrow Missile program is an international cooperative venture by the NATO Seasparrow Consortium to develop and produce an improved version of the NATO Seasparrow missile.

Phase 4 of this project involves the follow-on acquisition and through life support of Evolved Seasparrow missiles and quad-pack canisters.

SEA 1448 Phase 2B - ASMD Upgrade - Fire Control Radar

This project will deliver a state of the art Anti-Ship Missile Defence operational capability, providing an improved level of self-defence against modern anti-ship missiles for the Royal Australian Navy's Anzac Class frigates.

The ASMD project will provide the ANZAC Ships with enhanced platform survival against medium and emerging high end missile threats; multiple subsonic or supersonic missiles arriving near simultaneously. It will also enable ANZACs to give close-in protection to amphibious ships, supporting the Air Warfare Destroyer's area air defence capability with a local missile defence inner layer for a Task Group.

Project SEA 1448 (Phases 2A and 2B) will deliver a state of the art Anti-Ship Missile Defence operational capability, providing an improved level of self-defence against modern anti-ship missiles for the Royal Australian Navy's Anzac Class frigates.

SEA 1654 Phase 2A- WESTRALIA Replacement

SEA 1654 seeks to replace the existing Royal Australian Navy afloat support capability for maritime operations.

Phase 2A involved the purchase of a 37,000 tonnes deadweight commercial tanker (Delos). When delivered to Defence, the Delos was a new double hulled,

environmentally sustainable oil tanker, built in the Republic of Korea by Hyundai Mipo Dockyard Company.

The ship has been modified by Tenix to provide the RAN an Auxiliary Oiler (AO) capability to replace HMAS Westralia. Delos was commissioned HMAS Sirius and entered Navy service in September 2006.

SEA 4000 - Air Warfare Destroyer

The Air Warfare Destroyer Program is intended to deliver an affordable, effective, flexible and sustainable Air Warfare Destroyer capability.

The key outcomes for Phase 3 will be the finalisation of detailed design, construction of the ships, set to work of the Aegis Combat System and platform systems, test and trial and ultimately the delivery to Navy of at least three AWDs and their support system. The support system includes crew training, technical documentation, shore facilities, maintenance schemes and spare parts inventories.

Appendix 4: Defence's comments on the proposed report

Defence acknowledges the findings noted in this audit report, which assessed Defence's performance in the implementation of the strengthened Two-Pass process, as recommended in the 2003 Defence Procurement Review ('Kinnaird' Review), and agrees to each of the four recommendations made within the report as follows:

Recommendation No.1

Defence agrees. Defence already consistently engages with DoFD at the Band 1 level to allow access to cost data early in the capability development process for every DCP project. Access is provided to cost source data such as tender and market survey data early on in the process. Defence will work to formalise the process for engagement with DoFD (and PM&C and Treasury).

Recommendation No.2

Defence agrees. This will be done in parallel with a broader Defence portfolio wide activity on records management which is part of the Strategic Reform Program.

Recommendation No.3

Defence agrees. All DCP Cabinet Submissions already contain a Technical Risk Statement. Defence will refine the methodology as part of the Capability Development stream of the Strategic Reform Program.

Recommendation No.4

Defence agrees. All DCP Cabinet Submissions already contain this information but Defence will standardise the methodology and form of presentation.

The report notes that Defence has made significant progress in implementing the changes, as recommended by Kinnaird, but further improvement is needed.

defence has already begun addressing the issues highlighted in the audit report through the Defence Strategic Reform Program, and reforms to the capability development process outlined in the Government's response to the Mortimer Review.

Appendix 5: Finance's comments on the proposed report

Finance agrees with the recommendations made in the Proposed Report, and welcomes the opportunity to work with the Department of Defence to agree a suitable approach to capability development evaluation that engages Finance staff early in the process.

The proposed report identifies that Finance has not complied with the requirement to provide an independent attachment to Cabinet submissions from Defence, identifying cost and risk issues associated with each individual project submission, on at least 23 occasions. If this comment is retained, it should be balanced by the fact that Finance includes comments in both the front of Cabinet submissions and in the body of the submissions, which makes Finance's comments more prominent than they would be in an attachment.

Further, Finance also provides an independent Blue Brief for members of the National Security Committee, introduced by the previous Government, and continued by the current Government, which addresses the issues associated with cost and risk for major capital projects that are discussed by the Committee. In providing the Blue Brief, Finance provides greater information to assist the decision making process by the Committee, and meets with the intentions of the existing Cabinet Handbook.

Finally, in light of both the above points, we understand that the next update of the handbook will delete the now unnecessary requirement for an attachment. We would appreciate the drafting of the report reflecting the above points.

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*Rural and Remote Health Workforce Capacity – the contribution made by
programs administered by the Department of Health and Ageing*

Department of Health and Ageing

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Management of the M113 Armoured Personnel Upgrade Project

Department of Defence

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*Quality and Integrity of the Department of Veterans' Affairs Income Support
Records*

Department of Veterans' Affairs

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Delivery of Projects on the AusLink National Network

Department of Infrastructure, Transport, Regional Development and Local
Government

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Planning and Approval of Defence Major Capital Equipment Projects

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Management of the Australian Government's Action Plan to Eradicate Trafficking in Persons

Attorney-General's Department

Department of Immigration and Citizenship

Australian Federal Police

Department of Families, Housing, Community Services and Indigenous Affairs

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Army Reserve Forces

Department of Defence

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Management of the Tendering Process for the Construction of the Joint Operation Headquarters

Department of Defence

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Administration of the Petroleum Resource Rent Tax

Australian Taxation Office

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The Australian Taxation Office's Management of Serious Non-Compliance

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Management of the Movement Alert List

Department of Immigration and Citizenship

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Settlement Grants Program

Department of Immigration and Citizenship

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Online Availability of Government Entities' Documents Tabled in the Australian Parliament

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Administration of the Buyback Component of the Securing our Fishing Future Structural Adjustment Package

Department of Agriculture, Fisheries and Forestry

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Administration of the Securing our Fishing Future Structural Adjustment Package Assistance Programs

Department of Agriculture, Fisheries and Forestry

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Planning and Allocating Aged Care Places and Capital Grants
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The Super Seasprite
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Interim Phase of the Audit of Financial Statements of General Government Sector Agencies for the Year ending 30 June 2009

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Construction of the Christmas Island Immigration Detention Centre
Department of Finance and Deregulation

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Security Risk Management

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Funding for Non-government Schools
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Business Continuity Management and Emergency Management in Centrelink

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Management of Domestic Fishing Compliance
Australian Fisheries Management Authority

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An Investment in Assurance and Business Improvement	Sep 2007
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Making implementation matter	Oct 2006
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