

The Auditor-General
Audit Report No.40 2010–11
Performance Audit

Management of the Explosive Ordnance Services Contract

Department of Defence

© Commonwealth
of Australia 2011

ISSN 1036-7632

ISBN 0 642 81186 5

COPYRIGHT INFORMATION

This work is copyright. Apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth.

Requests and inquiries concerning reproduction and rights should be addressed to:

Executive Director
Corporate Management Branch
Australian National Audit Office
19 National Circuit
BARTON ACT 2600

Or via email:
webmaster@anao.gov.au



Canberra ACT
17 May 2011

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken an independent performance audit in the Department of Defence 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 *Management of the Explosive Ordnance Services Contract*.

Following its presentation and receipt, 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 and title.

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 (ANAO). 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 Australian Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

For further information contact:
The Publications Manager
Australian National Audit Office
GPO Box 707
Canberra ACT 2601

Telephone: (02) 6203 7505
Fax: (02) 6203 7519
Email: webmaster@anao.gov.au

ANAO audit reports and information about the ANAO are available at our internet address:

<http://www.anao.gov.au>

Audit Team

Natalie Whitley
Kim Murray
Kim Bond
Fran Holbert

Contents

Contents	5
Abbreviations and glossary	7
Summary and Recommendations	9
Summary	11
Introduction	11
Audit approach	14
Overall conclusion	14
Key findings	16
Summary of agency response	20
ANAO Comment	21
Recommendations	22
Audit Findings and Conclusions	23
1. Introduction	25
Management of explosive ordnance in Defence	25
Storage and distribution of explosive ordnance	26
Governance and management arrangements	30
Audit objective, scope and criteria	35
Report structure	35
2. Oversight of explosive ordnance managed under contract	36
Introduction	36
Corporate and business planning	36
Risk management	37
Business continuity management	39
Defence oversight of contractor work	39
3. Contract renegotiation and performance outcomes	42
Introduction	42
Contract review and renegotiation	42
Contract renegotiation	45
Renegotiation outcomes	46
Contractor performance against key performance measures	53
Defence contractual obligations	56
4. Contract expenditure on explosive ordnance distribution and storage	60
Introduction	60
Expenditure under the EO Services Contract	60
The Cost and Price Model	64
Efficiency improvements	72
The evergreen provisions of the EO Services Contract	76

Appendices	83
Appendix 1:	85
Other-than-serviceable explosive ordnance	85
Index.....	87
Series Titles.....	89
Current Better Practice Guides	94

Tables

Table 1.1	Main services provided under the EO Services Contract.....	29
Table 3.1	Defence estimates of cost overruns in the first 3 years of the EO Services Contract	43
Table 3.2	Key changes in renegotiated EO Services Contract	47
Table 3.3	Types of performance measures applied to the EO Services Contract	51
Table 3.4	Performance-based contract extension criteria	56
Table 4.1	Capability cost components.....	65
Table 4.2	Contract cost savings, 2008–09 to 2010–11 (\$'000).....	73
Table A 1	Serviceability of Defence's holdings of explosive ordnance.....	86

Figures

Figure S 1	Total expenditure on explosive ordnance storage and distribution, 2001-02 to 2009–10	18
Figure 1.1	Key stages in the management of explosive ordnance in Defence	26
Figure 1.2	Organisational structure of Explosive Ordnance Branch and the Directorate of Explosive Ordnance Services	32
Figure 3.1	EO Services Contract performance incentive framework	50
Figure 3.2	ADF unit performance against Defence obligations: returns and Naval ships ammunitioning/ de-ammunitioning measures.....	59
Figure 4.1	Total expenditure on explosive ordnance storage and distribution, 2001–02 to 2009–10	61
Figure 4.2	Annual explosive ordnance movement transactions, 2007-08 to 2009–10.....	62

Abbreviations and glossary

ABS	Australian Bureau of Statistics
ADF	Australian Defence Force
ADI Ltd	Australian Defence Industries Limited, now owned by Thales Australia
BCM	Business Continuity Management
CAR	Corrective Action Request
CCP	Contract Change Proposal
CCP12	Contract Change Proposal No 12. This is the version of the contract that was agreed between Defence and Thales Australia on 27 October 2006
CITCF	COMSARM IT Control Framework
CJLOG	Commander Joint Logistics
COMSARM	Computer System for Armaments
CPGs	Commonwealth Procurement Guidelines
CPM	Contract Performance Measure
CWBS	Contract Work Breakdown Structure
DEOS	Directorate of Explosive Ordnance Services
DMO	Defence Materiel Organisation
DSG	Defence Support Group
EO	Explosive Ordnance
EOMA	Explosive Ordnance Monitoring Authority Section in DEOS
EOSD	Explosive Ordnance Storage & Distribution Section in DEOS.
EO Services Contract	Explosive Ordnance Services Contract negotiated between Defence and ADI, with ADI now owned by Thales Australia

EPS	Equivalent Pallet Space
Explosive ordnance	All munitions containing explosives, nuclear fission or fusion materials and biological and chemical agents. This includes bombs and warheads; guided and ballistic missiles; artillery, mortar, rocket and small arms ammunition; all mines, torpedoes and depth charges; demolition charges; pyrotechnics; clusters and dispensers; cartridge and propellant actuated devices; electro-explosive devices; clandestine and other improvised explosive devices; and all similar or related items or components explosive in nature
FMA Act	<i>Financial Management and Accountability Act 1997</i>
FMA Regulations	<i>Financial Management and Accountability Regulations 1997</i>
JALO	Joint Ammunition and Logistics Organisation
JLC	Joint Logistics Command
KRA	Key Result Area
MiRF	Minor Retail Facility
PMF	Performance Management Framework
SoW	Statement of Work
S&Q	Survey & Quote work
Thales Australia	Thales Australia Limited
VCDF	Vice Chief of the Defence Force
Wholesale redistribution	The distribution of explosive ordnance among the depots and their pre-positioning to meet the anticipated needs of ADF units

Summary and Recommendations

Summary

Introduction

Management of explosive ordnance in Defence

1. The management of explosive ordnance¹ is integral to military capability, essential to the operations of the Australian Defence Force (ADF) and involves considerable levels of expenditure. This audit focuses on the Department of Defence's (Defence's) contractual arrangements for storing and distributing its \$3.1 billion inventory of explosive ordnance, representing some 60 per cent of Defence's reported total inventory at 30 June 2010.²

2. In July 2001, Defence engaged Thales Australia (the contractor) to store explosive ordnance at Defence depots under the Explosive Ordnance Services Contract (the EO Services Contract). Under the terms of the contract, the contractor also maintains Defence's explosive ordnance, distributes it to ADF users, receives returns of explosive ordnance from them and disposes of surplus or obsolete items. The services provided under the EO Services Contract are an essential component of ADF capability and have cost Defence \$398 million over the nine years to 30 June 2010.

3. This audit is the fourth in a current series of ANAO performance audits examining aspects of the major stages of Defence's and the Defence Materiel Organisation's (DMO's) management of explosive ordnance. The major stages are:

- the identification of explosive ordnance requirements and the acquisition of the explosive ordnance—aspects of which were examined in Audit Report No.24 2009–10, *Procurement of Explosive Ordnance for the Australian Defence Force* (March 2010) and in Audit

¹ The definition of explosive ordnance in the *Defence Security Manual* encompasses all munitions containing explosives, nuclear fission or fusion materials and biological and chemical agents. This includes bombs and warheads; guided and ballistic missiles; artillery, mortar, rocket and small arms ammunition; all mines, torpedoes and depth charges; demolition charges; pyrotechnics; clusters and dispensers; cartridge and propellant actuated devices; electro-explosive devices; clandestine and other improvised explosive devices; and all similar or related items or components explosive in nature.

² Defence's inventory is reported at cost, adjusted where applicable for loss of service potential. The costs of inventories are assigned by using a weighted average cost formula. Department of Defence, *Defence Annual Report 2009–10*, Volume 1, p. 214.

Report No.37 2009–10, *Lightweight Torpedo Replacement Project* (May 2010);

- the storage of explosive ordnance at Defence explosive ordnance depots and distribution of explosive ordnance to ADF users—the focus of this audit;
 - the sustainment or management of the explosive ordnance throughout its useful life;
 - the management of explosive ordnance by the end users of this materiel in Defence—the focus of Audit Report No. 37 2010–11, *Management of Explosive Ordnance held by the Air Force, Army and Navy* (April 2011); and
 - the disposal of explosive ordnance not consumed during its useful life, or otherwise declared excess or obsolete.
4. The management of explosive ordnance carries capability, safety, security, reputational and environmental risks across all stages of the explosive ordnance life cycle. The effective management of the EO Services Contract by Defence is an important part of managing those risks and supporting ADF capability.

The Explosive Ordnance Services Contract

5. Until 1997, each of the three Services (Navy, Army and Air Force) was responsible for managing its own explosive ordnance logistics. In response to the 1997 Defence Efficiency Review, Defence consolidated these functions into a new tri-Service organisation, the then Joint Ammunition and Logistics Organisation (JALO), and initiated a four-year program to market-test the storage and distribution of explosive ordnance. In May 2004, following the 2003 Defence Procurement Review, JALO's functions were reallocated between the Defence Materiel Organisation (DMO) and Defence. Since March 2008, the Directorate of Explosive Ordnance Services (DEOS) within the Explosive Ordnance Branch of Defence's Joint Logistics Command (JLC) has been responsible for the administration of the EO Services Contract.

6. Following market-testing, Defence entered into the EO Services Contract with Australian Defence Industries Limited (now Thales) in June 2001 for the storage, distribution and maintenance of both guided and non-guided

explosive ordnance for the ADF.³ The contract was for a period of ten years from 2001–02 to 2010–11, and included an option for Defence to extend the contract for a further five years.

7. Under the EO Services Contract, explosive ordnance storage and distribution services are centred on the contractor's management of 17 Defence-owned explosive ordnance storage and distribution facilities (depots). The contract provides for services such as:

- unloading imported explosive ordnance from commercial merchant vessels;
- positioning explosive ordnance at depots to meet ADF demands;
- issuing and transporting explosive ordnance to ADF units;
- accepting returns of explosive ordnance from ADF units; and
- ammunitioning and de-ammunitioning Navy ships.⁴

8. In 2004, Defence commissioned a major review of the EO Services Contract. The review was prompted by concerns over the higher than expected cost of the contract. In 2002–03, the first full year of operation, the contract cost of \$38.3 million was \$14 million more than originally estimated, and in 2003–04 the cost of \$43.3 million was \$8.9 million more than originally estimated. These cost overruns threatened the savings Defence expected from outsourcing explosive ordnance storage and distribution services.

9. The findings of the 2004 review prompted Defence and the contractor to jointly examine the identified major contractual issues in 2005 and 2006. By September 2006, they agreed to a major contract revision, which was signed in October 2006 and became effective from 1 July 2007. At that time, Defence exercised its option to extend the contract by a further five years to 15 years total, with the renegotiated end date being 2016.⁵

³ Australian Defence Industries Limited was acquired from the Australian Government by a joint venture involving Transfield and Thomson-CSF in November 1999. Thomson-CSF was renamed Thales in 2000, with the name of its Australian subsidiary becoming Thales Australia. In 2006, Thales Australia acquired full ownership of ADI Ltd and absorbed the company into its corporate structure. The maintenance services, which include a range of workshop repairs and scheduled maintenance, are not specifically examined in this audit.

⁴ These terms encompass the delivery of explosive ordnance to Navy ships, loading explosive ordnance onto Navy ships and unloading explosive ordnance from Navy ships.

⁵ The total of 15 years includes the five years for which the EO Services Contract had already been in operation at the time the variation was negotiated.

10. The revised contract aimed to improve the scope and efficiency of the services provided to Defence and to achieve better value for money. This was to be achieved by requiring continuous improvement efficiencies of at least two per cent a year (of real cost savings) and through a stronger performance management framework (PMF). The PMF enables the contractor's and Defence's performance to be monitored against an expanded range of performance measures. It provides financial incentives for the contractor to improve its performance against the performance measures, and annual performance reviews can result in payments to the contractor for excellent performance, or rebates from the contractor to the Commonwealth in the case of unsatisfactory performance.

11. Furthermore, contract extensions of up to a year can be granted for overall performance at or above a specified standard.⁶ As there is no limit in the contract on the number of performance-based contract extensions, the duration of the revised contract can potentially be extended indefinitely, provided that the contractor's performance continues to meet the required performance standards. In commercial terms, the performance-based contract tenure arrangements of the EO Services Contract are called 'evergreen' provisions.

Audit approach

12. The objective of the audit was to assess whether Defence is effectively managing the EO Services Contract. The audit focused mainly on Defence's contract management framework, including the arrangements to monitor the contractor's performance in delivering services under the contract. The audit also examined the processes used by Defence to develop the current version of the contract and the extent to which the revised contract, as negotiated in 2006, provides an assurance of better value for money when compared to the original contract signed in 2001.

Overall conclusion

13. Defence has established mechanisms, including well-developed performance management and monitoring frameworks, to support the

⁶ A change to the contract negotiated in 2006 provides that, commencing in 2008, the period of the contract will be extended for specified periods of up to a year if, following an annual performance review, the contractor's assessed level of performance meets performance standards listed in the contract, and the contractor was not in breach of the contract during the period under review.

effective management of the EO Services Contract. Defence's oversight includes an annual program of audits to improve the contractor's stock accuracy and integrity, and oversight of the security of the contractor's arrangements for transporting explosive ordnance.

14. Defence's 2006 contract renegotiation was effective in better specifying the services to be delivered, establishing a performance management framework, and in setting improvement and cost-reduction targets. Increases in contract costs have levelled off following the contract renegotiation, while marked improvements in the timeliness of the contractor's deliveries of explosive ordnance to ADF units have been achieved.

15. Defence and the contractor have been working cooperatively to identify areas of efficiency that could be derived from greater control on the use of services on offer and reductions in input costs. Nonetheless, there remain opportunities for Defence to obtain additional contract efficiencies, including by revisiting the margins paid for some contract elements and improving the forecasting of its explosive ordnance requirements. This could occur as part of Defence's regular reviews of the EO Services Contract costs, as provided for in the contract.

16. As noted at paragraph 11, there is currently no limit in the EO Services Contract on the number of performance-based contract extensions available to the incumbent contractor. Provided the contractor continues to meet contractually defined performance standards, the contract can potentially be extended indefinitely. Long-standing advice provided to agencies by the Department of Finance and Deregulation (Finance) is that such evergreen provisions do not provide the necessary assurance that the value for money requirements of the policy framework in the Commonwealth Procurement Guidelines (CPGs) will be met, and that they are likely to limit competition.

17. It is not clear from departmental records why Defence considered it necessary to provide for both a five year contract extension and the inclusion of evergreen provisions in the renegotiated contract in order to meet the contractor's priority for an increase in contract tenure. Entering into an evergreen arrangement as part of the 2006 contract renegotiations reduced the Commonwealth's ability to satisfy the requirements to test value for money over the long term because there is no certainty on when a further approach to the market will be made. Accordingly, in the course of its regular contract review process, Defence should seek to incorporate a contract expiry date to

allow for the services provided under the EO Services Contract to be market-tested.

18. The ANAO has made four recommendations aimed at improving Defence's management of contract risks, its forecasting models, the contract Cost and Price Model, and recommending that Defence seek a firm end date for the contract.

Key findings

Business planning and risk management

19. DEOS has established business planning for managing the distribution and storage of explosive ordnance and was largely responsible for conducting the 2006 renegotiation of the EO Services Contract between Defence and the contractor. This resulted in improvements to the contract and its extension from 10 to 15 years.

20. In accordance with the EO Services Contract, the contractor has implemented a soundly-based risk management framework and maintains a risk register. ANAO found that risks were identified and included in the contract risk register. Nevertheless, there is scope for more clearly specifying risks and ensuring they are regularly reviewed and updated.⁷ Additionally, DEOS could improve its risk management practices by addressing risks to Defence that are not addressed in the contractor's risk register.

21. Defence's management includes maintaining oversight of the ordnance managed by the contractor and identifying and managing risks. So far, Defence's risk management has focused mainly on maintaining oversight of ordnance stock integrity. As the contract arrangements have matured and the contractor's performance in this area has been satisfactory consistently, Defence advised ANAO that it now intends to place more emphasis on managing other contract risks. These risks include achieving ongoing savings on the cost of the contract, and maintaining the contract's complex Cost and Price Model.⁸

⁷ For instance, some risks were stated in very general terms, others had no identified mitigation strategies, while others had not been reviewed for some time.

⁸ The Cost and Price Model is a complex spreadsheet-based application that calculates the actual costs of the individual services provided to Defence by the contractor under the EO Services Contract, and then adds agreed 'margins' to determine the price payable by Defence.

Contract renegotiation and contractor performance

22. Having identified in 2004 that the cost of the EO Services Contract was significantly higher than had been projected, Defence initiated formal contract negotiations with the contractor. In October 2006 a number of improvements were incorporated into the renegotiated contract. These included a detailed statement of the services to be provided, the establishment of fixed costs for the contractor maintaining an agreed level of capability to deliver and store explosive ordnance, and a Cost and Price Model for contract services, including agreed price indices. Other significant additions were contractual commitments to continuous improvement and cost reduction, a performance management framework, and a revised risk management framework.

23. Since the commencement of the renegotiated contractual arrangements in July 2007, contract financial performance has improved, as indicated in Figure S 1. In constant-dollar terms, the cost of the EO Services Contract has stabilised. In nominal terms, the EO Services Contract costs in 2009–10 were \$49 million, representing a reduction of around 5.1 per cent on the cost of the contract in 2008–09 and only a little more than the cost of the contract in 2006–07. Savings on the total contract costs from 2008–09 to 2010–11 have been close to or above the target of 2 per cent of total contract costs.

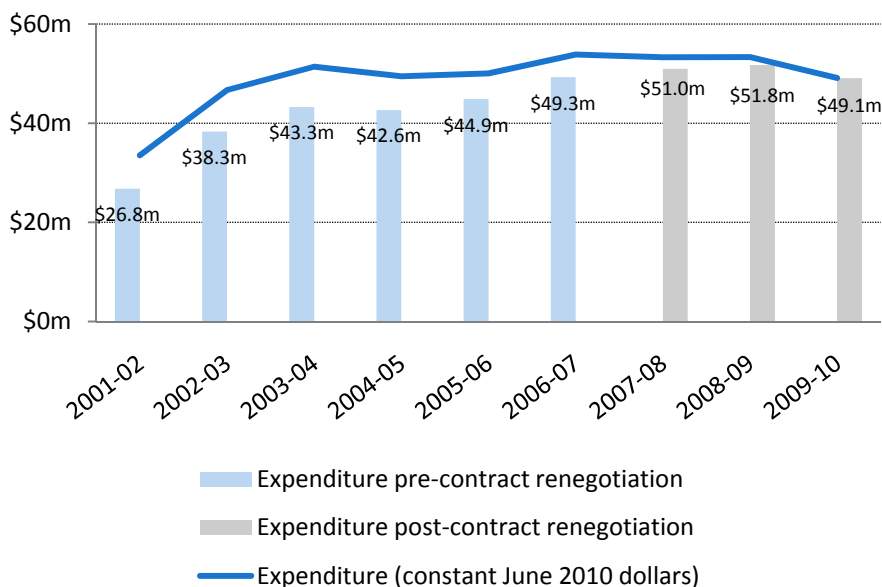
24. Defence data for 2007–08, 2008–09 and 2009–10 also indicates that the contractor has (at the 99 to 100 per cent level) met all of Defence's non-operational demands for issues of explosive ordnance. The contractor achieved similar levels of performance for operational demands⁹ in 2008–09 and 2009–10, improving on 2007–08 performance. Importantly, this occurred in conjunction with good performance against measures of the accuracy of contractor stock records. Accordingly, Defence assessed the contractor as performing at a high level and made incentive payments to the contractor totalling \$200 970 in 2008–09 and \$270 727 in 2009–10, for performance in those years.¹⁰

⁹ Explosive ordnance demands for ADF activities undertaken on operations or during war-fighting.

¹⁰ One performance payment of \$77 600 was made in 2002–03 under arrangements that applied before the contract was renegotiated in 2006.

Figure S 1

Total expenditure on explosive ordnance storage and distribution, 2001-02 to 2009-10



Note: Net amount after considering all cost recoveries for operations, DMO payments and other units, weapons, munitions and explosives and construction costs. This other expenditure amounted to \$0.52 million in 2007-08, \$2.84 million in 2008-09 and \$9.09 million in 2009-10. The composition of these costs, which includes a small amount of expenditure on work done by another contractor outside the EO Services Contract, is detailed in paragraphs 4.2 and 4.3.

Source: ANAO analysis of Defence data.

25. To date, contract amendments providing for performance-based contract extensions of one year have been made, based on the contractor's performance in each of 2008-09 and 2009-10. These contract amendments have extended the EO Services Contract's total length from 15 years to 17 years, ending in 2018 rather than 2016. Further extensions may be available, depending on the contractor's future performance.

Financial management of the Contract

26. As set out in the renegotiated EO Services Contract, Defence and the contractor are to use their best endeavours to achieve savings of two per cent each year. The ANAO considers that potential future savings and efficiencies could be achieved through:

- Better management of the Cost and Price Model, which is complex and elevates the risk of errors in amounts and calculations. Some errors in

the model were found by the ANAO. Defence would benefit from reviewing the model to ensure that it is delivering accurate results and that it is sustainable over the long term.

- More effective and efficient forecasting by Defence of its explosive ordnance demands. While almost all ordnance was delivered in full and on time in 2009–10, only 39 per cent was forecast in Defence's explosive ordnance management system. More efficient forecasting mechanisms, notably for ordnance items in short supply, could reduce the burden of forecasting on ADF units and still give the contractor sufficient notice to pre-position explosive ordnance at depots.
- The secure storage of explosive ordnance by ADF units (for instance, during extended exercises) where this is more cost-effective than the contractor collecting explosive ordnance for overnight storage and re-delivering it to the exercise area the following day.
- Developing generic disposal plans for certain items of unserviceable explosive ordnance, thus speeding up the disposal of these items and reducing contractor workloads.

27. Improving contract performance is important, as over 50 per cent of the contract costs are fixed and directed toward ensuring that the contractor maintains the capability to deliver explosive ordnance as required. Among the reasons Defence sought to renegotiate the contract in 2006 was the high margins it was paying for the services provided.¹¹ Notwithstanding the 2006 renegotiation, Defence continues to pay a similar margin, estimated at 10.6 per cent.¹² Because the contractor can recover all costs—including a profit margin—from Defence, the financial risks to the contractor are reduced. This

¹¹ Defence estimated that it was paying a weighted average margin of 9.48 per cent for services included in the Service Offerings component of the EO Services Contract and that the contractor was making additional profits on the costs to which these margins were applied ('margin on margin' profits), bringing the contractor's total weighted average profit margin to around 14 per cent. Using ABS data for 2004, Defence also noted that at the time the Contract was being renegotiated the transport and storage sector made a profit before tax of around 4 per cent (see paragraph 3.78). However, Defence accepted that this margin may have been low and more recent ABS data indicate that the Transport, Postal and Warehousing sector had a profit margin of 13.0 per cent in 2006–07 11.8 per cent in 2007–08 and 9.2 per cent in 2008–09 (see ABS, *Australian Industry 2008–09*, 8155.0, 28 May 2010).

¹² Because base contract costs, on which the margin is applied, were tightened in the 2006 contract revision, it is likely that current base contract costs more accurately reflect actual costs. As a result, it is likely that the contractor is making a smaller overall margin, even though the weighted rate of the margin is similar.

suggests that Defence would benefit from seeking to revise the current margins, including those for labour and administration.

Evergreen contract provisions

28. ANAO recognises that it is essential that Defence maintains the capability for the effective provision of explosive ordnance storage and distribution services. The current contractual arrangements to guarantee explosive ordnance capability include entering into a 15 year contract, meeting substantial fixed costs, and including evergreen provisions to further extend the contract if high performance standards are met.

29. However, the advantages of these arrangements must be considered in the context of the requirements of the Commonwealth Procurement Guidelines (CPGs). Long-standing advice to agencies by Finance¹³ is that evergreen provisions are inconsistent with the CPGs. They can substantially delay or preclude an approach to the market within a reasonable period, prevent a demonstration that the value for money principle is being achieved, and reduce competition.

30. While the EO Services Contract contains provisions that allow the contract to be terminated for convenience, it does not contain a firm end date, after which Defence would again approach the market for the delivery of explosive ordnance storage and distribution services. Provided that the contractor continues to meet specified performance standards, the contract could be extended indefinitely. Defence advised ANAO that it plans to carry out a detailed analysis of the value for money provided by the contract.

Summary of agency response

31. Defence appreciates the comprehensive audit undertaken by the ANAO and concurs with the majority of findings and recommendations in the audit report. The report confirms Defence's view that the Explosive Ordnance Services Contract is being managed effectively and is providing an excellent level of service to Defence. The report also identifies a number of potential

¹³ Department of Finance and Administration, 'Procurement Policy Framework: Frequently Asked Questions', November 2005, p. 27. Similar advice is currently also available to agencies on the website of the Department of Finance and Deregulation, see Procurement Policy Framework Frequently Asked Questions', updated February 2009, Q79, <<http://www.finance.gov.au/procurement/procurement-policy-and-guidance/procurement-policy-faqs.html>> [accessed 20 April 2011].

areas for improvement, including some that had already been identified by Defence and which are planned to be pursued throughout 2011.

32. Defence does not agree that the establishment of a firm date for expiry of the contract is the only effective way to ensure value for money. Defence believes that unique review provisions currently contained in the contract which provide full cost visibility, yearly contract reviews and a full contract review every five years are appropriate to ensure value for money.

ANAO Comment

33. The ANAO notes Defence's advice that areas for improvement raised in this report will be pursued throughout 2011.

34. Defence has not agreed with the recommendation directed towards the establishment of a firm end date for the EO Services Contract, which would allow the market to be tested. The EO Services Contract has been extended to 2018 at this time, some 17 years after the initial contract was signed. While contract extensions have been performance-based, 17 years is a lengthy period for such a contract given the benefits that can be derived from periodically re-testing the market; hence the ANAO recommendation. Defence administers other large scale, high value, complex contracts for which it has in place settled practices for market-testing at definite intervals.¹⁴

¹⁴ See for example: Auditor-General, *Garrison Support Services*, ANAO audit report No.11 2009–10, November 2009, pp. 33, 99, 124–125.

Recommendations

Recommendation No.1
Paragraph 2.13

The ANAO recommends that, to improve its risk management practices, key risks to Defence from its management of the EO Services Contract are addressed by Joint Logistics Command as part of Defence's risk management arrangements.

Defence response: *Agreed.*

Recommendation No.2
Paragraph 3.45

The ANAO recommends that, to meet contractual requirements and reduce the administrative burden on ADF units, Joint Logistics Command work with the Services to develop a forecasting process for pre-positioning explosive ordnance to meet ADF needs, particularly items in short supply and high demand.

Defence response: *Agreed.*

Recommendation No.3
Paragraph 4.40

The ANAO recommends that, to verify that the Cost and Price Model is fit-for-purpose, delivering accurate results, and sustainable over the long-term, Defence commission a review of the operation of the Cost and Price Model, including the parameters in the Model.

Defence response: *Agreed.*

Recommendation No.4
Paragraph 4.64

The ANAO recommends that, to ensure that value for money is being obtained, as part of its planned Contract reviews, Defence seek to include a firm end date for the EO Services Contract, which will allow the market to be re-tested.

Defence response: *Disagreed.*

Audit Findings and Conclusions

1. Introduction

This chapter provides background information on Defence's management of explosive ordnance and on Defence's contract for the storage and distribution of explosive ordnance. It also explains the objective and methodology of the audit.

Management of explosive ordnance in Defence

1.1 The effective management of explosive ordnance is integral to military capability and essential to the operations of the ADF. The procurement and through-life support of explosive ordnance involves extended lead times and the commitment of significant levels of resourcing. The primary users are Army, Navy and Air Force for Raise, Train, Sustain¹⁵ activities, and Joint Operations Command for operations.

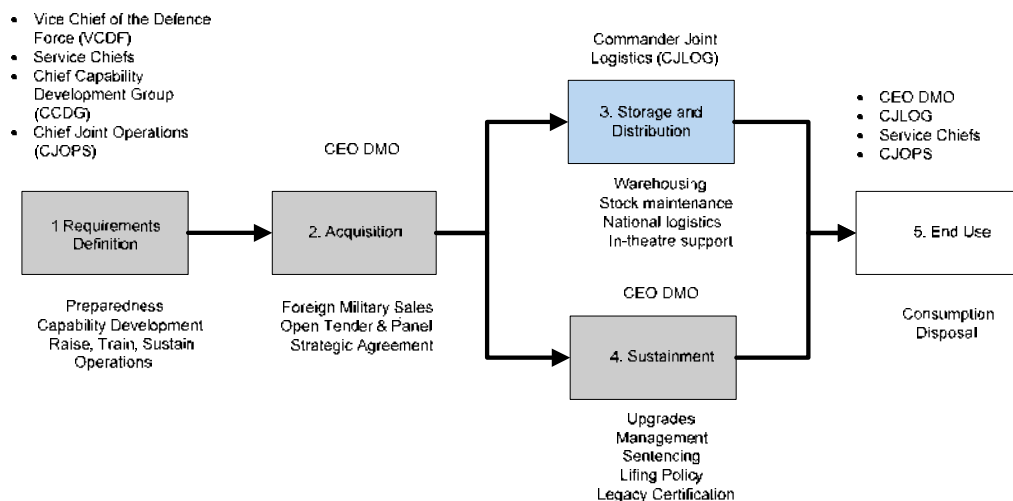
1.2 This audit focuses on the storage and distribution of explosive ordnance, which is one of the five major stages in Defence's management of explosive ordnance (see Figure 1.1). This audit is the fourth in a current series of ANAO audits examining Defence's and the DMO's management of explosive ordnance:

- Audit Report No.24 2009–10, *Procurement of Explosive Ordnance for the Australian Defence Force*, tabled in March 2010, focused on the procurement and through-life support arrangements to meet the explosive ordnance requirements of the ADF, particularly the non-guided munitions requirements of Army.
- Audit Report No.37 2009–10, *Lightweight Torpedo Replacement Project*, tabled in May 2010, examined the management of a complex guided munitions procurement project.
- Audit Report No.37 2010–11, *Management of Explosive Ordnance held by the Air Force, Army and Navy*, tabled in April 2011, focuses on the effectiveness of the accountability and control arrangements for explosive ordnance in the ADF at the unit level (providing coverage of part of the end-use stage described in Figure 1.1).

¹⁵ The term 'Raise, Train, Sustain' is used by the ADF to cover activities such as collective training, individual training and capability development, as distinct from ADF activities undertaken on operations or during war-fighting. See Major General M. A. Kelly, 'Challenges facing the Australian Army's Land Command', *United Service*, 59 (4) December 2008, pp. 24-25.

Figure 1.1

Key stages in the management of explosive ordnance in Defence



Source: ANAO analysis of Department of Defence documentation.

Storage and distribution of explosive ordnance

1.3 Until 1997, each of the three Services (Navy, Army and Air Force) was responsible for the management of its own explosive ordnance logistics. However, in response to the 1997 Defence Efficiency Review, Defence consolidated these functions into a new tri-Service organisation, the then Joint Ammunition and Logistics Organisation (JALO).¹⁶ At the same time, Defence initiated a four-year program to market-test the storage and distribution of explosive ordnance for the ADF.¹⁷

1.4 The market-testing program culminated in June 2001 when the Explosive Ordnance Services Contract (EO Services Contract) was signed between Defence and Australian Defence Industries Limited (ADI Ltd). The contract was for the period of ten years from 2002 to 2011 and provided for the

¹⁶ In May 2004, following the 2003 Defence Procurement Review, JALO's functions were reallocated between the Defence Materiel Organisation (DMO) and Defence.

¹⁷ The *Defence Security Manual* (Part 67 Explosive Ordnance Security, para 67.7) states that explosive ordnance consists of all munitions containing explosives, nuclear fission or fusion materials and biological and chemical agents. This includes bombs and warheads; guided and ballistic missiles; artillery, mortar, rocket and small arms ammunition; all mines, torpedoes and depth charges; demolition charges; pyrotechnics; clusters and dispensers; cartridge and propellant actuated devices; electro-explosive devices; clandestine and other improvised explosive devices; and all similar or related items or components explosive in nature.

storage, distribution and maintenance of both guided and non-guided explosive ordnance for the ADF.

1.5 ADI Ltd was acquired from the Australian Government in November 1999 by a joint venture involving Transfield and Thomson-CSF.¹⁸ Thomson-CSF was renamed Thales in 2000, with the name of its Australian subsidiary becoming Thales Australia. In 2006, Thales Australia (hereafter referred to as the contractor) acquired full ownership of ADI Ltd and absorbed the company into its corporate structure.

1.6 In 2004, Defence identified a number of opportunities to improve the scope and efficiency of the EO Services Contract, which led to a detailed review of the contract and the negotiation of a major variation. This major variation (Contract Change Proposal No 12, or CCP12) was signed in October 2006, effective from 1 July 2007.

1.7 The original EO Services Contract included an option for Defence to extend the initial ten year period of the contract by a further five years. In negotiating the revised EO Services Contract, Defence agreed to exercise this option: accordingly, the renegotiated EO Services Contract was for a term of 15 years.¹⁹ The renegotiated contract also provides the contractor with access to contract extensions of up to one additional year for each year that it meets defined performance standards.²⁰

Services provided under the EO Services Contract

1.8 Under the EO Services Contract, the contractor provides services in three major clusters: Service Offerings, Capability and Survey and Quote work.²¹ Specific services within each cluster are detailed in Table 1.1. Storage

¹⁸ Senate Foreign Affairs, Defence and Trade References Committee, *Report into the Sale of ADI*, February 2000, paragraph 2.41, page 22. Transfield was an Australian company and Thomson-CSF was a major French-owned electronics and defence contractor. Each of the joint venture participants acquired a 50 per cent stake in ADI Ltd.

¹⁹ The total of 15 years includes the five years for which the EO Services Contract had already been in operation at the time the variation was negotiated.

²⁰ Under the 27 October 2006 change to the contract (CCP12), commencing in 2008, following each annual performance review, the period of the contract may be extended for specified periods of up to a year, with the period of each extension being dependent on the level at which the contractor is assessed as meeting performance standards (listed in a contract attachment) in the previous year.

²¹ This categorisation is derived from an attachment to the EO Services Contract. This attachment lists a fourth category, 'Construction', which is not currently used. The contractor also undertakes projects, such as projects on major hazardous facility certifications and on 'other than serviceable' explosive ordnance, under the contract.

and distribution services are part of the Service Offerings cluster, and are centred on the contractor's management of 17 Defence-owned explosive ordnance storage and distribution facilities (depots).²²

1.9 DMO is responsible for the procurement of explosive ordnance, which, once procured, must be entered into Defence's explosive ordnance management system, the Computer System for Armaments (COMSARM), and then arrangements made for the contractor to receipt it into explosive ordnance storage depots.²³

1.10 ADF units provide forecasts of requirements three months in advance so that the contractor can ensure that, wherever possible, explosive ordnance is pre-positioned in depots servicing the units, using scheduled transport services to those depots.²⁴ The process of distributing explosive ordnance to depots is called 'wholesale redistribution'.

²² There are five 'stand-alone' facilities (located at Myambat, Jennings and Twofold Bay in NSW; and Mangalore and Port Wilson Explosive Area in Victoria) and 12 facilities that are located on ADF operational bases (at the Defence Establishment Orchard Hills, HMAS Albatross, RAAF Bases Williamtown and Singleton in New South Wales; HMAS Cerberus in Victoria; RAAF Base Amberley, Mount Stuart and RAAF Base Townsville – formerly Garbutt - in Queensland; Garden Island in Western Australia; RAAF Base Edinburgh in South Australia; Fort Direction in Tasmania; and at Darwin in the Northern Territory). Overall, there are effectively 15 depots, as some of the facilities (Myambat and Singleton in NSW and Mount Stuart and Townsville in Queensland) are managed by the contractor as single depots.

²³ The receipt, maintenance, issue, use and disposal of explosive ordnance in Defence explosive ordnance depots is recorded and managed through COMSARM, which is Defence's primary classified explosive ordnance inventory management system. It is from these depots that explosive ordnance is issued out of COMSARM to Service units, including Navy vessels, Air Force squadrons and Army regiments.

²⁴ Usually there are monthly scheduled services to the depots. Using scheduled deliveries avoids the need for ad hoc deliveries that can add significantly to contract costs.

Table 1.1

Main services provided under the EO Services Contract

Service cluster	Services
Service Offerings: Provide explosive ordnance receipt, storage, routine maintenance and distribution services to Defence	<ul style="list-style-type: none"> • Receive explosive ordnance from suppliers, including unloading commercial ships, preparing explosive ordnance for transportation at point of entry and receiving, inspecting and storing explosive ordnance at depot. • Manage the distribution of explosive ordnance among the depots and pre-position it to meet the anticipated needs of ADF units. This is known as 'wholesale redistribution'. • Transport explosive ordnance between depots and to-and-from ADF units. • Process the issue of explosive ordnance to and return from ADF units, including the ammunitioning and de-ammunitioning of Navy ships, and the provision of temporary storage, where required. • Maintain explosive ordnance and associated components.^(A) • Manage stock integrity.
Capability: Managing explosive ordnance services and maintaining an explosive ordnance support capability	<ul style="list-style-type: none"> • Work designed to retain the strategic capability to undertake explosive ordnance logistic management, operations and planning regardless of consumer activities (Service Offerings or Survey and Quote activities). Most Capability work is undertaken at a fixed cost, but some elements (for example, operators of Defence's Computer System for Armaments (COMSARM), stock-taking, storage and routine inspection program) are conducted at variable cost.
Survey and Quote (S&Q) work: Quotes for services not included in Service Offerings and Capability	<ul style="list-style-type: none"> • Largely ad hoc work for which the contractor provides Defence with quotes for the provision of the services requested by Defence and for which Defence provides separate purchase orders. This work includes such things as non-routine maintenance and workshop activities, direct delivery of explosive ordnance from the point of entry to a unit, the removal of explosive ordnance from shipping containers at a point of entry other than the Point Wilson Explosive Area, issue of explosive ordnance to ADF units from field ammunition points, disposal of explosive ordnance, facilities works implemented by the contractor, the provision of other explosive ordnance services to Defence, and explosive ordnance support for foreign forces.

Note: (A) Maintenance is not a focus of this audit.

Source: ANAO analysis of EO Services Contract.

1.11 Orders of explosive ordnance from ADF units (called 'demands') are also expected to be submitted around six weeks before the explosive ordnance is needed, but must be submitted at least two weeks before the explosive ordnance is needed. This lead-time is needed to give the contractor sufficient time to pre-position explosive ordnance without Defence having to incur

additional costs in doing so. The contractor prepares²⁵ and delivers the required explosive ordnance to the nominated delivery point, which is generally an ADF unit's explosive ordnance magazine or a military training area.

1.12 ADF units acknowledge receipt in writing and generally will subsequently return unused explosive ordnance (or related recyclable material) that is not required. Typically, the contractor collects this materiel from the unit's explosive ordnance magazine or training area. The contractor acknowledges receipt in writing and checks the returns, notifying the ADF unit of any discrepancies.²⁶ The contractor then re-packages the returned explosive ordnance for storage and redistribution, or for disposal or recycling as necessary.

Governance and management arrangements

1.13 The Department of Defence has the legislative responsibility for the transport, storage and handling of federal explosives ordnance in accordance with the *Explosives Act 1961* and regulations made under that Act, including the Explosives Transport Regulations 2002 and the Explosives Areas Regulations 2003. The administration of this legislation has been delegated by the Minister for Defence to Commander Joint Logistics (CJLOG), who is the Competent Authority for explosives ordnance.²⁷ The explosives subject to Defence's responsibility under the legislation are set out in the List of Authorised Commonwealth Explosives, published by the Department of Defence on 1 February 2002.²⁸

1.14 In March 2008, the Chief of the Defence Force appointed the Vice Chief of the Defence Force (VCDF) as the single point of accountability, with the aim of assuring the efficient and effective management of the explosive ordnance

²⁵ Explosive ordnance may need to be repackaged into required amounts prior to delivery. Any repackaging requires specialised workshop services because of safety and other considerations.

²⁶ Currently, significant loose quantities of explosive ordnance cannot be counted accurately at the pick-up point, although the contractor is planning to introduce machines to do this.

²⁷ See <<http://www.infrastructure.gov.au/transport/australia/dangerous/code.aspx>> [accessed 5 November 2010].

²⁸ See <<http://www.defence.gov.au/jlc/Documents/List%20of%20Authorised%20Commonwealth%20Explosives.pdf>> [accessed 5 November 2010], authorised by the Director of Ordnance Safety, in his role as Regulator for Storage and Transport of Commonwealth Explosives, in accordance with the Commonwealth *Explosives Act 1961* and associated Explosives Transport Regulations.

domain.²⁹ The Director General Explosive Ordnance (DGEO—see Figure 1.2) in Joint Logistics Command (JLC) has functional responsibility for discharging VCDF's appointed role and carrying out CJLOG's delegated responsibilities.

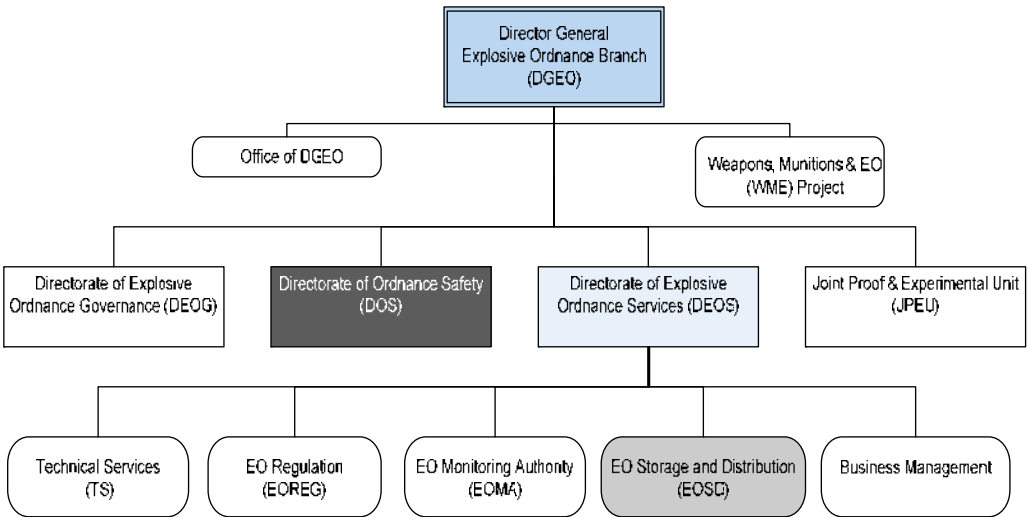
1.15 The DGEO is responsible for the administration of explosive ordnance and the management of the Explosive Ordnance Branch (the branch) in JLC. Among other things, the branch is responsible for providing explosive ordnance services to the ADF, including storage, distribution and governance. This extends to managing the explosive ordnance safety regime in Defence, and implementing logistic management and governance for Defence weapons, munitions and explosive ordnance in Defence. The branch provides assurances on the ADF's explosive ordnance and weapons through CJLOG to VCDF.

1.16 Organisationally, the Explosive Ordnance Branch includes the Directorate of Explosive Ordnance Services (DEOS—the light blue box in Figure 1.2) and the Directorate of Ordnance Safety (DOS—the khaki box in Figure 1.2). DEOS is responsible for, among other things, administration of the EO Services Contract. This includes monitoring the performance of the contractor and undertaking audits and inspections. DOS is responsible to CJLOG for technical regulatory matters of explosive ordnance storage and transport in accordance with the Defence Operations Manual 3 and Defence Explosive Ordnance Publication 103.

²⁹ This reform was, in part, a response to the 'Review of Defence Policy and Procedures for the Management of Explosives Ordnance', conducted in 2007 following an incident at the Graytown proof range that severely injured an APS employee. See Department of Defence, 'Explosive Ordnance Reform Program', June 2009, Annex A: Extract of Directive 4/2008 to VCDF, 11 March 2008.

Figure 1.2

Organisational structure of Explosive Ordnance Branch and the Directorate of Explosive Ordnance Services



Source: ANAO analysis of Defence documents.

1.17 Within DOS, the explosive ordnance Technical Regulatory Authority (TRA) undertakes audits and inspections on the implementation of safety policy and procedures for the handling, storage and transportation of explosive ordnance, including in areas of operations and during major exercises in Australia, if required. Defence informed ANAO that TRA audits focus primarily on high-level aspects of explosive ordnance safety management systems and that the TRA reports to CJLOG through the DGEO.

Directorate of Explosive Ordnance Services

1.18 DEOS is located at the Defence Establishment Orchard Hills in New South Wales and administers the EO Services Contract.³⁰ Among other things, DEOS is responsible for all ADF explosive ordnance licences, including all explosive ordnance facility licences. Facility licences are issued for five-year periods and specify the explosive limits for each building in the facility.³¹ The limits are recorded in COMSARM, along with the hazard classification and

³⁰ The EO Services Contract requires that there will be a contract authority responsible for the management and administration of the contract on behalf of the Commonwealth. The Director of EO Services is the contract authority.

³¹ For example, a facility in an earth covered building may be licensed for 70 000 kg net explosive.

division of the explosive ordnance stored in the building. COMSARM will issue a breach error message where non-conformance with the hazard classification is detected.

1.19 The other duties of DEOS include:

- monitoring explosive ordnance storage and distribution, including stock-take audits (spot checks) and audits of the contractor's transaction files and its compliance with the COMSARM IT Control Framework (CITCF), and the monitoring of the EO Services Contract Performance Management Framework (PMF);
- conducting safety audits of the explosive ordnance depots managed by the contractor, which are conducted every two years in accordance with Defence's Operations Manual 3;
- supplying technical services to regional Joint Logistics Units, via Regional Explosive Ordnance Services teams; and
- providing strategic capability advice for explosive ordnance storage and distribution, including explosive ordnance storage infrastructure.

1.20 Within DEOS, the Explosive Ordnance Storage and Distribution (EOSD) Section is directly responsible for the oversight and management of the EO Services Contract and employs four Contract Regional Operations Officers,³² responsible for liaising with ADF explosive ordnance users at a regional level. Most of the day-to-day contact that the contractor has with Defence is with EOSD.

Joint contract management arrangements

1.21 The contractor has organisational arrangements that broadly mirror those in place in Defence. Its contract managers are co-located with those of Defence at the Defence Establishment Orchard Hills, NSW.

1.22 Under the terms of the EO Services Contract, monthly Contract Progression Meetings are held at which Defence and the contractor's representatives discuss, among other things, emerging contract issues, including those that may need to be managed in accordance with the contract's

³² Located in Victoria, Queensland, Western Australia and the Northern Territory.

risk framework.³³ These meetings also review performance against contract performance measures, discuss continuous improvement or cost reduction initiatives, and monitor progress against previously identified action items.

1.23 Defence and the contractor meet each April to review, among other things, efficiency improvement initiatives. This is in addition to meetings on the management of product lines and contract changes.

Security, environmental protection and depot maintenance

1.24 Other key Defence organisations that support the distribution and storage of explosive ordnance include the Defence Security Authority (DSA), the Defence Environment Authority (DEA) and the Defence Support Group (DSG).

1.25 The DSA in Intelligence and Security Group conducts Protective Security Surveys of Defence facilities, including explosive ordnance depots. It undertakes physical security audits of all explosive ordnance depots and facilities every two years. It is the sponsor of the Defence Security Manual. The contractor is required to comply with any Corrective Action Request (CAR) issued by DSA as a result of a DSA protective security audit. The responsibility for monitoring, actioning and closing a CAR issued to the contractor lies with DEOS.

1.26 DEA conducts ad hoc environmental audits of depots, bays and ports. DSG maintains explosive ordnance depots on operational bases and at stand-alone facilities. Audits and inspections of on-base depots operated by the contractor can result in CARs that are either directed to DSG for remedy or for which DSG must make arrangements to remedy through the contractor. ANAO was informed by Defence that the contractor monitors all outstanding CARs, including those for which DSG is responsible.

³³ The contract requires that meetings be held between the contractor and the contract authority (that is, the Director of EO Services) in accordance with the Ongoing Management Plan, the Contract or as otherwise reasonably required by the Contract.

Audit objective, scope and criteria

1.27 The objective of this audit was to assess whether Defence is effectively managing the EO Services Contract. The audit did not include a physical stocktake of explosive ordnance at the Defence depots managed by the contractor. Relevant work of this nature is routinely undertaken as part of the audit work for Defence's annual financial statements.

1.28 The high-level audit criteria were:

- the EO Services Contract is administered to ensure the effective and efficient storage and distribution of explosive ordnance; and
- the EO Services Contract is managed in accordance with:
 - the provisions of the contract;
 - relevant Australian Government legislative and policy requirements, including those governing explosive ordnance, the CPG's, and Defence's procurement guidelines; and
 - prevailing better practice for contract administration.

1.29 The audit was conducted in accordance with ANAO auditing standards at a cost to the ANAO of approximately \$330 000. Resolution Consulting Services Pty Ltd provided the ANAO with assistance in the conduct of the audit.

Report structure

1.30 The remainder of the Report is in three chapters:

- Chapter 2 describes Defence's arrangements for managing the storage and distribution of explosive ordnance, and examines the identification and management of risks, and oversight and review arrangements;
- Chapter 3 outlines Defence's review and renegotiation of the EO Services Contract between 2004 and 2006, and examines the subsequent performance outcomes; and
- Chapter 4 examines the expenditure outcomes for the distribution and storage of explosive ordnance under the contract.

2. Oversight of explosive ordnance managed under contract

This chapter outlines Defence's arrangements for managing the EO Services Contract, including the identification and management of risks, and audit and review arrangements.

Introduction

2.1 In reviewing Defence's oversight of explosive ordnance management under the EO Services Contract, the ANAO considered relevant corporate and business planning undertaken by Defence and the contractor; risk management and business continuity management arrangements in relation to the EO Services Contract; as well as the audit and review of EO Services Contract activities, particularly transport. The ANAO examined these areas to determine the effectiveness of Defence's business processes, risk management and monitoring of EO storage and distribution services.

Corporate and business planning

2.2 Planning is an essential part of ensuring that explosive ordnance is available when required, at the right place and in useful quantities. Responsibility for planning and administration of the EO Service Contract rests with the Directorate of Explosive Ordnance Services (DEOS) within the Explosive Ordnance Branch of Joint Logistics Command (JLC). Among JLC's key objectives for 2009–10 is delivering 'improved explosive ordnance management, systems, support and services' and delivering 'logistic support to operations, Australian Defence Force (ADF) exercises and directed contingencies'.³⁴

2.3 The 2009–10 DEOS Business Plan provides links between its objectives and those of the Explosive Ordnance Branch and the JLC Command Plan. However, these 'objectives' are broad (for example, 'Deliver [*explosive ordnance*] to users and monitor against performance measures') and do not have a focus on performance improvement, with related performance improvement strategies and targets.

³⁴ Joint Logistics Command, *The Command Plan 2009–10*, August 2009, p. i.

2.4 To provide assurance that the contractor's management of the contract will be performed to the satisfaction of the Commonwealth, the contractor is required under the EO Services Contract to implement and maintain an Ongoing Management Plan. The Commonwealth may also require changes to this Plan. The Ongoing Management Plan details the arrangements that the contractor has put in place to manage the provision of the services required by the contract and its relationship with Defence.³⁵ However, it does not list business improvement priorities and strategies that may have been agreed with Defence.

2.5 The ANAO suggests that there would be benefit in DEOS introducing a greater performance improvement focus in its future business plans and in Defence seeking the inclusion of performance improvement priorities and strategies in the contractor's Ongoing Management Plan.

Risk management

2.6 Managing risk is an integral part of good management. The management of risks should be an integral part of procurement, including the development and management of contracts. Chapter 6 of the Defence Procurement Policy Manual stresses the importance of risk management and states that 'it is a good idea for risks and proposed risk mitigation strategies to be incorporated in a risk management plan'.

2.7 The main risks that the contractor faces in its management of the EO Services Contract relate to possible compliance failures. Such failures could result in accidents or loss of explosive ordnance, which could pose safety risks to ADF personnel and the wider community, adversely affect Defence's operational capability and could also adversely affect the contractor's reputation as a competent explosive ordnance storage and distribution manager.

2.8 The Contract Management Authority (DEOS) has overall responsibility for contract risk management. The EO Services Contract requires the contractor to implement the Contract Risk Management Framework, which identifies and prescribes arrangements for managing contract risk.

³⁵ It includes such things as the contractor's EO service management methodology; corporate systems; change management; quality and safety management; risk management; continuous improvement requirements; safety management; security; and emergency and on-call management.

2.9 The Risk Management Framework provides a sound basis for identifying, recording (in a risk register), reviewing and monitoring (in Contract Progression Meetings between Defence and the contractor) and escalating consideration of high level risks. However, while the Framework is soundly based and comprehensive, examination of the contract risk register showed that:

- risk mitigation strategies have not been identified for a number of risks;
- some risks are stated in very general terms (for example, 'Failure of Contract Governance');
- only four risks have been added to the risk register since May 2007 (one in 2009 and three in 2010); and
- some risks that the ANAO would not expect to be ongoing appear to have been outstanding for an unduly long period of time.³⁶

2.10 This indicates that the contract risk register has not been actively monitored and managed in recent years. To be effective, the risk management process needs to be rigorous, structured and systematic, with an emphasis on achievement of outcomes so that it does not become essentially a procedures-based exercise. The ANAO therefore suggests that Defence and the contractor review the risks identified in the risk register and implement appropriate strategies to address them.

2.11 DEOS does not have a risk management plan to address risks to Defence that are not addressed in the risk register maintained by the contractor. These risks include:

- maintenance of the contract's Cost and Price Model;
- poor performance by the contractor;
- higher than expected increases in the overall cost of the contract;
- any poor performance by Defence in meeting its own obligations;
- any failure by Defence to have sufficiently skilled and/or experienced resources to effectively manage the contract; and
- a possible future need to effect a transition to an alternative contractor.

2.12 The ANAO considers it important that these risks are addressed as part of DEOS' risk management arrangements.

³⁶ For example, 'Dispute over what constitutes gain sharing', raised in May 2007.

Recommendation No.1

2.13 The ANAO recommends that, to improve its risk management practices, key risks to Defence from its management of the EO Services Contract are addressed by Joint Logistics Command as part of Defence's risk management arrangements.

Defence response: *Agreed.*

Business continuity management

2.14 Business continuity management (BCM) is an integral part of risk management and provides guidance in response to events that cause significant disruption or outage to 'business as usual' operations. The ANAO confirmed that the contractor has a comprehensive BCM framework in place. These arrangements comprise:

- a BCM Policy;
- a BCM Framework;
- a Crisis Management Plan;
- a Central IT Disaster Recovery Plan;
- Business Continuity Plans for the contractor's various business operations;
- Business Impact Assessment Forms to inform risk assessments; and
- Emergency Management Plans for each work site.

2.15 Under Major Hazard Facilities legislation,³⁷ the contractor also prepares detailed safety reports for each site (which are a requirement in order to achieve major hazard facility licensing from Comcare).

Defence oversight of contractor work

2.16 Within DEOS, the Explosive Ordnance Storage & Distribution Section's (EOSD's) Governance Team has developed an annual work program under which each depot is audited at least once a year. To date, the audit effort has focused mainly on stock integrity, due to the critical nature of explosive ordnance from both capability and safety perspectives. Similarly, reviews of

³⁷ Specifically, Part 9 Major Hazard Facilities of the *Occupational Health and Safety (Safety Standards) Regulations*. The Safety Standards Regulations principal legislation is the *Occupational Health and Safety Act 1991*.

the COMSARM IT Control Framework have been aimed at improving stock integrity and accuracy.

2.17 Defence informed ANAO that, as stocktake discrepancies are now being maintained at very low rates, the Governance Team will in future reduce its previous strong focus on stocktake discrepancies and conduct a greater number of other audits of the contractor's compliance with the Capability components of the Cost and Price Model. These audits will involve checking the number of positions, classifications and qualifications of the labour capability component, as well as infrastructure, such as trucks and equipment.

2.18 ANAO confirmed that the contractor undertakes its own internal audits and submits an annual audit/inspection plan to DEOS for approval. However, the ANAO was informed that copies of these audit reports are not provided to Defence.

2.19 The annual work program is currently not risk-based and ANAO suggests that, as part of its development of its annual audit program, the Governance Team undertake a risk assessment to ensure that all high-risk areas are being addressed. In undertaking this risk assessment, Defence could request copies of the contractor's internal audits and also have regard to the findings and recommendations of audits being undertaken by other areas in Defence.

2.20 The Governance Team maintains a 'database' which tracks all audit/inspection recommendations arising from audits that it undertakes. It also tracks findings and recommendations arising from other Protective Security Survey audits and inspections. Other areas, such as the Explosive Ordnance Monitoring Authority section (EOMA) within DEOS, have similar mechanisms in place to track action on their own audit findings. While the Governance Team does not itself track the findings of the audits/inspections carried out by other areas in Defence, it does receive copies of a number of the audit reports. Governance Team representatives may also accompany environmental audit teams to ensure that the Team is aware of issues arising in the audits.

2.21 The ANAO noted that there are a large number of areas in Defence with oversight of the contractor's compliance with regulatory requirements,

such as those relating to safety, security and licensing.³⁸ However, there is no single register or database to help identify whether common or overlapping issues are being identified in the various audits. Such a system would also help to determine, for example, whether findings in one area have implications for performance in another area, and whether changes are needed to key performance measures. There may also be scope to schedule some audits with representatives from other relevant areas of Defence so that a holistic view is taken of a depot's operations.

Explosive ordnance transport

2.22 The transport of explosive ordnance must meet safety and security standards set by Defence and state government regulatory authorities. Transport of explosive ordnance is carried out both by the contractor itself and by sub-contractors to the contractor, particularly the transport of explosive ordnance between explosive ordnance depots (wholesale redistribution).

2.23 The last major audit of explosive ordnance transportation was undertaken by the Directorate of Ordnance Safety in 2008–09. The audit found that there was compliance with legislative and policy directives by the contractor and its sub-contractors.

2.24 Defence's requirements for the secure transport of explosive ordnance are set out in the Defence Security Manual, which was updated in October 2009. Among other things, the manual contains requirements for specified numbers of escorts and escort vehicles to accompany explosive ordnance when it is being transported.

2.25 The ANAO attended some deliveries of explosive ordnance to ADF units by the contractor and witnessed explosive ordnance being transported by one of the contractor's sub-contractors. Defence provided satisfactory evidence that the required numbers of escorts and escort vehicles were provided in these instances. Defence also identified a need to amend the Defence Security Manual to provide clear guidance on when support vehicles are needed for deliveries of small quantities of explosive ordnance.

³⁸ For example, the explosive ordnance Technical Regulatory Authority (TRA) in the Directorate of Ordnance Safety undertakes audits and inspections on the implementation of safety policy and procedures for the handling, storage and transportation of explosive ordnance, including in areas of operations and during major exercises in Australia, if required. Defence informed ANAO that TRA audits focus primarily on high-level aspects of explosive ordnance safety management systems and that the TRA reports to Commander Joint Logistics (JLOG) through the Director General Explosive Ordnance.

3. Contract renegotiation and performance outcomes

This chapter describes the lead up to, and the renegotiations that culminated in major changes to the contract in 2006. It also examines the contractor's performance against performance measures and the steps taken by Defence to meet its contract obligations.

Introduction

3.1 As noted in Chapter 1, in 2004 Defence identified a number of opportunities to improve the scope and efficiency of the EO Services Contract. This led to the conduct of a detailed review of the contract and, ultimately, the negotiation of a major contract variation that was signed in October 2006 and became effective from 1 July 2007.

3.2 Defence was prompted to seek a renegotiation, concerned by the increasing contracts costs evident in the early years (2002–03 to 2004–05). This chapter examines the steps Defence took to identify issues and engage the contractor in negotiations and Defence's desired contractual outcomes.

3.3 This chapter also examines the contractual outcomes of the negotiations, including the addition of performance and incentive measures into the contract. The new arrangements also clarified Defence's obligations, and Defence's fulfilment of these is examined at the conclusion of the chapter.

Contract review and renegotiation

3.4 In June 2004, Defence staff briefed the ADF Deputy Chiefs on budgetary difficulties with the EO Services Contract. In 2002–03, the first full year of operation, the contract cost of \$38.3 million was \$14 million more than originally estimated, and in 2003–04 the cost of \$43.3 million was \$8.9 million more than originally estimated (see Table 3.1). Defence expected actual costs to exceed baseline costs in 2004–05 by an estimated \$7.6 million. These cost overruns threatened the savings that Defence expected from outsourcing explosive ordnance storage and distribution services.

Table 3.1**Defence estimates of cost overruns in the first 3 years of the EO Services Contract**

Financial year	Baseline funding \$ million	Actual/Estimated \$ million
2002–03	24.5	39.0 ^(a)
2003–04	34.3	43.2
2004–05	36.4	43.0 ^(b)
Notes: (a) This included funding of increased services. (b) This excluded ongoing liabilities for the repair and servicing of non-guided explosive ordnance and for the disposal of explosive ordnance, estimated at \$12 million over 3 years.		

Source: ANAO analysis of Joint Logistics Command briefing materials, 29 June 2004.

3.5 Defence subsequently undertook a review of the EO Services Contract and engaged a consultancy firm to assist the reviewing area. The consultancy firm's report identified an increase in the 2003–04 cost over the 2002–03 budget baseline of around \$18.2 million, comprising:

- \$3 million in line with EO Services Contract escalation formulae, mostly in the extant price schedules for Issues and Returns (\$1.3 million) and Storage and Routine Maintenance (\$0.9 million);
- an additional \$5.3 million largely due to the net effect of items added to the contract over those items removed (net \$1.3 million) and to those items omitted from the original contract (\$3.9 million); and
- an additional \$9.9 million due to greater-than-anticipated volumes of movement compared to poor initial estimates of demand, the failure to include some items, increased operational tempo, and increased use of contractor services for a 24 hour, seven-days-a-week service provided at no direct cost to ADF units.

3.6 Defence's review identified poor initial estimates and increased operational tempo as the main cost-drivers. These were exacerbated by ADF units, in the absence of any moderating mechanism, placing unanticipated

demands on the contractor without regard to the costs involved.³⁹ Other key findings were that:

- Defence was paying for the cost of shifting some risks (such as uncertainty of the volume of explosive ordnance to be transported and stored at any one time) to the contractor;
- the volumes of explosive ordnance pre-positioned at depots were found to be greater than they would be if the contractor was making optimal use of the storage network;
- the contract activity baseline was out-of-date when the Request for Tender was issued and omitted some activities;
- the price model used an unrepresentative activity baseline for price-setting and included anomalies;
- the price escalation provisions in the contract favoured the contractor due to the high weighting given to labour costs; and
- there were no provisions to reduce the cost of the contract over time through efficiency improvements.

3.7 Defence estimated in September 2006 that it was paying the contractor a weighted average margin of 9.5 per cent for services included in the Service Offerings component of the EO Services Contract and that the contractor was making additional profits on the costs to which these margins were applied ('margin on margin' profits), bringing the contractor's total weighted average profit margin to around 14 per cent.

3.8 Defence also examined the profit margins of other companies supplying storage and transport services and Australian Bureau of Statistics (ABS) data, which indicated that the transport and storage industry made a profit before tax of around 4 per cent.⁴⁰ However, Defence accepted that its comparisons with other transport and storage companies may have been low, and more recent ABS data indicate that the Transport, Postal and Warehousing

³⁹ For example, although it may have been more cost effective for the contractor to make a delivery of explosive ordnance at the start of a week-long exercise and collect returned explosive ordnance at the end of the week, units tended to require daily delivery and collection of explosive ordnance for such exercises.

⁴⁰ Australian Bureau of Statistics, Year Book Australia 2004, <<http://www.abs.gov.au/Ausstats/abs@.nsf/46d1bc47ac9d0c7bca256c470025ff87/4fe2e160a3207e6eca256dea00053a7f!OpenDocument>> [accessed 21 January 2011].

sector had a profit margin of 13.0 per cent in 2006–07, 11.8 per cent in 2007–08 and 9.2 per cent in 2008–09. For this reason, Defence's Negotiation Directive for the renegotiation of the contract indicated that Defence was prepared to pay a margin of up to around 10 per cent, and sought to reduce the contractor's overall profit margin by better controlling base costs.⁴¹

3.9 Defence's review concluded that the management of future cost would depend mostly on its ability to accurately forecast use of explosive ordnance and to exert discipline on future demand for services, along with the contractor's ability and willingness to contain growth in wholesale redistribution. Defence saw the need to put its contract management on a more strategic footing, in conjunction with the contractor. Closer attention needed to be paid to the re-engineering of processes and to gain-sharing arrangements that would help drive the costs down.

Contract renegotiation

3.10 Following the completion of the 2004 contract review, Commander Joint Logistics wrote to the contractor in November 2004 proposing formal contract renegotiations.⁴² To facilitate the renegotiation process, Defence appointed a chief negotiator in December 2004 and engaged the consultancy firm that had conducted the contract review to develop a Contract Negotiation Directive.

3.11 The consultancy firm provided Defence with additional analyses. In August 2005 it provided advice on the development of a risk management framework for the EO Services Contract, and in December 2005 it provided a proposed baseline of Service demand data for 2004–05, including some trend analysis to assist Defence to assess the expected future level of demand for explosive ordnance under the contract. In September 2006, Defence received from its consultant an analysis of options for the contractor's continued tenure, for Defence's consideration during the contract renegotiations.

⁴¹ See ABS, *Australian Industry 2008–09*, 8155.0, 28 May 2010. There are also other factors, such as security screening of contractor staff, Defence Industry Security Program (DISP) accreditation for weapons, munitions and explosives, explosive ordnance specific insurance and vehicle configuration limitations, that need to be taken into account in comparing margins with those in general transport and warehousing operations.

⁴² The EO Services Contract provides for the Commonwealth to require, or the contractor to propose, changes to the contract. Contract change proposals (CCPs) are developed for any required or proposed changes. As at 1 October 2010, there had been 19 agreed CCPs. The major revision of the contract in October 2006 was CCP12, which came into effect on 1 July 2007.

3.12 Defence agreed with the contractor on a collaborative approach to the negotiations. The parties then established a Principals' Steering Group (PSG), which was jointly chaired by Defence and the contractor. The work of the PSG was overseen by a Project Working Group (PWG), which was also jointly chaired by Defence and the contractor. Defence and the contractor also agreed to incorporate agreed positions as revisions to the existing EO Services Contract. The PSG agreed on a joint statement of principles for the renegotiation process and met on 27 occasions, the last being the occasion of the signature of CCP12 by the parties on 27 October 2006.

3.13 Defence's strategic priorities for the renegotiation were to assure capability delivery to support ADF operations and training, to obtain greater budget certainty, and improve value for money. The contractor advised Defence that its priorities in the negotiations were to achieve strategic certainty by extending contract tenure, to expand the scope of the contract and to maintain its current level of contract revenue.

Renegotiation outcomes

3.14 The key changes negotiated and incorporated into the renegotiated EO Services contract under CCP12 are summarised in Table 3.2. They include contract period extension, the control of costs and performance monitoring and measurement.

Table 3.2**Key changes in renegotiated EO Services Contract**

Description of key change
Contract extended from 10 to 15 years, to 2016 In addition, yearly contract extensions of up to 12 months to be granted provided contractor meets contractually specified performance standards. No limit to the number of performance-based extensions. Further option for Commonwealth to extend for two consecutive two-year periods.
Contract Work Breakdown Structure included in the Statement of Work Improved clarity of each service to be provided under the contract, including detailed description of the service, and the work elements required for each service delivery. Minor variations to be mutually agreed, with all others only requiring a Contract Change Proposal (CCP).
Fixed costs agreed so as to maintain a base level of capability Fixed costs under new 'Capability' service category. Other costs vary with the level of demand placed on the contractor.
Service Offerings, Capability and Survey and Quote service categories replace twelve Price Schedules Agreed prices included in a Cost and Price Model, which calculates payments using agreed prices for work carried out, in order to meet actual demand.
Cost-down or continuous improvement provisions Defence and contractor to make best endeavours to each achieve a real reduction in the cost of the contract of two per cent a year
Performance management framework Contractor's performance measured against key reporting areas, Defence measured against effective management of the contract. Incentive payment to the contractor if overall performance exceeds specified levels, or rebate to the Commonwealth if performance fails to reach specified levels. If overall performance in a year is high and continuous improvement efficiencies are achieved, contract period extensions may be granted.
Revised Risk Management Framework Contractor to manage contract risks in accordance with arrangements specified in revised contract, and responsible for managing operational risks as per AS/NZS 4360:2004.

Source: ANAO analysis.

Contract period extension

3.15 As noted in Table 3.2, the renegotiation extended the contract period for a further five years to 2016, a total period of 15 years. It also provided for additional contract extensions of up to 12 months each to be granted subject to the contractor meeting contractually specified performance standards and not

being in breach of the contract during the period under review.⁴³ These annual contract extensions can be granted over an indefinite period, effectively making them perpetual or so-called 'evergreen' provisions.⁴⁴

3.16 A September 2006 Tenure Options Paper provided to Defence by its consultant advisor canvassed the option of provisions rewarding the contractor for good performance by contract period extensions, including the possibility of evergreen provisions. Defence was advised in the Paper that:

The evergreen concept is typically deployed when 'steady state' performance has been achieved: a situation which currently does not exist with [*the contractor*].

The evergreen period can be granted for (say) five years, and the evergreen clause will state that for every period of satisfactory performance, the service provider is granted an extension of a similar period.

Evergreen clauses are best complemented with agreed negotiation points to ensure that there is some tension on the service provider other than the performance framework, and to ensure that the shape of the contract is continuously aligned with the current shape of the business and key requirements.⁴⁵

3.17 The Tenure Options Paper provided to Defence during the renegotiation noted that the contractor had yet to achieve steady-state performance. Accordingly, the main pre-condition for considering an evergreen arrangement had yet to be satisfied. Nonetheless, Defence agreed to the inclusion of evergreen provisions in the contract without also including a

⁴³ The performance based requirements for a contract extension are listed at Table 3.4. As required in Attachment T (Contract Performance Management Framework) to the contract (section 2.16), Defence examines the contractor's achievement of efficiency improvements required under Clause 8.5 in determining the contractor's compliance with the contract. Clause 2.1.1 of the contract also requires that there must be at least three years remaining at the commencement of the year being assessed and that the Commonwealth has not issued a notice to terminate the Contract pursuant to clause 27.2.1 (termination and reduction for contractor default).

A one-year extension was incorporated in CCP 18, in recognition of the fact that the contractor achieved the specified levels of performance in 2007–08. This means that the contract period has now been increased to 16 years.

⁴⁴ There is also an option for the Commonwealth to extend the contract for two consecutive two-year periods, whether or not the contractor is eligible for performance-related contract extensions, provided the Commonwealth gives the contractor at least six months prior notice and the contractor agrees.

⁴⁵ Department of Defence, 'Tenure Options Paper', September 2006, p. 2.

time limit on either the evergreen provisions or the total agreed term of the contract.⁴⁶

Controlling contract costs

3.18 To clarify the services that are to be provided under the contract, the description of the Statement of Work (SoW) was improved. The SoW lists all work elements related to the delivery of agreed services, describes each element in the breakdown and defines the mutual obligations of the parties in achieving these outcomes.⁴⁷

3.19 To better distinguish the basis of contract costs, fixed and variable cost items were made explicit. Some costs are deemed to be fixed, so as to maintain a base level of capability, and are included in the new Capability service category. Other costs vary with the level of demands placed on the contractor.

3.20 As noted in paragraphs 3.7 and 3.8, Defence estimated that, in September 2006, it was paying the contractor a weighted average profit margin of 9.5 per cent (excluding 'margin on margin' profits). Under the renegotiated contract, the ANAO estimates that, as of April 2010, the overall weighted margin paid to the contractor is 10.6 per cent.⁴⁸ This is 1.1 percentage points higher than the estimated margin of 9.5 per cent as at September 2006, before the contract was renegotiated, and higher than Defence's negotiation target of up to 10 per cent. These margins do not include any 'margin on margin' gains that the contractor may be making, though it is likely that this element (and so the overall margin) has been reduced because Defence undertook a detailed review of the base costs for inclusion in the renegotiated contract.

Performance monitoring and measurement

3.21 The renegotiated EO Services Contract includes a performance incentive framework, depicted at Figure 3.1, and a Contract Performance Management Framework (PMF) to measure the contractor's performance

⁴⁶ While there is no time limit on the evergreen provisions in the EO Services Contract, an attachment to the Contract (the Statement of Work) does provide for a review of the cost/resource baseline after the first year of operation and triennially thereafter, annual reviews of contract prices and five yearly reviews of the cost-down mechanism, which seeks to promote efficiency improvement.

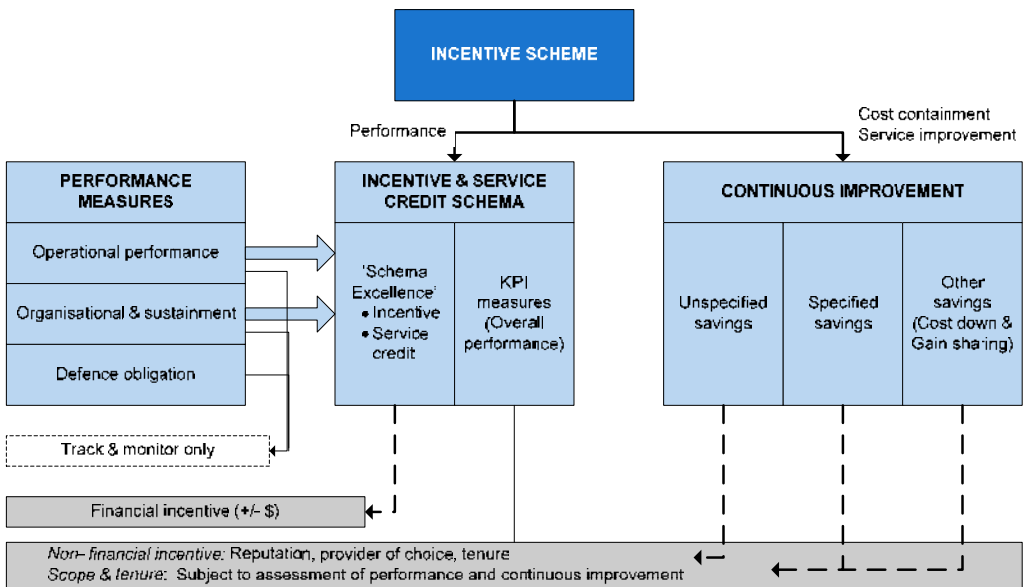
⁴⁷ Minor variations may be mutually approved by the parties, but where a change affects the level of service or requires adjustment to the Cost and Price Model, the contract requires that the change will be implemented through a Contract Change Proposal (CCP).

⁴⁸ This figure is net of a General and Administration charge that is described at paragraph 4.15.

against the six key results areas (KRAs) of compliance, sustainability, availability, stock integrity, service satisfaction, and safety.⁴⁹ Different types of measures are available under each KRA, as shown in Table 3.3.

Figure 3.1

EO Services Contract performance incentive framework



Source: Defence documentation.

⁴⁹ These areas were drawn from the former JLC Strategic Plan, which has since been replaced by 'The Command Plan 2009–10' for JLC, and which no longer identifies these strategic areas.

Table 3.3**Types of performance measures applied to the EO Services Contract**

Type of measure	Description
Key measures	These are used to shape explosive ordnance services performance and are linked to incentivised measures.
Performance measures	Provide additional information on performance against the key measures. They can be elevated to key measures and key measures can be reduced to performance measures, where priorities change.
Performance metrics	Other measures that may assist in promoting performance improvement. They can be elevated to performance measures.
Defence obligation measures	Provide information on how well the Commonwealth is performing in providing the environment that enables the contractor to deliver its requirements effectively and efficiently.

Source: ANAO analysis of Defence documentation.

3.22 The number of measures against which performance is now being assessed has increased substantially from 20 in 2006–07, prior to the contract renegotiation, to 47 measures in 2009–10.⁵⁰ Of these, 31 measures relate to the performance of the contractor and 16 measures to Defence’s performance against its obligations under the contract.

3.23 The ANAO examined the application of the 47 current performance measures to determine whether they were suitably linked to the KRAs. ANAO identified that:

- the key measures and performance measures applying to the contractor focus chiefly on KRAs for stock availability, stock integrity and compliance, with significant though lesser emphasis on safety and sustaining the storage and distribution capability;
- performance metrics applying to the contractor relate mainly to KRAs for service satisfaction⁵¹ and sustaining the storage and distribution capability; and

⁵⁰ An additional 14 measures were also identified for future implementation, as data became available or which Defence and the contractor have agreed require more experience with the Contract before they can be defined properly. Some of these 47 measures include additional sub-measures or a breakdown of data.

⁵¹ That is, how well Defence meets its obligations to provide adequate lead-times to the Contractor to meet the explosive ordnance demands and other requirements of ADF units, including forecasts of explosive ordnance demands for the coming three months.

- the overwhelming majority of Defence obligation measures relate to ADF unit satisfaction, with others relating to stock availability, stock integrity and sustainability.

3.24 ANAO analysis of the performance measures against the main elements of the Statement of Work (the detailed services to be provided under the contract) showed that their application was consistent with Defence's KRAs. Specifically, the current performance measures apply primarily to the issue and return of explosive ordnance and to the management and sustainment of explosive ordnance support services as outlined in the SoW. They also apply to a significant though lesser degree to the receiving of explosive ordnance stock into the system and to its storage. However, some elements of the SoW, such as support to foreign forces or other government agencies, are not covered.

Opportunities to improve the performance framework

3.25 Defence informed ANAO that it expects to expand the coverage of performance measures to include, for example, a measure relating to disposals of explosive ordnance. Currently, there are also few measures relating to transport and storage efficiency. The latest revision to the contract's PMF (taking effect from 2010–11) notes that:

A detailed review of industry within Defence and the Commercial environment was unable to identify suitable KPI's for storage and transport optimisation measures. It has been agreed that these measures should be monitored as economic benchmarks as a means of ongoing performance monitoring.⁵²

3.26 Defence and the contractor have since identified four such measures, which will be important in helping to monitor that services are being delivered efficiently. ANAO suggests that, in monitoring performance against these additional measures, consideration be given to the inclusion of related performance improvement targets in the contract, against which performance could be directly measured.

3.27 ANAO also saw the opportunity for Defence and the contractor to refine contract performance measures to enable consistent and direct comparisons of performance over time. For example, inconsistent timeframes have been used over time to measure the contractor's performance in

⁵² Attachment T (Contract Performance Management Framework) to the EO Services Contract, section 2.2.

delivering explosive ordnance demands in full and on-time. This means that it is not presently possible to measure the contractor's relative performance in respect of demands which were forecast in accordance with the contract, compared to its servicing of other demands, including urgent demands.

3.28 The PMF provides for the incorporation of business metrics and benchmarking within the PMF over time.⁵³ In examining opportunities to further improve coverage of contract deliverables, the ANAO suggests that Defence also seek to provide adequate coverage of the contractor's responsibilities under each SoW element of the contract, measures of efficiency as well as effectiveness, and measures that are comparable over time.

Contractor performance against key performance measures

3.29 Since the commencement of the renegotiated contract, Defence's data for 2007–08, 2008–09 and 2009–10 indicates that the contractor has, on almost all occasions, met in full and on time non-operational demands for issues of explosive ordnance (at the 99 to 100 per cent level). The contractor achieved similar levels of performance for operational demands in 2008–09 and 2009–10, improving on 2007–08 performance. Importantly, this occurred in conjunction with good performance against measures of the accuracy of contractor stock records.

3.30 To measure the levels of satisfaction of ADF units with the contractor's services, DEOS conducts six-monthly surveys of ADF units. While not all ADF units responded to the surveys,⁵⁴ ANAO analysis of responses received in 2008–09 suggests that ADF units have high regard for the standard of

⁵³ The EO Services Contract defines **business metrics** as 'ways of measuring the process or business whose performance is being managed. [They] will enable both Parties to monitor and analyse trends in the shape of the business, giving an insight into trends in demand for various services across the whole depot structure and a clear and transparent view of what is driving costs in the business'. Similarly, **benchmarking** is defined as, 'the process of comparing input, process or output measurements between business units (the [Contractor's] depots) or with other organisations. This will help to better understand and manage the business of EO services support'.

⁵⁴ For example, there was a response from only one ADF unit at Holsworthy Barracks in NSW, which is home to 17 Signals Regiment, the 3rd Battalion, the 3rd Royal Australian Regiment (3RAR), the 2nd Commando Regiment (2 CDO Regt) and the 1st Health Support Battalion. This compares with responses from 16 units at Gallipoli Barracks in Queensland to the first six monthly survey (four of these units also responded to the second six-monthly survey).

performance provided by the contractor. Where ADF units provided comments on the contractor's performance, they were mostly complimentary.⁵⁵

3.31 The DEOS surveys tend to be completed by quartermaster staff in units who have day-to-day contact with the contractor. ANAO found that ADF staff directly involved in military exercises tended to have less favourable perceptions of the standard of customer service provided by the contractor than ADF unit staff who fill out the DEOS surveys. These unit level perceptions may arise, in part, from misunderstanding of the responsibilities of the contractor and of units. There may be value in DEOS regional staff periodically seeking the views of ADF unit commanders on the quality of service provided. This may help to promote a better understanding of the roles that both the contractor and the ADF units are expected to play in the effective delivery of explosive ordnance.

Explosive Ordnance Storage and Distribution Section's role in performance monitoring

3.32 The EOSD Section, within the Directorate of Explosive Ordnance Services, is actively involved in collating and reporting on the performance of the contractor. However, it has to date performed limited detailed analysis of the contractor's performance, such as:

- examining the data and undertaking intelligence gathering to identify opportunities to streamline processes and realise efficiencies;
- trend analysis to uncover anomalies in services and charging; and
- intelligence gathering to assist in improvements/efficiencies by ADF units.

⁵⁵ Areas where ADF units on occasions indicated that performance improvements were warranted included:

- The length of time it takes the contractor to reconcile the initial count of unused explosive ordnance that is returned by ADF units at the conclusion of an exercise with the final count of this explosive ordnance that the contractor carries out at the depot. To overcome this issue the contractor is planning to automate the collection of 'broken' lots of explosive ordnance in the future.
- Frustration when the contractor delivers small, rather than large, lots of explosive ordnance without first alerting the unit. Small lots consume extra time in receipt and acquittal before and after an exercise and the unit needs to be prepared for this. Under the EO Services Contract, the contractor is required, where possible, to use the oldest stock first, to prevent stock from expiring and thus generate an unnecessary disposal and replacement requirement. The contractor may deliver small lots to use older stock first.

3.33 EOSD is planning to put the PMF into its COMSARM computer system. This may enable it to reduce the amount of time it devotes to the preparation of performance reports and increase its capacity to analyse information. Such analysis would assist Defence in identifying opportunities for efficiency improvement and in further developing its management of the contract.

Performance incentives

3.34 Prior to the 2006 contract renegotiation, incentive payments could be made if the contractor met or exceeded specified standards of performance for: delivery of service to the customer; visibility of ADF explosive ordnance information; and compliance with ADF explosive ordnance controls for a six month period. Between 2001–02 and 2006–07, the contractor received one payment of \$77 600 in 2002–03 under these provisions.

3.35 Under the renegotiated contract arrangements, the contractor accumulates, on a monthly basis, points for superior performance—points are deducted for inferior performance. Scores for the reporting period, weighted for their impact, are totalled. A net positive total can result in the contractor receiving an incentive payment, while a negative total score can require the contractor to rebate money to the Commonwealth.

3.36 Monthly performance reports are tabled and considered at the monthly Contract Progression Meetings between the contractor and Defence. Based on the monthly report, and any agreements made in the contract review meeting, the contract authority will consider the amount of incentive payment or service credit for the period.

- Incentive payments totalling \$200 970 in 2008–09 and \$270 727 in 2009–10 were made for performance in those years.⁵⁶ To receive these payments, the contractor was assessed as having achieved performance against the Performance Schema of 80.5 per cent in 2008–09 and 87.4 per cent in 2009–10.

3.37 At the end of each year, the Director of Explosive Ordnance Services (as the contract authority), considers the contractor's performance for the year and any overall incentive payment or rebate therefore payable under the contract. Under the renegotiated contract, if the specified high standards of performance

⁵⁶ Performance is assessed for the year from June to May, rather than for the financial year July to June.

against the six key performance indicators are achieved (see Table 3.4) and the contractor has not been in breach of the contract during the period under review (in particular, required cost efficiencies or ‘continuous improvement’ are met) for 2008–09 and subsequent years of the EO Services Contract, the contractor is eligible for extensions of the contract.⁵⁷

Table 3.4

Performance-based contract extension criteria

Annualised KPI total %	85-90%	90-95%	Over 95%
Eligible extension period	6 months	9 months	12 months

Source: Defence documentation.

3.38 Defence assessed the contractor as having achieved an overall performance level of 98.1 per cent in 2008–09 and 98.7 per cent in 2009–10 against all current performance indicators used for contract term extensions.

3.39 From the available records, it was not apparent to ANAO that the contract authority had considered any cost-savings achieved by the contractor in the annual contract review process. ANAO therefore suggests that, in future, the EOSD Section include an assessment of the specified and unspecified savings achieved (or not) by the contractor in the annual performance review leading to recommendations to the contract authority on whether tenure should be extended.

Defence contractual obligations

3.40 The EO Services Contract includes measures of how well Defence is performing in providing the environment to enable the contractor to meet its contractual requirements effectively and efficiently. Specifically, the PMF includes a number of Defence obligation measures against four of the contract’s six KRAs (sustainability, stock availability, stock integrity and service satisfaction). In respect of the performance of ADF units, ANAO found there is room for improvement

⁵⁷ Contract term extensions require that the contractor’s overall performance in any year against the key measures will exceed 85 per cent (see Table 3.4).The contractor must also have achieved the ‘cost-down’ targets under the Continuous Improvement Program (or, if these targets were not achieved, must have satisfied Defence that there were good reasons why they could not be achieved). A failure to achieve targeted savings does not constitute a breach of the contract, but may be taken into account by the Commonwealth in any performance review.

3.41 To meet its contractual obligations, each month Defence requires ADF units to provide forecasts of their next three months' demands for explosive ordnance, so that the contractor is able to pre-position the required explosive ordnance at the nearest depots. If explosive ordnance is not pre-positioned, the contractor cannot guarantee that demands will be met in the relevant timeframe. Failure to properly pre-position ordnance can lead to additional costs if the contractor has to arrange an unanticipated delivery of explosive ordnance. In this event, DEOS passes the additional charge on to the Service requiring the explosive ordnance.

3.42 In 2009–10, an average of 39 per cent of actual issues of explosive ordnance had been forecast in COMSARM. Of issues that had not been forecast, the contractor was given less than 30 days notice in approximately 64 per cent of cases. DEOS has raised the need for ADF units to improve their forecasting of explosive ordnance requirements with each of the Service's headquarters. Specifically, the EOSD Section has arranged for the development of a COMSARM-generated report showing the proportions of explosive ordnance services demand lines each month that have been forecast by units of each Service. It plans to provide copies of these reports to ADF units in the future.

3.43 Although the proportion of ADF units submitting forecasts for the coming three months does not achieve the desired levels, the contractor's recent performance in timely delivery has been very good. ANAO was informed by Defence that this was because the contractor uses its knowledge of ADF units' historical requirements to anticipate demands. ANAO was also advised by ADF units visited during fieldwork for this audit that one of the reasons that they do not provide forecasts is their belief that the contractor will be able to meet their needs regardless.

3.44 While most explosive ordnance items can typically be effectively pre-positioned regardless of forecast requirements,⁵⁸ ANAO was informed by both Defence and the contractor that there are some 10 to 20 explosive ordnance items that are in relatively short supply and for which forecast requirements are most useful. There would be value in Defence reviewing its forecasting requirements to maintain optimal pre-positioning of ordnance to meet demands and ensure best management of items in short supply or high

⁵⁸ Using ADF units' previous usage profiles as a guide.

demand. Given the contractor's demonstrated performance in anticipating unit demands, this may also assist in streamlining and reducing the administrative burden of the current system of monthly ADF unit forecasts of three months' explosive ordnance requirements.

Recommendation No.2

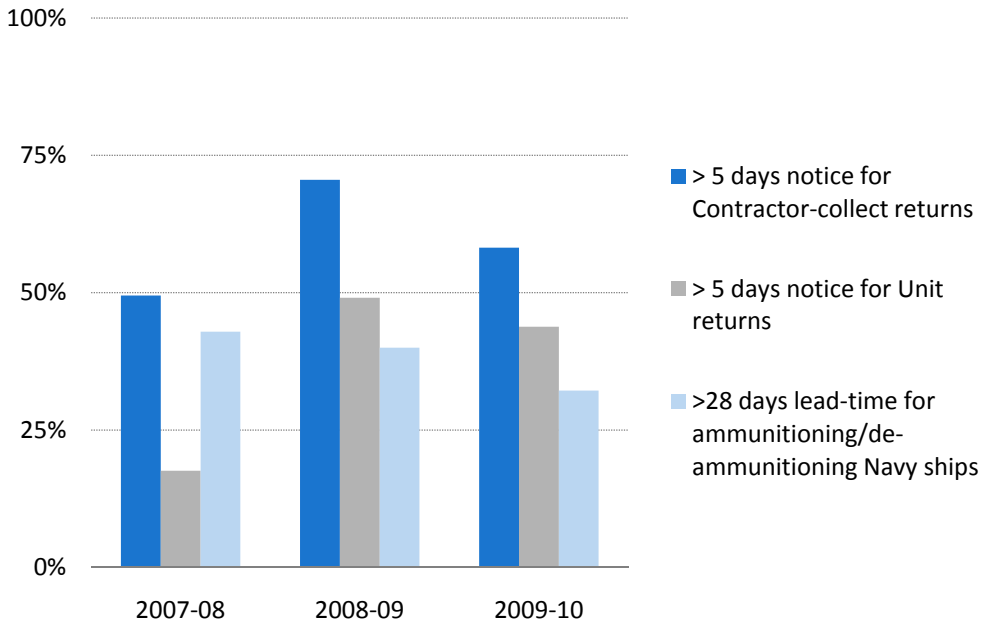
3.45 The ANAO recommends that, to meet contractual requirements and reduce the administrative burden on ADF units, Joint Logistics Command work with the Services to develop a forecasting process for pre-positioning explosive ordnance to meet ADF needs, particularly items in short supply and high demand.

Defence response: *Agreed.*

3.46 Two other areas of responsibility of ADF units, which fall under the service satisfaction KRA, include:

- the provision of least 28 days lead-time for ammunitioning and de-ammunitioning Navy vessels; and
- the provision of at least five days lead-time for returning explosive ordnance (contractor to collect, or unit to deliver).

3.47 The performance of ADF units against these measures is shown in Figure 3.2. It shows that there has been little improvement in ADF units' providing the required lead times.

Figure 3.2**ADF unit performance against Defence obligations: returns and Naval ships ammunitioning/ de-ammunitioning measures**

Source: ANAO analysis of Defence data.

4. Contract expenditure on explosive ordnance distribution and storage

This chapter assesses the effectiveness of the arrangements that Defence has implemented to manage the expenditure on the Explosive Ordnance Services Contract, and examines opportunities for further efficiency improvements, including revisiting the contract's evergreen provisions.

Introduction

4.1 The ANAO examined the trends in expenditure under the EO Services Contract and considered whether there were opportunities for reducing costs through improvements in efficiency. The chapter outlines:

- the changes in expenditure over time, in relation to the volume of ordnance managed under the EO Services Contract;
- the costs, and potential areas for improvement, of each of the three service clusters provided under the contract;
- the maintenance of the Cost and Price Model;
- opportunities for efficiency improvements; and
- the management of the contract's evergreen provisions.

Expenditure under the EO Services Contract

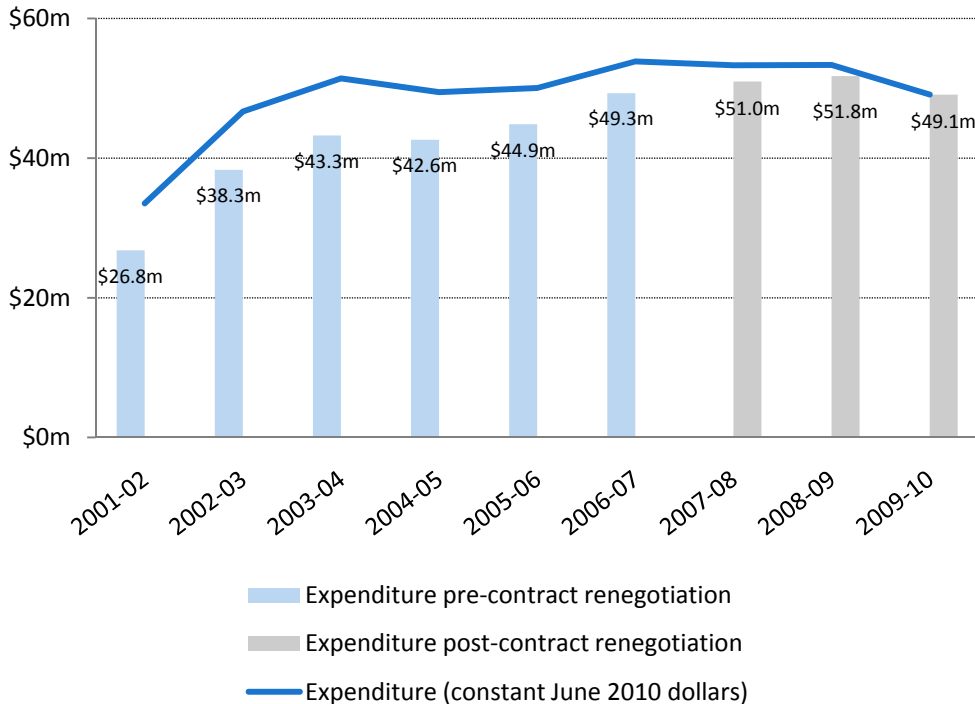
4.2 The key driver for renegotiating the contract was escalating contract costs. The intention was to better identify the services to be delivered and better control costs. As shown in Figure 4.1, the rise in the total annual expenditure by Defence on explosive ordnance distribution and storage has levelled off over the last three years, both in nominal terms (shown in dark blue in Figure 4.1) and constant-dollar terms.⁵⁹ This has occurred under the renegotiated arrangements with the contractor, during which time the constant-dollar expenditure has started to fall from its peak in 2006–07.

⁵⁹ In 2009–10, around \$4.1 million of emergency capital works were carried out at explosive ordnance depots. Some of these works were undertaken by the Contractor for the Defence Support Group, which is responsible for this function. This expenditure is not included in the total EO Services Contract nor in Figure 4.1.

4.3 While Defence uses the contractor to provide the bulk of explosive ordnance storage and distribution services, it has also used the services of another provider where it considered it could obtain better value for money for Survey and Quote services. These amounts are included in Figure 4.1.

Figure 4.1

Total expenditure on explosive ordnance storage and distribution, 2001-02 to 2009-10



Note: Net amount after considering all cost recoveries for operations, DMO payments and other units, weapons, munitions and explosives and construction costs. This other expenditure amounted to \$0.52 million in 2007-08, \$2.84 million in 2008-09 and \$9.09 million in 2009-10. The bulk of expenditure was made to the contractor under the EO Services Contract, however in some cases another contractor was engaged for ad hoc Survey and Quote work where Defence considered they provided better value for money. Defence paid this alternative supplier \$543 738 in 2007-08, \$303 721 in 2008-09 and \$768 274 in 2009-10 for these additional services.

Source: ANAO analysis of Defence data, Australian Bureau of Statistics (ABS) Consumer Price Index data.

4.4 Setting aside the escalation of expenditure between the first and second years of the Contract,⁶⁰ up until the end of 2006-07, expenditure on explosive ordnance distribution and storage increased at an average annual rate of

⁶⁰ As 2001-02 costs relate only to a partial year of operation of the contract.

6.5 per cent, compared with an average annual rate of inflation over that period of 2.8 per cent. In the first two years after the renegotiated contract took effect on 1 July 2007, the rate of increase of expenditure fell to 2.5 per cent (compared to inflation of 3.0 per cent) and then decreased by 5.1 per cent between 2008–09 and 2009–10 (while inflation ran at 3.1 per cent).

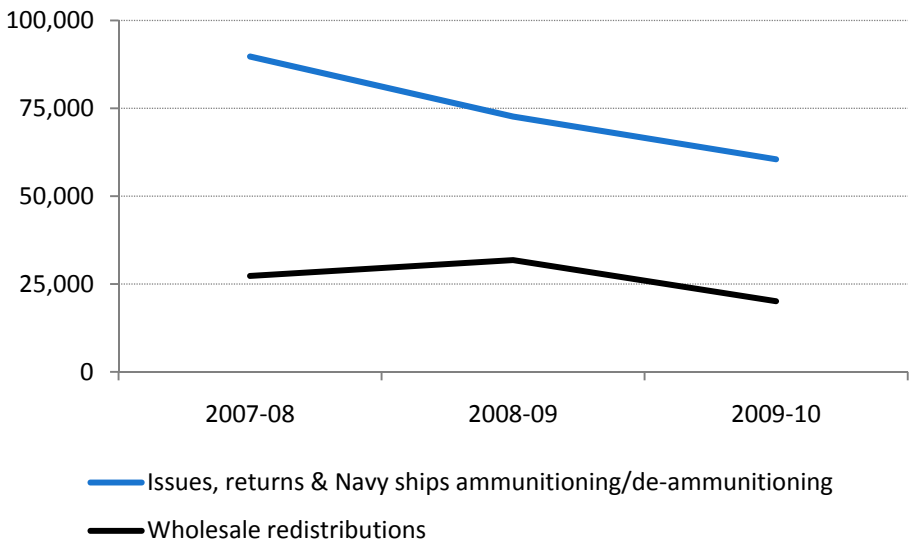
4.5 Overall, following the renegotiation of the contract in 2006, contract cost increases have been controlled.

Impact of EO stock movements on expenditure

4.6 The ANAO examined the impact of EO stock movements on contract expenditure. As noted in Figure 4.1, in constant-dollar terms, following the renegotiation of the contract in 2006, EO Services Contract expenditure was steady over the period 2007–08 to 2008–09 and fell in 2009–10. At the same time, the number of issues and returns of explosive ordnance (issues and returns of explosive ordnance to ADF units, ammunitioning and de-ammunitioning of Navy ships, wholesale redistribution of explosive ordnance and receipts of explosive ordnance from suppliers) also declined, as shown in Figure 4.2.

Figure 4.2

Annual explosive ordnance movement transactions, 2007–08 to 2009–10



Source: ANAO analysis of Defence data.

4.7 However, while the total number of issues and returns for 2009–10 fell by 17 per cent compared to the previous year, EO Services Contract expenditure fell by the much smaller amount of 5.1 per cent (or 6.5 per cent in constant-dollar terms). The same period saw wholesale movements (the grey line in Figure 4.2) fall by more than a third.⁶¹ This may suggest more efficient redistribution.

4.8 The relative insensitivity of expenditure in relation to the quantities of explosive ordnance transported and stored reflects the high proportion of fixed costs paid under the contract, in the form of payments for the Capability cluster of services. Payments for the Capability cluster of services, which sustain the capability to support Service Offerings and Survey & Quote services, have averaged 58 per cent of contract expenditure over the period 2007–08 to 2009–10, the period over which the renegotiated contract has been in effect.

4.9 Defence informed ANAO that, over the last two years, the contractor has also absorbed the cost of scope increases that Defence and the contractor have estimated at around \$528 000 in 2007–08, \$1 237 000 in 2008–09 and \$823 000 in 2009–10.⁶²

Cost to Defence of administering the contract

4.10 The ANAO estimated the annual cost to Defence of administering the EO Services Contract was about \$1.8 million in 2009–10, or 3.4 per cent of the total contract cost. This estimate includes the salaries of 14.2 staff notionally attached to the EOSD Section, travel, training and other costs directly attributable to the EOSD Section, and an estimate of associated on-costs.⁶³ It does not include other costs indirectly related to the administration of the EO

⁶¹ The total annual volumes of explosive ordnance receipts and wholesale redistributions of explosive ordnance (which are proportional to receipt volumes) give a broad indication of the overall volume of explosive ordnance moving through the storage and distribution chain each year.

⁶² The contractor absorbed costs such as the procurement of equipment (trucks, forklifts etc), and construction of facility upgrades and refurbishments and reduced mark-ups for some services. The original contract also included payments to the contractor to maintain employment levels at the regionally-based depots of Myambat and Jennings in NSW and Mangalore in Victoria. The 2004 EO Services Contract Review cites costs of \$4.5 million in 2002–03 and \$4.8 million in 2003–04. These costs have now been incorporated into the EO Services Contract, with some staff in regional areas now engaged on an 'Other than Serviceable EO' project, funded separately from the EO Services Contract.

⁶³ These include such things as superannuation, long service leave, workers compensation, human resources support, information and communication technology support, property operating and other general organisational expenses, including a proportion of the DEOS business group costs. The cost estimates are based on the Defence new policy costing template.

Services Contract such as the costs of various third party and DEOS audits and regulatory oversight of explosive ordnance services, which arguably would need to be conducted regardless of whether explosive ordnance services were provided by a contractor or by Defence itself.

4.11 DEOS does not currently monitor the overall cost of contract administration. ANAO suggests that DEOS establish a consistent method to calculate these costs and then monitor them as part of its ongoing business planning processes, to gain a more accurate understanding of the total cost of the EO Services Contract and to allow Defence to identify any variations in this cost over time.

The Cost and Price Model

4.12 Defence's principal mechanism for managing payments to the contractor is the Cost and Price Model. The Model is a very large Microsoft Excel spreadsheet of about 15 MB, incorporating some 100 000 calculations. The model calculates the actual cost of each individual service provided to Defence by the contractor on a monthly basis. The model then adds margins, as set out in the EO Services Contract, to compute the contract price payable by Defence each month. The model also:

- assists financial forecasting by providing planning information (such as estimates of issues and returns of explosive ordnance) that can be used to estimate current and future proposed expenditure;
- allows Defence to analyse total prices on the basis of model inputs and agreed pricing formulas for the various elements in the Contract Work Breakdown Structure; and
- provides a capability for doing financial 'what if' exercises by varying the inputs, using a copy of the model, to assess their likely financial impacts.

4.13 The original Cost and Price Model was based on the absorption costing method: that is, both direct and indirect—or overhead—costs related to the activity were incorporated into the cost base. Following the renegotiation of the contract, the model now separates direct (service-related) from indirect (capacity) costs and allocates these to each activity. Only variable and marginal costs are applied to services in the Service Offerings cluster, with all fixed costs allocated to the Capability cluster, including the total cost of COMSARM operators, some of which is fixed with the remainder dependent on workload

activity. The ANAO examined each of the three clusters of services provided under the contract (see Table 1.1 for an overview) to identify potential areas for improvement.

Capability costs

4.14 Under the Services Contract, Capability costs are those incurred to sustain the support capability that is being purchased by Defence. Capability costs include supervisory, support and managerial components, which are effectively independent of daily service demand delivery. The main types of Capability costs are categorised at Table 4.1. Capability labour is based on the actual number of staff that the contractor and Defence agree is required to sustain the explosive ordnance Services capability, including the labour required to meet peaks in demand.⁶⁴ Capability costs were \$29.3 million in 2007–08 and \$29.7 million in 2008–09 and 2009–10.

Table 4.1

Capability cost components

Cost classification	Cost elements/
General management (GM)	Core staff-related costs (wages, recruitment, indirect travel and subsistence, fringe benefits tax etc). Office support, materials and equipment (tools etc), information technology, insurance, depreciation and subscriptions and publications and amenities.
Operations	Direct travel and subsistence. Staff related costs (temporary and contract labour, allowances, personal protective equipment etc).
Safety and compliance	Licensing and vehicle security. Audits and other compliance activities.
Infrastructure	Site support costs (cleaning, environmental management, fire services, maintenance of equipment and facilities). Utility costs (telephone, electricity, water, gas, sewerage).

Source: ANAO analysis of Defence documents.

4.15 In addition to these costs, the contractor charges a General and Administration margin (included in the Cost and Price Model), which:

⁶⁴ Capability labour includes the following categories of staff: general management; safety and compliance; operations; infrastructure; COMSARM inventory operator/supply clerk; warehousing; stocktaking; and construction.

covers company/corporate overhead that sits outside the [*Explosive Ordnance Services*] operating costs (e.g. shared services, corporate overhead for HQ, Domain HQ, Legal, payroll etc).⁶⁵

4.16 The contractor has informed Defence that these costs are separate from contract management and administration costs that are included in and funded under the Capability component, and that in 2009–10, these costs exceeded the mark-up provided for in the Contract by 0.44 percentage points. The contractor advised Defence that actual costs of \$3.243 million were incurred.

4.17 The ANAO suggests that Defence review with the contractor the make-up of the General and Administration margin. In doing so, consideration could be given to arranging for the cost of items that can be directly attributed to the EO Services Contract to be included in Capability service cluster, and ensuring that the General and Administration component represents a reasonable attribution of the other overhead costs that the contractor incurs on the EO Services Contract.

Service Offerings' costs

4.18 The cost of each service in the Service Offerings cluster is the marginal or variable cost involved in the physical receipt, delivery and return of explosive ordnance. For each Service Offering (such as the issue of explosive ordnance to an ADF unit), costs are calculated separately for processing and transport (where applicable). Labour rates are calculated for each component of a Service Offering (for example, for the delivery of a pallet of explosive ordnance of a specified size to an ADF unit at a particular location) by reference to negotiated rates of effort (that is, the amount of time specified in the Cost and Price Model for the contractor's staff members to provide the service). The cost of Service Offerings was \$16.9 million in 2007–08, \$21.2 million in 2008–09 and \$17.6 million in 2009–10.

4.19 Labour and material costs in the Cost and Price Model are adjusted on a quarterly basis according to ABS indices of average weekly earnings and materials used in manufacturing industries respectively. Transport costs are adjusted on a quarterly basis for changes in the price of fuel, using the average price per litre for the previous month (for transport provided by the

⁶⁵ Advice provided by the contractor through Defence, 13 July 2010.

contractor) or that specified under other contractual arrangements (for sub-contractor provided transport services).

Survey and Quote costs

4.20 All requests from Defence for services other than defined Service Offerings are treated as Survey and Quote (S&Q) work under the EO Service Contract. S&Q work includes, but is not limited to, urgent or special runs, the disposal of surplus, out-of-life or damaged explosive ordnance or other non-explosive materials, non-routine maintenance, complex workshop testing, the packing and examination of explosive ordnance, commercial work,⁶⁶ and construction work.

4.21 Under the terms of the Contract, all S&Q work must be fully costed and quotations submitted to Defence for approval. Work can only begin once Defence has approved the work and has given the contractor a signed acceptance (the purchase order). The contractor must also advise Defence if there are variations to the quoted work required to complete the task under consideration.

4.22 The Cost and Price Model is updated monthly with actual S&Q invoicing data obtained from the contractor's Enterprise Resource Pricing system.

4.23 There is no requirement under the EO Services Contract for Defence to use the contractor for S&Q work if it can obtain better value for money for this work from other suppliers, and Defence provided the ANAO with instances where such work had gone to another contractor.⁶⁷ However, Defence does not have a system in place to obtain and evaluate quotes for S&Q work both from the contractor and from other potential suppliers, except where Defence has evaluated that it is neither practical nor beneficial (in terms of receiving value for money) to obtain more than a single quote from the contractor. Adopting such a system would assist in demonstrating that the value for money requirements of the CPGs are met.⁶⁸

⁶⁶ Work undertaken on a commercial basis outside the specified EO Services Contract services.

⁶⁷ Defence has used another contractor with expertise in the engineering field of repairs and refurbishment of explosive ordnance containers. See the Note to Figure 4.1 for the costs of the services provided by this alternative contractor.

⁶⁸ Value for money and encouraging competition are requirements of the CPGs to be applied to all procurement.

4.24 A set margin was agreed for S&Q work under the Cost and Price Model as renegotiated under CCP 12 in 2006.⁶⁹ However, Defence informed ANAO that margins are now negotiated on a case by case basis.

4.25 Defence informed ANAO that a consideration when setting the initial margin for S&Q work was the unpredictable volume of such work and the possibility that the contractor would need to employ resources in addition to those required for Service Offerings, such as hiring casual labour to perform the work. Since 2007, the value of S&Q work has been \$4.8 million in 2007-08, \$0.845 million in 2008-09 and \$1.8 million in 2009-10. However, over this period, the contractor has also undertaken other S&Q work for the DMO (for which DEOS recovered the cost from the DMO). Including this work, the value of S&Q work carried out by the contractor amounted to \$4.8 million in 2007-08, \$3.7 million in 2008-09 and \$6.0 million in 2009-10.

4.26 Given Defence's experience with the annual volume of S&Q work since 2007, and recognising the likelihood that the contractor will continue to perform the majority of this work, ANAO suggests that Defence review the margins it has been paying for S&Q work and consider formalising standard S&Q margins for various types of services that more closely reflect the financial risks to the contractor in each case.

Labour costs

4.27 Under the EO Services Contract, labour costs comprise a proportion directly applied to the contracted work (called a labour utilisation factor) with the remainder meeting other labour costs. The labour utilisation factors represent the ratio of staffing hours actually used over the amount of staffing hours available.⁷⁰ For Service Offerings, this implies a labour productivity discount rate, which is used to set the staffing levels in each facility, and to determine the labour rate used (in some instances indirectly) to arrive at the unit price charged to Defence.

4.28 Under the original contract, the labour productivity discount rate was set on the basis that the workload was likely to be variable and because the explosive ordnance depots were widely dispersed. In 2005, during its contract

⁶⁹ This excludes an additional margin for General and Administration.

⁷⁰ Staffing hours available are calculated by deducting allowances for weekends, public holidays and annual and sick leave and adding in overtime.

review, Defence was advised by its consultants that there was limited merit in this approach and that there could be benefit in Defence determining an appropriate labour utilisation factor for each site and service output.

4.29 In the revised contract, Defence retained the labour utilisation rate, but this rate has been progressively increased by one percentage point over the past three years of the contract, so reducing the labour productivity discount rate.

4.30 ANAO's examination found that the available staffing hours had already been discounted for annual and sick leave, and wait-times have also been built into the hours needed to perform the various services. ANAO's examination of the Cost and Price Model further identified that the calculation of available staffing hours included more public holidays than have been gazetted, effectively increasing the nominal productivity discount for Service Offerings. The calculation of available staffing hours for Capability also incorrectly included provision for overtime. The contractor subsequently acknowledged this error and made a credit to Defence for the costs that had been incorrectly charged.

4.31 With the additional experience that Defence and the contractor have now had with the contract, ANAO considers that there would be benefit in Defence reviewing the current labour utilisation factors and, where possible, reconciling the contract costs (as calculated by the Cost and Price Model) with the actual costs incurred by the contractor. Defence would then be better placed to seek changes to labour rates as part of its ongoing contract management.

Cost effective use of the services under the EO Services Contract

4.32 Since the EO Services Contract came into effect, the proportion of explosive ordnance collected by ADF units from the depots has fallen to around five per cent, compared to 85 per cent prior to the contract coming into effect. Before 2001, ADF units going on an exercise would generally collect and transport enough explosive ordnance for the whole exercise, forming a 'picket' to provide security for unused explosive. ADF units would transport unused explosive ordnance to the depot at the conclusion of the activity. Currently, however, ADF units will generally arrange for the contractor to deliver the required explosive ordnance each day of the exercise and collect it again each night rather than having it delivered once and only picked up again at the end of the exercise.

4.33 This current practice of ADF units involves additional costs to Defence under the contract. ANAO accepts that, in a range of circumstances it may well be more cost effective and secure for the contractor to deliver, and collect returns of, explosive ordnance than to have ADF units undertake these tasks themselves. However, the services do not appear to weigh the financial costs⁷¹ with, for instance, the advantages of ensuring that ADF units maintain the necessary capability to manage and secure explosive ordnance in the field.

Managing the Cost and Price Model

4.34 ANAO examined DEOS' current Cost and Price Model to assess its data integrity and fitness for purpose. The Cost and Price Model is managed by the contractor, with the working version of the model maintained on a joint drive on the Defence Restricted Network (DRN).⁷² Any change to the model is subject to consultation with, and verification by, Defence. Defence keeps archived copies of superseded versions of the model on the DRN and Defence Record Management System (which is not accessible by the contractor's staff).⁷³ These copies are available as part of the audit trail, if required, and a revisions' register is kept in the model of the changes that have been made to it.⁷⁴

4.35 Defence's consultants reviewed the Cost and Price Model in October 2006 and concluded that there was still considerable effort required before the model could be regarded as an industrial-strength model which was fit-for-

⁷¹ For example, the ANAO observed in its field visit to the Mount Stuart Training Area in Townsville that ADF units must travel past the driveway to the explosive ordnance depot on their way to and from the range. It would therefore be possible for the units to collect the explosive ordnance from the depot on their way to the range and return unused explosive ordnance and/or empty containers (often empty containers are required to be returned to the contractor when explosive ordnance is used up) at the conclusion of their exercise. However, it is the common practice of units to arrange for the Contractor to deliver and collect the explosive ordnance from the range, sometimes on a daily basis, even though the unit personnel may remain out at the range for a number of days, as units find this service to be more convenient.

⁷² Access to this drive is restricted to authorised users in the EO Storage and Distribution section and in the contract. Currently two staff in Defence and four contractor staff have access to working versions of the cost price model. The model is also password protected.

⁷³ The contractor separately maintains copies of the spreadsheet in its IT environment.

⁷⁴ To ensure that changes are not made inadvertently to the Cost and Price Model, certain worksheets and cells in the model are protected (that is, to change these cells the protection in the sheets would first have to be removed). When changes are made to any parameters, both the contractor and EOSD check to verify if the changes generate output as expected. The ANAO was advised by the contractor that integrity testing is also carried out by an expert when major changes occur. Defence does not use available software to check formulas in the spreadsheet.

purpose. In particular, the consultants advised that, in their opinion, the model fell short of the original key objectives in the following areas:

- the ability to cost and price each order received from the individual Services so that adequate information is available to verify the price charged for a particular service demand;
- reducing Defence's exposure to overcharging via better definition, description and visibility of fixed costs via 'capability cost drivers and sizing metrics';
- the ability to produce an accurate annual budget for both Defence and the contractor and perform basic 'what if' analysis;
- the ability to cost end-to-end processes to avoid cost-shifting to other parts of the service chain and/or to advise the total cost of performing a service; and
- the ability to demonstrate the appropriateness of the cost audit trail and its suitability for billing purposes.

4.36 The consultants advised Defence that the department should obtain an independent check of the final version of the model before it was used. Defence did not do this, because it was satisfied with the checks that the consultants had done and with its own checking of the model. ANAO notes that Defence's consultants did not see the final version of the model.

4.37 Because the model is complex, there is a significant risk that errors could go undetected. These could include errors in the design of the model (for example, in formulas in the model), user errors, and potential fraudulent errors. By way of example, ANAO identified a number of errors in the model that had been present since it was first implemented. This emphasises the need for rigorous checks of both the accuracy of the model's calculations and of the inputs to the model (which are mainly extracted from COMSARM).

4.38 Defence has ensured that there is a detailed guide on the Cost and Price Model as an attachment to the contract. Nonetheless, there is limited knowledge of the model in Defence. At the time of this audit, heavy reliance was placed on the knowledge of two key Defence staff. Defence and the contractor acknowledge that the current model is approaching the effective limit of a spreadsheet-based model, that it is close to capacity and should be replaced. In developing any new model, it is important that Defence undertakes a detailed risk analysis of the various options and of how the future model will be managed.

4.39 The ANAO examined a complex spreadsheet application in a previous audit, concluding that it warranted careful testing, documentation and management, including ensuring that it was the best tool for the purpose.⁷⁵ The ANAO considers that it would be timely for Defence to commission a review of the Cost and Price Model to check the accuracy of base data, ensure that it is fit-for-purpose, and delivering correct results.

Recommendation No.3

4.40 The ANAO recommends that, to verify that the Cost and Price Model is fit-for-purpose, delivering accurate results, and sustainable over the long-term, Defence commission a review of the operation of the Cost and Price Model, including the parameters in the Model.

Defence response: *Agreed.*

Efficiency improvements

4.41 As noted in Table 3.2, the renegotiated contract included arrangements to contain and reduce the costs over time through efficiency improvement measures. Defence and the contractor discuss savings measures in Contract Progression Meetings in around April of each year. Agreed changes are reflected in the Cost and Price Model and, where necessary, in the contract through Contract Change Proposals:

The parties will use their best endeavours to reduce the cost of Services through Specified Savings and Unspecified Savings, to achieve a real cost reduction of two per cent of the total Contract price each year commencing from 1 July 2008 for five consecutive years.⁷⁶

4.42 Specified Savings are those agreed between Defence and the contractor, while Unspecified Savings are labour productivity related savings at the discretion of the contractor. The renegotiated contract states that:

⁷⁵ See in particular Recommendation 1 of Audit Report No.38 2004–05, *Payment of Goods and Services Tax to the States and Territories*, that 'Treasury review whether the spreadsheet that it presently uses to calculate ... payments of GST to the States is sufficiently robust and reliable for that purpose and likely future uses; and ... in future circumstances requiring the complex calculation and payment of substantial amounts from the Consolidated Revenue Fund ... identify the most appropriate system or tool for calculating payments ...'

⁷⁶ Clause 8.5.4 of the renegotiated contract. Under Clause 8.5.7, any failure to comply with any obligation, or achieve targeted savings under Clause 8, by either party, does not constitute a breach of the contract, but may be taken into account by the Commonwealth in any performance review.

The Contractor shall deliver labour productivity related Unspecified Savings for contracted Services to the value of 1% each year commencing from 1 July 2008 for five consecutive years. The labour productivity related Unspecified Savings shall be implemented by an increase in the labour utilisation factor by 1% each year on the labour utilisation factor of 76% set at the Base Date in the Cost-Price Model...

4.43 Specified and Unspecified Savings identified by Defence between 2008–09 and 2010–11 are shown in Table 4.2. Savings on the total contract costs over this period have been close to or above the target of 2 per cent of total contract costs, including survey and quote costs.

Table 4.2

Contract cost savings, 2008–09 to 2010–11 (\$'000)

Saving type	2008–09	2009–10	2010–11
Specified savings	334.0	393.6	378.1
Unspecified savings	104.6	128.3	89
Absorbed scope increases	528.6	1236.8	823.6
Gain shares	25.0	33.9	38.1
Total	992.2	1792.6	1328.8

Source: Defence and contractor advice.

4.44 Defence informed ANAO that it is pursuing a number of efficiency improvement measures, including:

- reducing inspection costs by removing a redundant additional inspection of explosive ordnance from its Benalla depot on receipt into store (estimated saving of \$365 000 a year);
- ensuring that containers of explosive ordnance arriving by commercial ship are cleaned prior to leaving the port of exit (predominantly the USA), so avoiding the need for the containers to be fumigated and cleaned (estimated saving of around \$205 000 a year); and
- ensuring that ADF units improve their ordering practices, such as reducing the number of cancellations and alterations of their explosive ordnance demands and not over-ordering, both of which increase contractor workloads and contract costs (estimated saving of \$637 000 a year).

4.45 Defence informed the ANAO that the intention of this provision in the contract is that labour productivity related savings will be achieved by increasing the labour utilisation factor by one percentage point each year, though this will not 'deliver labour related Unspecified Savings for contracted services to the value of 1 per cent each year'. Defence has informed ANAO that it will seek to correct this provision in a future Contract Change Proposal.

Optimisation of Defence's storage and distribution network

4.46 Defence recognises that its storage and distribution network plays a major role in determining the effectiveness of explosive ordnance storage and distribution. How cost-efficient the contractor can be in distributing explosive ordnance to ADF units is constrained to a large degree by the location of the various explosive ordnance depots and their proximity to the Defence bases that they support.

4.47 Defence is taking steps to improve the efficiency of some elements of explosive ordnance storage and distribution. These include:

- Reviewing its network of explosive ordnance depots with the aim of improving the efficiency of its explosive ordnance distribution arrangements. Defence is considering establishing a new wholesale distribution depot and restructuring other parts of its current wholesale distribution network to improve the efficiency of receipts of explosive ordnance from overseas suppliers and the distribution to explosive ordnance depots, which supply ADF units.
- Establishing small storage depots (called Minor Retail Facilities—MiRFs) in a number of locations at or close to military training areas, where use of explosive ordnance is greatest. The ANAO understands that, while the introduction of MiRFs, which will be operated by the contractor, is likely to increase costs within the Capability component of the EO Services Contract,⁷⁷ total contract costs to Defence are expected to decrease because the MiRFs are expected to enable Defence to reduce the cost of transport of explosive ordnance issues and returns in the planned MiRF locations. The construction of the MiRFs is to be partly funded under the Army's Enhanced Land Force (ELF) initiative.

⁷⁷ Because the contractor will need to maintain a core level of staffing and other support at a greater number of facilities.

Defence is proposing to construct MiRFs in four areas in 2011–12 and possibly a further four locations at a later time.

Disposal of unserviceable explosive ordnance and related materials

4.48 Disposals of explosive ordnance or other related materials (such as spent casings or storage boxes) that are unserviceable or are no longer needed are item and occurrence-based, and require approval of a disposal plan by DMO. Once DMO provides authorisation for disposal of the explosive ordnance or other materials, arrangements are then made for disposal of the explosive ordnance or other materials in accordance with the DMO-authorised disposal plan. This may involve:

- transport of the explosive ordnance to an approved Defence disposals company (for disposal of small arms ammunition) or to Woomera in South Australia (for demolition by Defence of other ammunition);
- the sale by the DMO of some surplus explosive ordnance (for example, to the armed services of other countries);
- the sale of spent materials by the contractor under the EO Services Contract, with revenues being paid into the Consolidated Revenue Fund after deduction of the contractor's processing fees;⁷⁸
- the use of some 'out-of-life' explosive ordnance for training (for example, in bomb disposal training); and
- disposal of other materials to recycling centres.

4.49 Any costs that the contractor incurs in the disposal process are recovered from the DMO outside the cost of the EO Services Contract. The contractor also undertakes work for the DMO (for which Defence estimates a value of \$600 000 in 2009–10) under an 'Other-than-serviceable Explosive Ordnance' project.⁷⁹ For example, explosive ordnance that is purchased by the DMO may not be compliant with the marking standards used by Defence when it is delivered,⁸⁰ as it may be more cost effective to have it re-marked by

⁷⁸ These fees also provide an incentive for the contractor to seek to maximise the returns from the sale of surplus materials.

⁷⁹ Appendix A provides a fuller description of Other-than-serviceable Explosive Ordnance, along with current estimates of holdings of ordnance in this category.

⁸⁰ All explosive ordnance must be marked consistently in accordance with standards used by Defence.

the EO Services Contractor in Australia than to have this done before it arrives in Australia.

4.50 During fieldwork for this audit, the ANAO was shown some non-explosive materials (packaging, shoulder rocket launcher tubes etc) that Defence advised had been in storage for many years, awaiting approval from the DMO for their disposal. These materials have to be moved around in the store to make room for other new materials that require storage. Each move within a store may incur an additional processing charge. On 10 June 2010, the DMO approved a generic disposal plan for these materials that also involves the exercise of delegation approval by the Director of Explosive Ordnance Services or other nominated appointment. This should address this issue.

4.51 On 10 June 2010, the DMO also approved a Generic Disposal Directive for the contractor to dispose of certain types of safety matches.⁸¹ Similar arrangements may be feasible for other types of explosive ordnance, which would assist in the timely disposal of items that are no longer of any practical use to the ADF. Additionally, if the generic disposal plan also provided delegate approval, to financially write off items that are disposed of in accordance with a generic disposal plan, it may also be possible for the Director of Explosive Ordnance Services, or his nominee, to authorise the disposal of items without needing to seek further approval from the DMO, thereby expediting the disposal of certain items of explosive ordnance.

4.52 The ANAO therefore suggests that EOSD and the DMO examine the feasibility of expanding the range of material that can be disposed of using generic disposal plans, so as to achieve savings in the overall cost to Defence of storing and disposing of relevant explosive ordnance or associated materials.

4.53 Information on the serviceability of Defence's holdings of explosive ordnance is at Appendix 1.

The evergreen provisions of the EO Services Contract

4.54 As discussed at paragraphs 3.15 and 3.37, the renegotiated EO Services Contract includes provisions under which performance-based extensions can be granted. At the time of this audit, two such extensions had been granted.

⁸¹ Safety matches are matches that need to be struck against a specially prepared surface.

4.55 As the contract includes no explicit limit on the number of performance-based extensions that can be made, the EO Services Contract effectively includes a perpetual option or so-called ‘evergreen’ provisions.

4.56 In December 2005 in correspondence with the Office of the DMO General Counsel, the then Director of Explosive Ordnance Services noted that he had previously raised with the General Counsel the issue of extending the contract beyond the then current ten years tenure (plus five years option), and the General Counsel had expressed the view that ‘this should not pose a problem provided there was a business case that clearly substantiated this as being in the best interests of the Commonwealth’. ANAO notes that Defence did not form a business case for extending the contract prior to the agreement of the five-year contract extension as part of contract renegotiations.

4.57 In the event, Defence informed ANAO that it did not seek advice from Finance on whether the revised EO Services Contract was consistent with Commonwealth policies. There is no record that the then DMO General Counsel provided written advice on the ‘evergreen’ provisions and Defence informed the ANAO that no business case was developed for the inclusion of such provisions.

4.58 The Office of the Special Counsel within the Office of the General Counsel provided support in drafting the revised contract. Again, there is no record of written advice having been provided during the drafting of the contract on the consistency of the ‘evergreen’ provisions with the Financial Management and Accountability (FMA) legislation⁸² and government policy. However, the former Project Director for the contract review advised the Deputy Director Explosive Ordnance Storage and Distribution in July 2010 that his understanding of the view of the Office of the DMO General Counsel’s position of the time was that:

the ‘evergreen’ provisions were only ever potential because it relied on [*the contractor*] performing to win an extension i.e. it was never truly evergreen because the contract has a definitive end date but is only ever extended based on excellent performance.⁸³

⁸² *Financial Management and Accountability Act 1997* and the *Financial Management and Accountability Regulations 1997*.

⁸³ Advice provided to ANAO on 6 July 2010.

4.59 In November 2005, prior to the contract renegotiations, the then Department of Finance and Administration (Finance) provided general guidance to agencies on the use of 'evergreen' provisions in Australian Government contracts in the following terms:

Evergreen contracts are contracts which have no expiry date or which include a perpetual option. They are not consistent with the policy framework in the CPGs as there is usually no way of demonstrating and ensuring that the principle of value for money is being achieved without an approach to the market within a reasonable period.⁸⁴

4.60 Defence did not explicitly consider the potential for the performance arrangements, and extensions based on performance, to give rise to a perpetual option. This development would not be supported by the CPGs. In particular, Finance Circular 2006/02 of 3 August 2006 provided the following advice:

There appear to be circumstances where some agencies administer contracts that have evolved to a stage where legally they could be continued in perpetuity. Such arrangements are difficult to reconcile with obligations to achieve value for money and are likely to limit competition. Agencies should approach the market in respect of property or services provided under any such existing contracts as soon as practicable.

All contracts should regularly and objectively be reviewed to test that they continue to represent value for money. In practice this generally occurs when an agency approaches the market. In addition it is good practice to include a clear end-date and/or termination provision in the contract. For example, this could be a stated date beyond which any contract extension options can no longer be exercised.⁸⁵

4.61 The contract amendment incorporated a provision for tenure extension calculation in the contract, expressed in the following terms:

Where the Contractor's Overall Performance percentage for the year is in excess of 85% and they have achieved agreed Continuous Improvement, the Commonwealth will extend the tenure of the Contract as part of the Ever Green provisions in accordance with Clause 2.1.⁸⁶

⁸⁴ Department of Finance and Administration, 'Procurement Policy Framework: Frequently Asked Questions', November 2005, p. 27. Similar advice is provided in the Department of Finance and Deregulation's current 'Frequently Asked Questions' on Procurement.

⁸⁵ Finance Circular 2006/02, 'Commonwealth Procurement Guidelines – Clarification', 3 August 2006, p. 3.

⁸⁶ Attachment T (Contract Performance Management Framework) to the EO Services Contract, section 2.16.

4.62 There are provisions in the contract that allow for termination of the contract for convenience. In ANAO's view, these provisions and the planned reviews of the cost/resource baseline and continuous improvement provisions offer Defence the opportunity to include in a future contract revision a firm end date for the contract, beyond which further extensions will not be available.

4.63 Defence informed the ANAO that it intends, as part of the planned contract resource reviews, to carry out a detailed review of the contract with the assistance of the Financial Investigation Service of the DMO. It will be seeking to determine the relative value for money of the contract as it stands, at which point the market should be re-tested, and what other steps Defence can take to ensure that the contract is providing value for money.

Recommendation No.4

4.64 The ANAO recommends that, to ensure that value for money is being obtained, as part of its planned Contract reviews, Defence seek to include a firm end date for the EO Services Contract, which will allow the market to be re-tested.

Defence response: *Disagreed.*

4.65 Defence considers that prescribing a fixed end date for the EO Services Contract is not necessary to demonstrate value for money. The contract allows for full visibility of costs borne by the contractor, and includes a requirement for a full review of contract every five years (due in financial year 2011–12). A major focus of the review is to ensure that value for money is being achieved, through the use of a variety of means, including formal financial investigation and benchmarking of activities against best practice standards. Further, Recommendation No.3 will also support Defence's ability to demonstrate value for money.

4.66 The EO Services Contract is complex, which resulted in the original market-testing taking approximately four years (including transition). Any future market-testing activity would be both lengthy and extremely costly.

4.67 The current contract also has clauses that allow the Commonwealth to terminate the contract at any time. Therefore, if Defence is not satisfied that value for money is being achieved, Defence would terminate the contract and go to the market.

Contractor response:

4.68 The EO Services Contract Review involved Defence and Thales establishing steering and working groups focusing on all aspects of the Contract (including Cost and Price, Demand, Performance, Risk, Scope/Statement of Work). The Review introduced the Joint Statement of Principles, by which both parties undertook the review and became the principles enunciated in the Preamble of the Contract. They are:

- mutual strategic certainty;
- fair price/reasonable rate of return;
- value for money;
- flexibility;
- clarity;
- culture and process of continuous improvement;
- effective performance management regime; and
- transparency.

4.69 These principles align with the value for money, effective use of resources and transparency requirements of the current Commonwealth Procurement Guidelines (CPGs). Key drivers of the Contract are:

- continuous improvement;
- performance management;
- service excellence; and
- contractual real cost savings.

4.70 The same drivers underpin the value for money requirements of the CPGs. The CPGs (5.7) recognise that:

Participation in the procurement process imposes costs on agencies and potential suppliers and these costs should be considered when determining a process commensurate with the scale, scope and relative risk of the proposed procurement.

4.71 Reference to the Contract as 'evergreen' should not be taken to mean automatically a term in perpetuity. Firstly the contractor must achieve a level of service excellence without a breach of contract to earn any tenure extension. Additionally the Performance Management Framework is annually reviewed

between the parties, the outcome being a negotiated reweighting of KPIs. These new KPI targets are then the baseline of service for the following year. Where the contractor fails to meet the Commonwealth target for service, no or a reduced tenure may be the result; this process can facilitate a mechanism for achieving a future more finite tenure under the contract.

ANAO comment

4.72 The EO Services Contract has been extended to 2018 at this time, some 17 years after the initial contract was signed. While contract extensions have been performance based, 17 years is a lengthy period for such a contract given the benefits that can be derived from periodically re-testing the market; hence the ANAO recommendation. Defence administers other large scale, high value, complex contracts for which it has in place settled practices for market-testing at definite intervals.⁸⁷



Ian McPhee
Auditor-General

Canberra ACT
17 May 2011

⁸⁷ See for example: Auditor-General, *Garrison Support Services*, ANAO audit report No.11 2009–10, November 2009, pp. 33, 99, 124–125.

Appendices

Appendix 1:

Other-than-serviceable explosive ordnance

1. ANAO Performance Audit Report No.24 2009–10 *Procurement of Explosive Ordnance for the Australian Defence Force* reported that, at 30 June 2009, Defence's stock holdings of explosive ordnance inventory were valued at \$2.9 billion, and that some 46 per cent of the value of the explosive ordnance inventory was categorised as other than 'serviceable' by the DMO.
2. Explosive ordnance that has been categorised by Defence as other than 'serviceable' should not be confused with explosive ordnance that is 'unserviceable' and needs to be disposed of. It includes, for example, explosive ordnance that has not been assembled to make it useable because there is no immediate requirement for this or because it is safer to store the explosive ordnance in this way. Explosive ordnance that is other than 'serviceable' also includes explosive ordnance that is repairable or which is 'out of life' and may be able to be rendered serviceable.
3. The DMO has recently reviewed the way in which explosive ordnance is categorised to provide more meaningful information on the readiness or serviceability of its explosive ordnance holdings. While retaining three broad categories ('Serviceable', 'Potentially Serviceable' and 'Unserviceable'), there have been some changes to the composition of these categories. Serviceable explosive ordnance holdings include explosive ordnance that can be issued with restrictions and the Potentially Serviceable category comprises explosive ordnance that can be made serviceable (including explosive ordnance holdings that are not ready for issue because there are no sound logistical reasons to make them fully serviceable at the time).
4. A comparison of the availability of Defence's holdings of explosive ordnance at 30 June 2009, using the previous methodology, which was the basis of the figures in ANAO Report No.24 2009–10, and its revised methodology is at Table A 1.

Table A 1

Serviceability of Defence's holdings of explosive ordnance

Serviceability of explosive ordnance holdings	Previous categorisation				Revised categorisation			
	30 Jun 2009		30 June 2010		30 Jun 2009		30 June 2010	
	\$m	%	\$m	%	\$m	%	\$m	%
Serviceable	1573	54%	1 748	58%	1701	57%	1902	63%
<i>Ready for issue with no restrictions</i>					1 602	55%	1 774	59%
<i>Serviceable restricted</i>					99	3%	127	4%
Potentially Serviceable	1204	42%	1 152	38%	1075	37%	999	33%
<i>Pending^(A)</i>					232	8%	130	4%
<i>Able to be made serviceable^(B)</i>					843	29%	869	29%
Unserviceable	124	4%	133	4%	125	4%	134	4%
<i>Beyond repair</i>					36	1%	17	1%
<i>Disposals</i>					89	3%	116	4%
Total	2901	100%	3033	100%	2902	100%	3034	100%

Notes: Differences in totals/sub-totals reflect rounding of numbers.

(A) *Pending*: Current condition of explosive ordnance item has still to be confirmed, but is expected to be serviceable. These include items that have been returned by ADF units or items that have been receipted, but have still to be formally accepted in system.

(B) *Able to be made serviceable*: Condition of item is understood and can be made serviceable by completing acceptance into service process; issue of a Service of Life extension; or completing authorised maintenance, repair or rectification activities.

Source: Defence Materiel Organisation.

- These figures indicate that there has been an improvement of around six percentage points in the availability of Serviceable explosive ordnance between 30 June 2009 and 30 June 2010 using the revised methodology (and four percentage points using the previous methodology).

Index

A

Air Force, 12, 25–26, 28

Army, 12, 25–26, 28, 74, 91

Australian Bureau of Statistics, 19, 44–45, 61, 66

Australian Defence Industries Limited, 12–13, 26, 27

B

Business Continuity Management, 39

C

Capability work, 27, 29, 40, 47, 49, 63–66, 69, 74

Commander Joint Logistics, 30–32

Commonwealth Procurement Guidelines, 15, 20, 67, 78, 80

Computer System for Armaments (COMSARM), 28–29, 32–33, 40, 55, 57, 64–65, 71

COMSARM IT Control Framework, 33, 40

Contract Change Proposal, 27, 47–49, 68, 72, 74

Contract Change Proposal No 12, 27, 45–46

Contract Work Breakdown Structure, 47, 64

Corrective Action Request, 34

Cost and Price Model, 16–18, 22, 38, 40, 47, 49, 60, 64–72

D

Defence Efficiency Review, 12, 26

Defence Materiel Organisation (DMO), 11–12, 18, 25–26, 28, 61, 68, 75–77, 79, 85–86

Defence Restricted Network (DRN), 70

Defence Security Authority (DSA), 34

Defence Support Group, 34, 60

Directorate of Explosive Ordnance Services (DEOS), 6, 12, 16, 31–34, 36–40, 53–54, 57, 63–64, 68, 70

Directorate of Ordnance Safety (DOS), 31–32, 41

E

Evergreen, 14–15, 20, 48–49, 60, 76–78, 80

Explosive Ordnance Monitoring Authority Section (EOMA), 40

Explosive Ordnance Storage & Distribution Section (EOSD), 33, 39, 54–57, 63, 70, 76

F

Financial Management and Accountability Act 1997, 77

Financial Management and Accountability Regulations 1997, 77

J

Joint Ammunition and Logistics Organisation, 12, 26

Joint Logistics Command, 12, 22, 31, 36, 39, 43, 50, 58

K

Key Result Area, 50, 58

L

List of Authorised Commonwealth Explosives, 30

M

Minor Retail Facility, 74

N

Navy, 12, 13, 25, 26, 28, 29, 58, 62

P

Performance Management Framework,
14, 33, 47, 49, 52–53, 55, 56

S

Service Offerings work, 19, 27, 28, 29,
44, 47, 63–64, 66, –69

Statement of Work, 47, 49, 52–53, 79

Survey & Quote work, 27, 29, 63, 67–68

T

Tenure Options Paper, 48

Thales Australia Limited, 11–13, 27, 70, 79

Series Titles

ANAO Audit Report No.1 2010–11

Implementation of the Family Relationship Centres Initiative

Attorney-General's Department

Department of Families, Housing, Community Services and Indigenous Affairs

ANAO Audit Report No.2 2010–11

Conduct by Infrastructure Australia of the First National Infrastructure Audit and Development of the Infrastructure Priority List

Infrastructure Australia

ANAO Audit Report No.3 2010–11

The Establishment, Implementation and Administration of the Strategic Projects Component of the Regional and Local Community Infrastructure Program

Department of Infrastructure, Transport, Regional Development and Local Government

ANAO Audit Report No.4 2010–11

National Security Hotline

Australian Security Intelligence Organisation

Attorney-General's Department

Australian Federal Police

ANAO Audit Report No.5 2010–11

Practice Incentives Program

Department of Health and Ageing

Medicare Australia

ANAO Audit Report No.6 2010–11

The Tax Office's implementation of the Client Contact - Work Management - Case Management System

Australian Taxation Office

ANAO Audit Report No.7 2010–11

Confidentiality in Government Contracts: Senate Order for Departmental and Agency Contracts (Calendar Year 2009 Compliance)

ANAO Audit Report No.8 2010–11

Multifunctional Aboriginal Children's Services (MACS) and Crèches

Department of Education, Employment and Workplace Relations

ANAO Audit Report No.9 2010–11

Green Loans Program

Department of the Environment, Water, Heritage and the Arts

Department of Climate Change and Energy Efficiency

ANAO Audit Report No.10 2010–11

Centrelink Fraud Investigations

ANAO Audit Report No.11 2010–11

Direct Source Procurement

ANAO Audit Report No.12 2010–11

Home Insulation Program

Department of the Environment, Water, Heritage and the Arts

Department of Climate Change and Energy Efficiency

Medicare Australia

ANAO Audit Report No.13 2010–11

*Implementation and Administration of the Civil Aviation Safety Authority's
Safety Management System Approach for Aircraft Operators*

ANAO Audit Report No.14 2010–11

Capitalisation of Software

Australian Bureau of Statistics

Civil Aviation Safety Authority

IP Australia

ANAO Audit Report No.15 2010–11

Food Standards Australia New Zealand

ANAO Audit Report No.16 2010–11

*Centrelink's Role in the Process of Appeal to the Social Security Appeals Tribunal and to the
Administrative Appeals Tribunal*

Centrelink

Department of Education, Employment and Workplace Relations

Department of Families, Housing, Community Services and Indigenous Affairs

ANAO Audit Report No.17 2010–11

2009–10 Major Projects Report

Defence Materiel Organisation

ANAO Audit Report No.18 2010–11

*Government Business Managers in Aboriginal Communities under the Northern Territory
Emergency Response*

Department of Families, Housing, Community Services and Indigenous Affairs

ANAO Audit Report No.19 2010–11

Army Aboriginal Community Assistance Program

Department of Families, Housing, Community Services and Indigenous Affairs

ANAO Audit Report No.20 2010–11

Administration of the Wine Equalisation Tax

Australian Taxation Office

ANAO Audit Report No.21 2010–11

Indigenous Housing Initiatives: the Fixing Houses for Better Health program

Department of Families, Housing, Community Services and Indigenous Affairs

ANAO Audit Report No.22 2010–11

*Audits of the Financial Statements of Australian Government Entities for the Period Ended
30 June 2010*

ANAO Audit Report No.23 2010–11

Home Ownership of Indigenous Land Program

Department of Families, Housing, Community Services and Indigenous Affairs

Indigenous Business Australia

ANAO Audit Report No.24 2010–11

The Design and Administration of the Better Regions Program

Department of Regional Australia, Regional Development and Local Government

ANAO Audit Report No.25 2010–11

Administration of the Trade Training Centres in Schools Program

Department of Education, Employment and Workplace Relations

ANAO Audit Report No.26 2010–11

Management of the Tender Process for a Replacement BasicsCard

Department of Human Services

ANAO Audit Report No.27 2010–11

Restoring the Balance in the Murray-Darling Basin

Department of Sustainability, Environment, Water, Population and Communities

ANAO Audit Report No.28 2010–11

Management of the Australian Broadband Guarantee Program

Department of Broadband, Communications and the Digital Economy

ANAO Audit Report No.29 2010–11

Management of the Implementation of New Policy Initiatives

Australian Federal Police

ANAO Audit Report No.30 2010–11

Digital Education Revolution Program—National Secondary Schools Computer Fund

Department of Education, Employment and Workplace Relations

ANAO Audit Report No.31 2010–11

Administration of the Superannuation Lost Members Register

Australian Taxation Office

ANAO Audit Report No.32 2010–11

Northern Territory Night Patrols

Attorney-General's Department

ANAO Audit Report No.33 2010–11

The Protection and Security of Electronic Information Held by Australian Government Agencies

ANAO Audit Report No.34 2010–11

General Practice Education and Training

General Practice Education and Training Limited

ANAO Audit Report No.35 2010–11

Management of the Overseas Leased Estate

Department of Foreign Affairs and Trade

ANAO Audit Report No.36 2010–11

Service Delivery in CRS Australia

Department of Human Services

ANAO Audit Report No.37 2010–11

Management of Explosive Ordnance Held by the Air Force, Army and Navy

Department of Defence

ANAO Audit Report No.38 2010–11

Management of the Certificate of Compliance Process in FMA Act Agencies

ANAO Audit Report No.39 2010–11

Management of the Aviation and Maritime Security Identification Card Schemes

Attorney-General's Department

Department of Infrastructure and Transport

Current Better Practice Guides

The following Better Practice Guides are available on the Australian National Audit Office website.

Human Resource Information Management Systems	
Risks and Controls	Mar 2011
Fraud Control in Australian Government Entities	Mar 2011
Strategic and Operational Management of Assets by Public Sector Entities –	
Delivering agreed outcomes through an efficient and optimal asset base	Sep 2010
Implementing Better Practice Grants Administration	June 2010
Planning and Approving Projects	
an Executive Perspective	June 2010
Innovation in the Public Sector	
Enabling Better Performance, Driving New Directions	Dec 2009
SAP ECC 6.0	
Security and Control	June 2009
Preparation of Financial Statements by Public Sector Entities	June 2009
Business Continuity Management	
Building resilience in public sector entities	June 2009
Developing and Managing Internal Budgets	June 2008
Agency Management of Parliamentary Workflow	May 2008
Public Sector Internal Audit	
An Investment in Assurance and Business Improvement	Sep 2007
Fairness and Transparency in Purchasing Decisions	
Probity in Australian Government Procurement	Aug 2007
Administering Regulation	Mar 2007
Developing and Managing Contracts	
Getting the Right Outcome, Paying the Right Price	Feb 2007
Implementation of Programme and Policy Initiatives:	
Making implementation matter	Oct 2006

Legal Services Arrangements in Australian Government Agencies	Aug 2006
Administration of Fringe Benefits Tax	Feb 2006
User-Friendly Forms	
Key Principles and Practices to Effectively Design and Communicate Australian Government Forms	Jan 2006

