The Auditor-General
ANAO Report No.28 2017–18
Performance Audit

Defence's Procurement of Fuels, Petroleum, Oils, Lubricants, and Card Services

Department of Defence

Australian National Audit Office

ISSN 1036–7632 (Print)
ISSN 2203–0352 (Online)
ISBN 978-1-76033-331-7 (Print)
ISBN 978-1-76033-330-0 (Online)

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Canberra ACT

19 February 2018

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken an independent performance audit in the Department of Defence titled *Defence's Procurement of Fuels, Petroleum, Oils, Lubricants, and Card Services.* The audit was conducted in accordance with the authority contained in the *Auditor-General Act 1997*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of this audit to the Parliament.

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

Yours sincerely

Grant Hehir
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, financial statement audits and assurance reviews 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.

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Summary and recommendations

Background

1. The Australian Defence Force (Defence) procures, stores and distributes a combination of ten commercial and military grade fuels and lubricants to geographically dispersed locations to maintain the mobility of the Australian Defence Force (ADF). Military specification fuels include additives that Defence considers essential for the operation of its ships, aircraft and vehicles, often in demanding environments.

2. Fuel is Defence's largest single commodity expenditure, amounting to an annual spend of approximately $423 million in 2016-17. In 2015, Defence undertook an open tender exercise to secure supplies of bulk fuels, petroleum, oils and lubricants, and fuel cards for the five year period from February 2016 until February 2021.

3. Defence's fuel supply chain has been the subject of numerous reviews over the past 15 years, both internal and external. These reviews have consistently identified weaknesses in Defence's fuel supply chain management.

4. The scope of this audit focuses on the 2015 procurement of bulk fuel, petrol, oil and lubricants and fuel card services. The audit also examines Defence's contract management arrangements and the controls framework for Defence's fuel inventory.

Audit objective and criteria

5. The objective of the audit was to assess whether Defence achieves value for money in the procurement of fuel. To form a conclusion against the objective, the ANAO adopted the following high-level audit criteria:

- procurement processes complied with the Commonwealth procurement framework and relevant Defence requirements; and
- Defence's contracting and purchasing arrangements achieve value for money for the Commonwealth.

Conclusion

6. Defence designed and implemented an effective competitive tender process but did not develop a negotiation strategy to maximise value for money and there remains scope to improve the effectiveness of contract management, purchasing and assurance arrangements to demonstrate that value for money is being achieved.

7. Defence's open tender and evaluation processes were fit for purpose. The processes were largely compliant with Commonwealth and Defence requirements. While the fuel pricing formula applied was industry standard, Defence was unable to demonstrate that value for money was maximised as Defence did not seek to negotiate lower prices for some components of the pricing formula before supply contracts were signed.

8. Defence's contract management would benefit from improved integration of key information systems and reduced manual intervention, including in the calculation of fuel prices.

9. Defence's ability to provide assurance over the management of its fuel supply chain is limited by infrastructure and information technology deficiencies and insufficient central data analysis. Defence is currently implementing some short-term initiatives to improve central oversight, however significant systems level improvement regarding assurance controls is not scheduled to commence until 2022.

Supporting findings

The Commonwealth procurement framework and Defence's internal requirements

10. Defence's procurement process for bulk fuel was largely compliant with the Commonwealth Procurement Rules and Defence's internal requirements. Weaknesses in administration related to:

- conflict of interest management—while Defence developed clear probity and conflict of interest plans, Defence did not appropriately manage a declared potential conflict of interest in relation to a key person on the Tender Evaluation Team;
- risk management procedures—a risk register for the procurement was developed early in the tender process, however it was not updated at key milestones during the process or when new risks emerged; and
- records management—Defence produced and retained all official evaluation reports but was unable to locate various working files and meeting records for the purposes of this audit.

The tender evaluation process

11. The complexity of the procurement was significant, with detailed requirements for over 100 geographically dispersed sites, multiple fuel types and several service requirements.

12. Defence's design of the tender evaluation process was fit for the purpose of dealing with this complexity. The Tender Evaluation Plan provided for multiple assessment stages, specialist working groups and comprehensive criteria.

13. Defence implemented the evaluation process and stages as outlined in its Tender Evaluation Plan. It produced the documents required for each stage of the evaluation and weighted criteria in line with the advice provided to tenderers. However, the clarity and transparency of Defence's decision making was reduced by a lack of adequate records underpinning the outcomes as determined by the tender evaluation working groups.

Value for money assessment

14. The 2015 fuels tender and evaluation process was designed to produce a value for money outcome. Defence undertook an open tender process, conducted detailed evaluation of tenders, considered price and non-price value, and applied an industry standard fuel pricing methodology.

15. Defence's failure to negotiate to attempt to achieve lower prices for some components of the fuel pricing formula before supply contracts were signed compromised its ability to demonstrate that value for money was maximised for the Commonwealth.

Managing the bulk fuel contracts

16. Defence's processes and controls over the calculation of fuel prices do not provide adequate assurance, with manual processes supplementing inadequate information technology systems. Defence's fuel management inventory system is still not fully integrated with Defence's financial management system.

17. Defence relies on a range of documents to guide contract management and oversight of each supplier's performance. Development of an internal procedural guidance document would assist staff and provide a source of corporate knowledge.

18. While Defence recognised that it required skills in the fuels services area not immediately available to it on the establishment of the Fuel Services Branch, it continues to rely heavily on contracted services at high cost.

Inventory management and assurance

19. Although Defence has some inventory management controls in place—such as physical security at large fuel installations—key elements of Defence's controls and assurance processes to detect volume discrepancies remain ineffective. Central data analysis is insufficient, and infrastructure and information technology systems require modernisation. These deficiencies have been known about for several years.

20. Defence is undertaking corrective action to enhance assurance controls and to better manage bulk fuel stocks pending more permanent reforms, which are planned as part of the Defence Fuels Transformation Program.

21. The development of a more contemporary and integrated system for collecting and storing fuel inventory data would strengthen risk management, the control and assurance framework and support more informed fuel purchasing decisions. Improvements to relevant infrastructure, IT and controls under the Defence Fuels Transformation Program are not scheduled to commence until 2022.

Recommendations

Recommendation no. 1

Paragraph 2.39

That, for future procurements within the Fuels Services Branch, Defence:

(a) explicitly considers the potential conflicts of interest that may arise when employing individuals and contractors with recent industry experience; and institutes controls to ensure that all such matters are fully managed and documented;

(b) reviews and updates procurement risk registers at a minimum at all key decision points and milestones, when risk events materialise and as new risks arise throughout a procurement; and

(c) strengthen risk and records management by ensuring that all personnel involved are aware that tenders and related documents cannot be removed from Defence's classified systems without express authority by senior management.

Recommendation no. 2 **Paragraph 2.89**	That for future procurements within the Fuels Services Branch, Defence conducts an independent evaluation of the 2015 fuel procurement process, strategy and arrangements to inform the next procurement process and to maximise a value for money outcome.
Recommendation no. 3 **Paragraph 3.43**	To improve the management of its bulk fuel inventory, Defence should implement arrangements to provide assurance that control arrangements are working as intended.

Summary responses

22. A summary response from the Department of Defence is set out below. Kiah Consulting was provided with extracts of the draft report and its summary comments are also set out below.

Department of Defence

23. Defence welcomes the ANAO Audit Report into the Procurement of Fuels, Oils, Lubricants and Card Services and agrees with the recommendations.

24. Defence is satisfied with the value for money outcome achieved from the procurement process. In addition to price, Defence sought fuel suppliers which could provide Defence with assured cost-effective supply solutions that featured flexibility in meeting routine and surge requirements as well as support through alternate supply options or storage. The fundamental objective of the procurement process was the need for Defence fuel supply contracts to be able to supply volumes of fuel products as required by Defence to various physical locations across Australia within specific timelines.

25. Defence notes the recommendations provided build upon the progress currently being made by Defence across the Defence fuel supply chain. Many of these outcomes have stemmed from the Defence Fuel Network Review which was completed in June 2017. This review delivered an Implementation Strategy for the Future Defence Fuel Supply Chain; which led to the establishment of the Defence Fuel Transformation program to execute the Implementation Strategy. The Defence Fuel Transformation program is fully funded and Defence will be seeking Government endorsement later this year to progress this activity.

Kiah consulting

26. We appreciate the opportunity to make comment on the observations regarding probity and use of consultants that reflect on Kiah.

27. We seek to be clear that any probity process failure was outside of our influence and that we took care to ensure that any perceived conflict of interest was declared. While there may be some concern as to the process, we do observe that a purchaser turned supplier may present a conflict, but a ‘poacher turned gamekeeper’ simply makes for a knowledgeable consultant, however discomforted the suppliers may feel.

28. The view that consultants should be replaced by public servants is without foundation. We provide a managed services work program using consultants drawn from industry senior executives. Kiah consultants are working alongside Defence to re-establish a self-reliant Defence

capability, operating safely to contemporary standards. This is not a role that can be achieved from within the public sector without assistance. The lack of expertise is what gave rise to the issues being addressed and the public sector simply cannot internally generate the expertise it needs.

29. When Defence urgently sought to establish the Fuels Services Branch (FSB), they leveraged two existing contracts. Since FSB has been established we have been competed three times, in addition to the competitive establishment of the panels. We have been awarded two contracts and a portion of a third, with Kiah providing about 50% of the overall consulting effort. We have repeatedly demonstrated our comparative value through competition.

30. The value of our contribution is also demonstrable and measureable. At a cost of around $4m a year, effort and skills varying according to need, we have delivered contemporary industry practices at a fraction of what it cost industry when developed for them. We have been instrumental in delivering $15m pa savings in operating costs and at least $200m of avoided infrastructure spend. None of it would have been achievable by Defence without the introduction of diversity of thought and industry experience that we provide – otherwise the benefits would have been reaped already.

31. Defence has acted engaged wisely, sought competition and established a model that integrates Defence and the consultants for sustainable outcomes and knowledge transfer. We are disappointed that this is not recognised in the report.

Key learnings for all Australian Government entities

32. Below is a summary of key learnings identified in this audit report that may be considered by entities when managing procurements and large inventories.

Procurement

- Maximising value for money—relies on entities not only undertaking sound tender processes and assessments but also pursuing value for money through effective negotiation strategies.

Records management

- Retaining tender assessment working documents—the importance of entities officially filing both tender evaluation reports and detailed individual assessments or modelling to ensure their decisions are transparent and have an accessible audit trail.

Governance and risk management

- The dynamic and ongoing nature of risk assessment—while the development of risk assessments and plans is crucial, they must also be living documents updated at major decision points, when risk events materialise and when new risks arise.
- Implementing probity plans in full—processes and controls which ensure full implementation of probity plans assist entities to lower risk during procurements.
- The value of centralised assurance and data analysis—ensuring there are robust mechanisms in place to centrally collect and analyse data in order to investigate possible discrepancies, can help manage risk and provide confidence in the operation of complex systems or programs.

Audit findings

1. Background

Introduction

1.1 Supplies, including fuel, are a fundamental input to Defence capability. Defence procures, stores and distributes fuel to geographically dispersed locations to maintain the mobility of the Australian Defence Force. Defence uses a combination of ten commercial and military grade fuels.[1] Military specification fuels include additives that Defence considers essential for the operation of its ships, aircraft and vehicles, often in demanding environments.

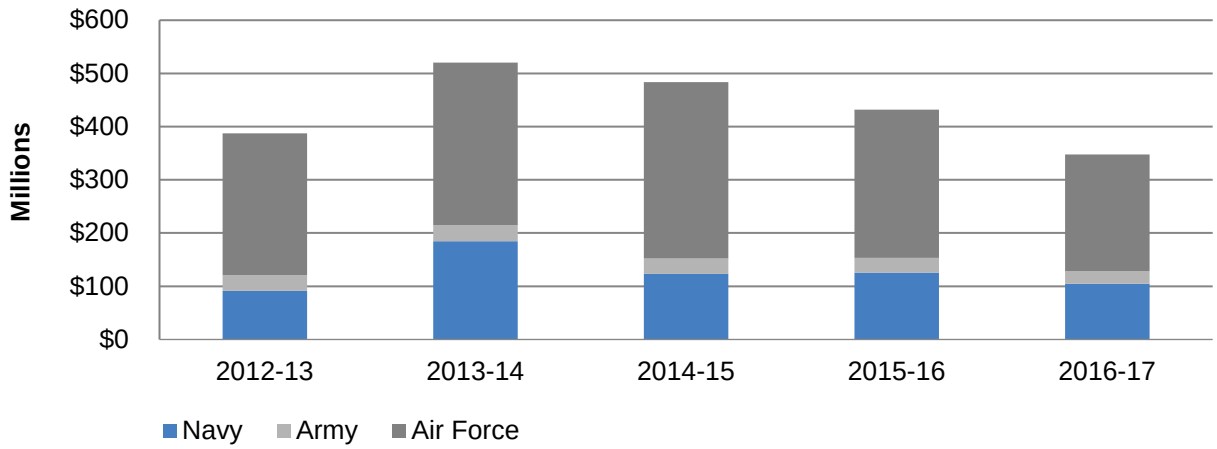
1.2 Fuel is Defence's largest single commodity expenditure. Primarily, Defence purchases fuel in bulk, with the majority of fuel consumed by Air Force and then Navy, with Army being the smallest consumer. The majority of this demand is for military specific grades of fuel for which Defence is the sole Australian customer.

1.3 Key statistics about Defence's fuel arrangements are:

- 107 fuel sites, with the capacity to store 167 million litres (ML);
- a requirement for seven different types of fuel, including three military specification fuels (MilSpec);
- annual fuel consumption of 423 ML (2016–2017), equivalent to 0.9 per cent of total fuel consumption in Australia (2015–16);
- the largest user of fuel by service is Air Force, which consumes approximately 70 per cent of total fuel; and
- an annual spend on fuel of approximately $423 million.

1.4 Figure 1.1 shows the cost of fuel and lubricants purchased by Defence from 1 July 2012 to 30 June 2017. Over this period, Defence spent $2.1 billion on fuel and lubricants, including $630 million by Navy, $139 million by Army and $1.4 billion by Air Force.

Figure 1.1: Total cost of fuel ($m), by Service, 1 July 2012 to 30 June 2017



Source: Defence documents.

1 Appendix 3 lists the 10 different types of fuel and fuel products.

1.5 Table 1.1 summarises the estimated contract values for bulk fuels and related products over five years from Defence's seven suppliers. Financial approvals at contract signature totalled $1.9 billion, but actual contract values will depend on prices at the time of delivery.

Table 1.1: Summary of approved estimated deed values (February 2016–February 2021)

Company	Estimated value ($, millions AUD, five year period)
Caltex	867.4
Viva Energy	491.1
BP	401.7
Viva Energy Aviation (formerly Shell Aviation)	119.1
AS Harrison	8.2
World Fuel Services	5.6
Interchem	3.2
Total (over five years)	1896.3

Source: Defence documentation

1.6 These contracts and the related procurements are administered by the Fuel Services Branch within Defence's Joint Logistics Command Group.

Audit objective and criteria

1.7 The objective of the audit was to assess whether Defence achieves value for money in the procurement of fuel. To form a conclusion against the objective, the ANAO adopted the following high-level audit criteria:

- procurement processes complied with the Commonwealth procurement framework and relevant Defence requirements; and
- Defence's contracting and purchasing arrangements achieve value for money for the Commonwealth.

1.8 In undertaking the audit, the ANAO:

- reviewed relevant Defence files and documentation, including contracts, policies, briefs and performance reports;
- collected and analysed data relating to the bulk fuel contracts; and
- interviewed key Defence personnel including: Commander Joint Logistics; members of the Fuel Services Branch; relevant stakeholders; and representatives from each of the Services.

Audit scope

1.9 The scope of this audit includes Defence's 2015 procurement of bulk fuel, petrol, oil and lubricants and fuel card services; and the subsequent management of relevant contracts. It also examines aspects of the controls framework for Defence's bulk fuel inventory.

1.10 The audit was conducted in accordance with the ANAO Auditing Standards at a cost to the ANAO of $472,467.

1.11 The team members for this audit were Dr Marlene Edmondson, Robina Jaffray, Dr Ashlin Lee, Jed Andrews and David Brunoro.

2. The fuel procurement process

Areas examined

The ANAO examined whether Defence's 2015 procurement process for the purchase of fuel was designed and implemented to achieve value for money for the Commonwealth.

Conclusion

Defence's open tender and evaluation processes were fit for purpose. The processes were largely compliant with Commonwealth and Defence requirements. While the fuel pricing formula applied was industry standard, Defence was unable to demonstrate that value for money was optimised as Defence did not seek to negotiate lower prices for some components of the pricing formula before supply contracts were signed.

Areas for improvement

The ANAO has made a recommendation aimed at improving Defence's administration of probity issues, risk management and document security during procurements. A further recommendation is directed towards conducting an independent evaluation of the 2015 fuels procurement process to inform the next procurement.

2.1 This chapter considers:

- whether the 2015 procurement process complied with the Commonwealth procurement framework and relevant Defence requirements, focusing on:
  - the procurement strategy;
  - procurement planning and governance;
  - probity arrangements;
  - risk management;
  - records management;
- whether the tender evaluation process was fit for purpose; and
- whether Defence achieved value for money.

Did the procurement process follow the Commonwealth's procurement framework and Defence requirements?

Defence's procurement process for bulk fuel was largely compliant with the Commonwealth Procurement Rules and Defence's internal requirements. Weaknesses in administration related to:

- conflict of interest management—while Defence developed clear probity and conflict of interest plans, Defence did not appropriately manage a declared potential conflict of interest in relation to a key person on the Tender Evaluation Team;
- risk management procedures—a risk register for the procurement was developed early in the tender process, however it was not updated at key milestones during the process or when new risks emerged; and
- records management—Defence produced and retained all official evaluation reports but was unable to locate various working files and meeting records for the purposes of this audit.

The Commonwealth procurement framework and Defence's internal requirements

2.2 Defence procurement is governed by the Commonwealth Procurement Rules[2] and Defence's Procurement Policy Manual. Risk management, an integral part of procurement, is governed by the Commonwealth Procurement Rules, the Commonwealth Risk Management Policy[3] and Defence's Project Risk Management Manual. The Commonwealth Procurement Rules contain both mandatory requirements and good practice to assist agencies in their procurement activities. The Rules are issued by the Minister for Finance and apply to all Australian Public Service procurements.

2.3 Achieving value for money is the core rule of the Commonwealth Procurement Rules.[4] In achieving value for money, procurements should:

- encourage competition and be non-discriminatory;
- use public resources in an efficient, effective, economical and ethical manner that is not inconsistent with the policies of the Commonwealth;
- facilitate accountable and transparent decision making;
- encourage appropriate engagement with risk; and
- be commensurate with the scale and scope of the business requirement.

2.4 Defence has developed its own Defence Procurement Policy Manual which is 'the principal compliance document for Defence officials conducting procurement'.[5] The purpose of the Defence Procurement Policy Manual is to assist Defence officials to comply with the requirements of the Commonwealth Procurement Rules and Defence policy when undertaking procurements and to provide general guidance around the process, such as using plain English and encouraging officials to use 'a strategic approach and commercial expertise'.[6]

Procurement strategy

2.5 The Commonwealth Procurement Rules provide that a 'consideration of value for money begins by officials clearly understanding and expressing the goals and purpose of the procurement'. The Director General of Fuel Services approved a procurement strategy for fuel contracts on 21 May 2015. Reflecting the broader Commonwealth Procurement Rules, Defence's fuels procurement strategy aimed to: provide demonstrable value for money benefits to Defence; encourage competition; facilitate accountable and transparent decision making; encourage appropriate engagement with risk; and be commensurate with the scale and scope of Fuel Services Branch business requirements.

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2 Department of Finance, *Commonwealth Procurement Rules*, July 2014. (These rules were updated on 31 March 2017 but the July 2014 version was applicable at the time of the 2015 procurement).

3 https://www.finance.gov.au/sites/default/files/commonwealth-risk-management-policy.pdf <accessed 18 August 2017>.

4 Department of Finance, *Commonwealth Procurement Rules*, July 2014, p. 13.

5 The latest version of the Defence Procurement Policy Manual was issued in April 2017, superseding the March 2016 version. The version applying at the time of the procurement under review was issued in February 2014 and this is the version referenced.

6 Available from <http://www.defence.gov.au/casg/DoingBusiness/ProcurementDefence/Policies/DefenceProcurementPolicyManual/> [accessed 7 August 2017].

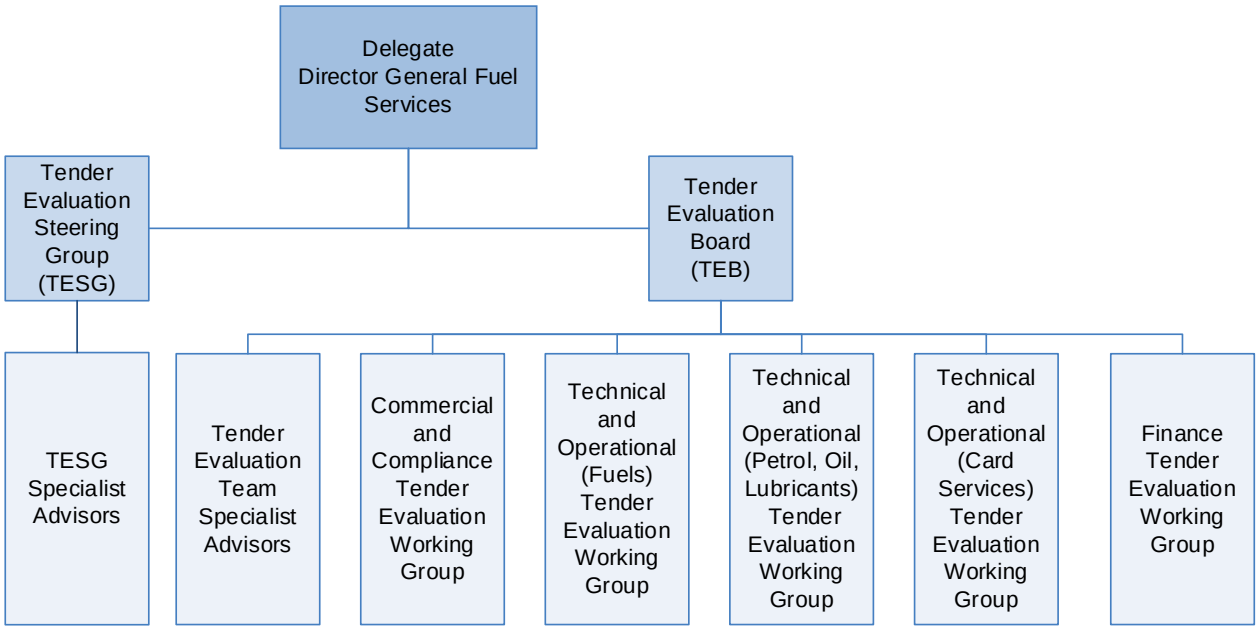
2.6 The conditions of tender included the following objectives for the procurement:

- support for the Australian Defence Force fuel supply chain vision of safe sustained delivery of an efficient, effective, integrated and professional fuel and petroleum, oils and lubricants supply chain that supports the operational needs of the ADF;
- surety of supply: at all locations; within and across the greatest number of delivery methods; for the maximum range of supplies; and with a minimum number of contractors;
- best value for money in accordance with the evaluation criteria; and
- provide the range of supplies through a prime contractor relationship with the Commonwealth.

Procurement planning and governance

2.7 The Commonwealth Procurement Rules provide that accountability and transparency in procurement is achieved through effective planning and governance. In addition to the tender documentation prepared by Defence for listing on AusTender, Defence prepared a tender evaluation plan, probity plan and risk documentation. The tender evaluation plan established the criteria, processes and methodologies through which tenders were to be assessed for the supply of fuel. It also defined the roles and responsibilities of the Tender Evaluation Team, which comprised the Tender Evaluation Board and seven tender evaluation working groups.[7] Independent probity and procurement advice was also available. Governance arrangements for the tender are presented in Figure 2.1 below.

Figure 2.1: Tender governance arrangements



Source: Defence Tender Evaluation Plan.

7 The Tender Evaluation Team was not a discrete entity. The Tender Evaluation Team had a total of 18 members including the Chair.

2.8 The Tender Evaluation Team was required to:

- conduct evaluations of each of the tenders in accordance with the tender evaluation plan;
- evaluate all tenders ethically and fairly**;**
- undertake the detailed evaluation according to the evaluation criteria; and
- prepare narratives, summaries and reports.

2.9 The Tender Evaluation Board had responsibility for overseeing the working groups and the production of a Source Evaluation Report which provided final recommendations to the delegate. The Board comprised the Tender Evaluation Team Chair and Deputy Chair, and leaders of the working groups—totalling four personnel.[8] The Tender Evaluation Working Groups conducted detailed evaluations and included officers/contractors with specialist expertise.[9]

2.10 The Tender Evaluation Plan stated that the Tender Evaluation Steering Group's role was to provide advice to the delegate and the tender evaluation team to ensure 'that the [Tender Evaluation Team] complied with Commonwealth policies including [the Commonwealth Procurement Rules] and Department policies, procedures and practices to ensure achievement of [value for money]'.[10] The Steering Group comprised three members: the Chair of the 2010 procurement; Defence's Chief Procurement Officer; and the 2015 Tender Evaluation Board Chair.

2.11 Defence was unable to provide minutes or meeting records for the Tender Evaluation Working Groups or Tender Evaluation Steering Group. Consequently, there is no visibility of the advice provided by the Tender Evaluation Steering Group, and it is not possible to confirm that the Tender Evaluation Steering Group met on two occasions as required by the Tender Evaluation Plan. As required in the Tender Evaluation Plan, the Steering Group endorsed the Source Evaluation Report, prepared by the Tender Evaluation Board, on 11 November 2015.[11]

Probity management

2.12 The Commonwealth Procurement Rules require the ethical administration of procurement, including the identification and management of conflicts of interest and the equitable treatment of participants.

2.13 A comprehensive probity plan was finalised in July 2015. The plan set out the authority and structure to address probity issues in relation to the fuels procurement. The plan provided that:

a. there is to be a clear and fair procurement process that is conducted in accordance with applicable Commonwealth legislation and policy;

b. all tenderers are to be treated fairly and equitably…;

c. tender evaluation is to be conducted in accordance with the approved Tender Evaluation Plan (TEP);

8 The four personnel comprised the Tender Evaluation Team Chair, the Deputy Chair (who also led the Commercial and Compliance Working Group), the leader of the three Technical and Operational Working Groups, and the leader of the Finance Tender Working Group.

9 Of the 18 personnel in the Working Groups, 15 were Defence personnel and three were contractors.

10 Tender Evaluation Plan, p. 13.

11 Records management issues are discussed further in paragraphs 2.35 to 2.38 of this audit report.

d. commercially sensitive information… is to be protected at all times;

e. there must be a clear audit trail; and

f. perceived, potential and actual conflicts of interest must be identified and addressed.

2.14 The probity plan also provided for the appointment of an independent probity advisor and set out the scope of the advisor's role. The probity advisor was consulted on a number of occasions for advice on matters such as: alternative tenders; requests from tenderers for clarification after closure of the tender submission date; screening queries; the appropriateness and accuracy of advice to tenderers during the process; and conflict of interest management.

Conflict of interest management

2.15 The Commonwealth Procurement Rules require officials to act ethically throughout the procurement.[12] Defence also has specific instructions on managing potential conflicts of interest, which apply to Defence personnel and external service providers under contract to Defence. Conflicts can be actual, potential or perceived.

2.16 In November 2014, in preparation for the 2015 bulk fuel tender, Defence sought contractor assistance in developing the Statements of Work for the 2015 bulk fuel tender. Defence received a single tender response from a consulting firm nominating a contractor for the position. The contractor had been employed a short time earlier as deed manager for a major supplier to Defence under previous fuel supply contracts, having until September 2014 worked in the area.

2.17 Defence required all personnel working on the tender evaluation to complete a Conflict of Interest Declaration, although there was no requirement to complete a declaration for pre-tender work.[13] Seven personnel declared a potential conflict of interest, including the contractor, who appropriately declared previous employment with a supplier.

2.18 At Defence the contractor assisted with a number of specific technical roles, including at the pre-tender stage (December 2014–July 2015), reviewing the Statements of Work and making recommendations on pricing formulae. Post tender, the contractor had significant roles in evaluating value-for-money outcomes for Defence as the chair of the Finance Tender Evaluation Working Group and as a member of the Tender Evaluation Board. In these roles, the contractor, as a member of the Tender Evaluation Board, signed off on the Initial Screening Report, the Comparative Assessment Report, the Finance Tender Evaluation Working Group evaluation, and the Source Evaluation Report, all of which included evaluations of the tender submitted by the company in which the contractor had previously been employed.

2.19 Defence provided the independent probity advisor with only six of the seven declared conflict of interest forms. There is no evidence that Defence provided the contractor's form to the probity advisor, or raised the contractor's declared potential conflict of interest with the probity

12 Ethical behaviour includes recognising and dealing with actual, potential and perceived conflicts of interest. Department of Finance, *Commonwealth Procurement Rules*, July 2014, p. 17.

13 Defence requires relevant personnel to complete a conflict of interest declaration. The form defines a conflict of interest as '…where an incompatibility exists, or where it could be reasonably perceived that an incompatibility exists, between the public duty of a person and a current or prospective interest of that person or a member of that person's immediate family'.

advisor at any point. Consequently, Defence officials did not receive any advice on this particular declaration as a basis for developing an appropriate management strategy.[14]

The probity implications of Defence's Fuel Network Review for the tender process

2.20 The probity plan requires that all tenderers are to be treated fairly and equitably. A probity issue arose during the tender evaluation period and when meetings of Defence's Fuel Network Review took place concurrently with the fuel procurement evaluation process.[15] The objectives of the Fuel Network Review were to identify enterprise risk and network resilience, reduce costs and explore greater collaboration with industry. The Fuel Network Review process involved consultation with selected industry stakeholders.

2.21 Two participants in Fuel Network Review meetings were also tenderers being evaluated for the supply of fuels to Defence. This was recognised as a potential probity issue, with both the fuel procurement Tender Evaluation Team and the Fuel Network Review team seeking probity advice on the matter. The probity advice, which was shared between the two teams, included strategies to ensure that the integrity of the tender process was not compromised and stated that 'for reasons of accountability, Defence needs to ensure that these probity issues have been identified and addressed, and that a record is made showing that this was done'.

2.22 Defence did not provide any written advice to participants regarding the necessity not to discuss the fuels tender at future Fuels Network Review meetings. Defence has advised that one further Fuel Network Review meeting took place on 3 November 2015, but no record of this meeting appears in the probity or communications registers.

Security of tender information

2.23 The Commonwealth Procurement Rules 2014 provided that:

> 7.20 When conducting a procurement … entities should take appropriate steps to protect the Commonwealth's confidential information; and
>
> 7.21 [Suppliers'] *submissions* **must** be treated as confidential before and after the award of a *contract*.[16]

2.24 The Tender Evaluation Plan required all tendered material to be handled appropriately, to be kept secure and not to be used for personal gain or to prejudice fair competition. The evaluation working groups and their advisers were responsible for ensuring the physical security and confidentiality of all information relating to evaluation.

2.25 The Tender Evaluation Plan stated that all tender material was to be downloaded and receipted from AusTender and then transferred to Objective, Defence's secure electronic records system. From this point on, tender information was to be classified 'For Official Use Only' and kept secure. The Tender Evaluation Plan further required the Tender Evaluation Team Chair to approve

14 Defence has advised the ANAO it is reviewing its handling of the matter.

15 The Fuel Network Review is part of Defence's Fuel Network Implementation Strategy. It commenced in September 2015.

16 Department of Finance, *Commonwealth Procurement Rules*, July 2014, p. 21.

the removal of any documents from the evaluation location or the accessing of tender documents electronically at remote locations.[17]

2.26 Defence records indicate that tender information was removed from Defence's secure system. Defence has not been able to provide evidence that the removal of the information was approved in accordance with Defence requirements. In the course of the audit the ANAO advised Defence of this issue and it is currently being reviewed by Defence.

Risk management

2.27 There were several frameworks in place to assist Defence to manage risk in procurement activity at the time of the fuel procurement. These included:

- the *Public Governance, Performance and Accountability Act 2013*;
- the Commonwealth Risk Management Policy 2014;
- the Commonwealth Procurement Rules 2014[18]; and
- Defence's Project Risk Management Manual.

2.28 The *Public Governance, Performance and Accountability Act 2013* (PGPA) establishes a framework for the identification and management of risk. In particular, s16 of the PGPA Act provides that accountable authorities of all Commonwealth entities must establish and maintain appropriate systems of risk oversight, management and internal control for the entity. Risk management is expected to be embedded as part of the culture of an entity.

2.29 The Commonwealth Procurement Rules 2014 require entities to establish processes for the identification, analysis, allocation and treatment of risk when conducting procurements. The Rules provide that the effort directed to risk assessment and management should be commensurate with the scale, scope and risk of the procurement. [19]

2.30 Defence's Project Risk Management Manual was initially developed for the Defence Materiel Organisation (now the Capability Acquisition and Sustainment Group). Its purpose is to 'define robust and systematic risk management processes and provide defence personnel with advice and guidance on how to manage risk in projects'. The manual requires that all project risks be documented in a risk register and that staff are to update the risk assessment for a project at key decision points and milestones.

2.31 A risk register was established for the 2015 procurement. The risk register showed progressive refinement in the initial weeks in terms of the risks identified, their source and their degree of seriousness.[20] Defence advised that the resources used to develop the initial risk register included the material liability risk template, the risk category and the risk impact

17 Para 5.1.4 of the Tender Evaluation Plan stated that: 'The TET Chair may approve the removal of documents from the evaluation location of the accessing of tender documents electronically at remote locations for the purposes of conducting evaluations off-site'.

18 These rules were updated on 31 March 2017 but the July 2014 version was applicable at the time of the 2015 procurement.

19 Department of Finance, *Commonwealth Procurement Rules*, July 2014, p. 23.

20 Defence document – fuels procurement risk register.

categories as described in the Project Risk Management Manual, and risk registers from previous procurements.

2.32 Defence advised that Fuel Services Branch was obliged to operate in line with Defence and Commonwealth procurement policy, which included reference to the Defence Project Risk Management Manual for practical advice and guidance. The Project Risk Management Manual required Defence personnel to update the risk register at key decision points and milestones. There is no evidence that risks were reviewed after 30 June 2015 even though the Request for Tender did not close until 30 July 2015, after major milestones were achieved and when contracts were signed in 2015 and 2016.[21]

2.33 Defence advised that its approach in addressing risks was to 'appropriately [resolve] issues, as they arose, to ensure all tenderers had access to the same information and clarifications':

> The risk register was used to plan the procurement strategy and processes. All issues that arose during tender release and evaluation stages were appropriately considered and Defence's management approach was to immediately action and resolve such issues by either:
>
> - releasing RFT Addendums via AusTender to ensure all tenderers have access to the same information/clarifications from the Commonwealth; or
> - identifying and addressing … issues for negotiation in the Source Evaluation Report and Deed Negotiation Directives.

2.34 Defence should have documented risks arising throughout the procurement and any mitigating treatments, which is useful to inform future procurements. However, Defence did not do this.

Records management

2.35 The Commonwealth Procurement Rules require entities to maintain documentation commensurate with the scale, scope and risk of the procurement, including records of relevant approvals and decisions. A key purpose of these record keeping requirements is to document how value for money is considered and achieved.[22]

2.36 Defence's Endorsement to Proceed and Tender Evaluation Plan required the maintenance of an audit trail. The Tender Evaluation Plan stated that:

> To maintain an audit trail, records of the evaluation process will be kept and include reasons justifying decisions made by each [Tender Evaluation Working Group] as well as the [Tender Evaluation Board] in relation to each of the evaluation criteria assessed.

21 The Request for Tender was released on 4 June 2015. The audit team examined five of the 12 versions of the risk register, including the final four versions, numbers 9–12, which were developed during the period 22 December 2014–27 July 2015, although there is no evidence that the status of individual risks was updated after 30 June 2015.

22 Department of Finance, *Commonwealth Procurement Rules*, July 2014, s7.2(c), p. 19.

2.37 Defence prepared reports as required by the Tender Evaluation Plan. However, Defence was unable to locate various working files and meeting records for the purposes of this audit, including:

- working files of the conduct of the corporate assessments, or of the financial viability assessments undertaken for five suppliers, which underpinned analysis in the Financial Evaluation Report;
- records that specifically detailed how the estimated Deed values were calculated, or to provide a breakdown of the estimated Deed value by product type and contractors;
- minutes and working documents for meetings of the tender evaluation working groups or tender evaluation steering group; and
- complete records of how it addressed possible risks brought to its attention by potential suppliers.

2.38 The absence of working files and meeting records meant there was an insufficient audit trail for review of all aspects of the tender process.

Recommendation no.1

2.39 That, for future procurements in Fuel Services Branch, Defence:

(a) explicitly considers the potential conflicts of interest that may arise when employing individuals and contractors with recent industry experience; and institutes controls to ensure that all such matters are fully managed and documented;

(b) reviews and updates procurement risk registers at a minimum at all key decision points and milestones, when risk events materialise and as new risks arise throughout a procurement; and

(c) strengthen risk and records management by ensuring that all personnel involved are aware that tenders and related documents cannot be removed from Defence's classified systems without express authority by senior management.

Entity response:

2.40 Defence accepts the recommendation to apply to future Fuel Services Branch complex procurements.

2.41 *Defence will amend the standard operating procedures and policies within Fuel Services Branch as they relate to procurement to ensure all issues in this report are appropriately addressed.*

Was the tender evaluation process fit for purpose?

The complexity of the procurement was significant, with detailed requirements for over 100 geographically dispersed sites, multiple fuel types and several service requirements.

Defence's design of the tender evaluation process was fit for the purpose of dealing with this complexity. The Tender Evaluation Plan provided for multiple assessment stages, specialist working groups and comprehensive criteria.

Defence implemented the evaluation process and stages as outlined in its Tender Evaluation Plan. It produced the documents required for each stage of the evaluation and weighted criteria in line with the advice provided to tenderers. However, the clarity and transparency of Defence's decision making was reduced by a lack of adequate records underpinning the outcomes as determined by the tender evaluation working groups.

2.42 To assess if the tender process was fit for purpose, the ANAO considered the following:

- the tender process and evaluation criteria; and
- the evaluation process.

The tender process and evaluation criteria

2.43 The Defence procurement process starts with an Endorsement to Proceed. This document was signed off on 3 June 2015 and formally progressed the procurement process to allow Defence to release the Request for Tender to the market for a potential procurement initially estimated at $1.5 billion over five years.[23]

2.44 Defence's Request for Tender comprised:

(a) the overarching Request for Tender document;

(b) Statements of Work for the three components to be procured (bulk fuels; petroleum, oils and lubricants; and fuel card services)[24]; and

(c) detailed tender data requirements.

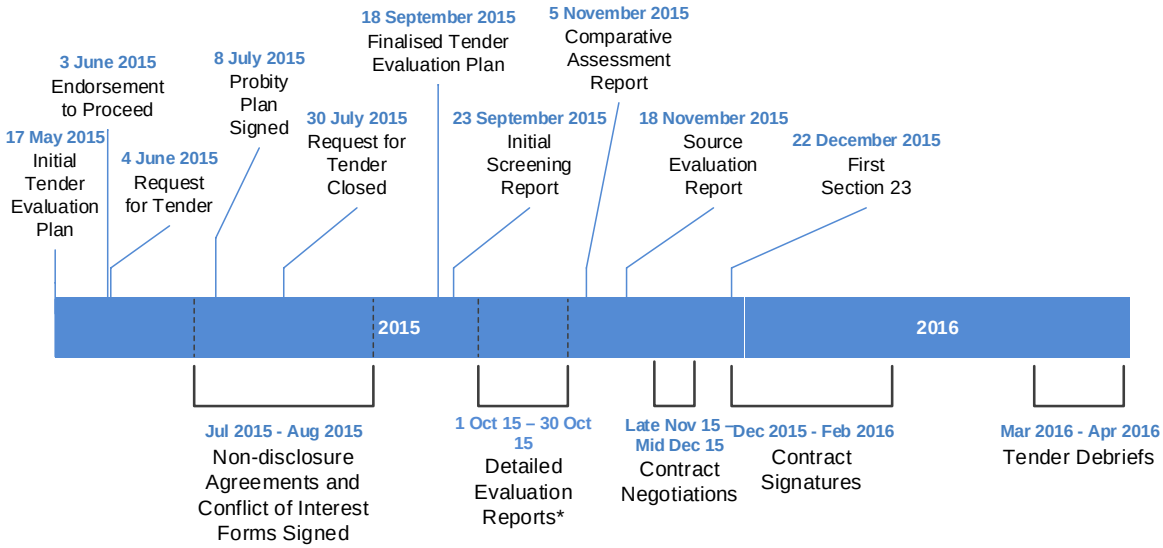
2.45 Tenderers were invited to submit a response against an individual statement of work, all statements of work or any combination of the three statements of work. The statements of work were detailed and specified the products and services to be delivered, product specifications, delivery locations, relevant standards and applicable timeframes.

23 The Endorsement to Proceed confirms: the scope; procurement method; the status of the request for tender; the assessment of risks associated with the procurement; whether specialist legal and probity advice has been sought; the estimated dollar value of the procurement; and the endorsement of the Defence Chief Procurement Officer.

24 The three categories were further sub-divided into:
(a) five categories for bulk fuels: military specification fuel deliveries; civilian airports; marine fuels; and two categories for land fuels;
(b) three categories for petrol, oil and lubricants: military specification oils, lubricants and allied products; commercial oils, lubricants and allied products; and fuel drum stock; and
(c) two categories for fuel card services: aviation fuel and commercial retail cards.

2.46 Potential suppliers were given eight weeks to submit tenders (from 4 June to 30 July 2015) and tender evaluation was conducted between 31 July 2015 and 11 November 2015, when the Source Evaluation Report was signed off by the Tender Evaluation Board. Contracts were signed progressively from December 2015 to February 2016.[25] Figure 2.2 illustrates key processes and timeframes.

Figure 2.2: Timeline of bulk fuel tender (May 2015–April 2016)



*Final Amendment Financial Evaluation Report 26 November 2015

Source: ANAO analysis of Defence documents.

The tender evaluation process

2.47 The size, scale and scope of the procurement resulted in a complex tender evaluation process. There were detailed tender requirements for over 100 sites and three different statements of work to assess (for bulk fuels; packaged petroleum, oil and lubricants; and card services). The assessment process used both weighted and unweighted criteria, resulting in a range of factors having to be considered to arrive at final judgements about each supplier.

2.48 As noted at paragraph 2.6 Defence was seeking an outcome that would provide surety of supply: at all locations; within and across the greatest number of delivery methods; the maximum range of supplies; and with a minimum number of contractors.

2.49 The Tender Evaluation Plan outlined that a value for money assessment was to be produced that had regard to:

- the degree to which the tender met technical, compliance and commercial requirements;
- an assessment of each tender against its offered pricing proposal; and
- an assessment of the risks and opportunities identified with each tender.

25 Section 23 of the PGPA Act allows entities to enter into financial commitments and arrangements (including contracts) on behalf of the Commonwealth.

2.50 The six stages of the evaluation process and the outcomes are shown in Table 2.1.

Table 2.1: Tender evaluation stages

Stage	Reports and Outcomes
Stage 1: Initial Screening	Eight of the ten tenders met the Tender Evaluation Plan's mandatory compliance requirements. These eight tenders were: • AS Harrison • BP • Caltex • Interchem • Shell Aviation • Viva Energy • World Fuel Services, and • a consortium bid from two of the companies listed above.
Stage 2: Shortlisting	Initial Screening and Shortlisting Report (23 September 2015) Shortlisting was not conducted given the completeness of compliant tender submissions.
Stage 3A: Detailed Evaluation against Technical and Operational, Commercial and Compliance Requirements	Technical and Operations Tender Evaluation Working Group Detailed Evaluation Report (30 October 2015) Commercial and Compliance Tender Evaluation Working Group Detailed Evaluation Report (23 October 2015) These reports included: an analysis of each tenderer's performance against evaluation criteria in the form of a score for each criteria; and a qualitative statement that addressed key strengths and weaknesses of each tender and for compliance and risk.
Stage 3B: Detailed Evaluation against Financial Requirements	Finance Tender Evaluation Working Group Detailed Evaluation Report (final amendment 26 November 2015) The report included: financial viability of tenderers; compliance with pricing and payment terms; early payment and national discounts; and an analysis of bids—lowest cost solutions and modelling of alternative scenarios.
Stage 4: Comparative Assessment, and identification of risks and opportunities	Comparative Assessment Report (5 November 2015) Value for money assessment and an overall ranking of the tenders.

Stage	Reports and Outcomes
Stage 5: Source Evaluation Report	Source Evaluation Report (18 November 2015) The SER serves to record the detailed evaluation results, provide the source from which issues for contract negotiation will be drawn, and to provide an audit trail for the detailed assessments made in arriving at the source selection recommendation.
Stage 6: Negotiations, tender notification and debriefing	Negotiation Reports Shell Aviation (17 December 2015) Viva Energy (17 December 2015) Caltex (17 December 2015) AS Harrison (18 December 2015) Interchem (22 December 2015) World Fuel Services (22 December 2015) BP (11 February 2016) Contract Negotiation Reports are prepared after contract negotiations are concluded and detail the outcomes of contract negotiations with the authorised representatives of the successful tenderers. The reports contain a summary of negotiation outcomes for areas such as deed management, pricing and supply chain resilience issues. Defence offered and conducted tender debriefings in 2016.

Source: ANAO analysis of Defence documents.

Initial screening and shortlisting

2.51 As required under the tender evaluation plan, initial screening by the Tender Evaluation Board was undertaken to check tenders against minimum content and format requirements, conditions for participation, and essential requirements (conditions of tender 5.5, 5.6 and 5.7 respectively). Ten tenders were received and two were assessed as not meeting one or more of the requirements listed above. The initial Screening and Shortlisting report was produced by the Tender Evaluation Team Chair on 23 September 2015. The report concluded that there was little to be gained in conducting shortlisting, due to the completeness of the tender submissions which passed initial screening. Eight tenders proceeded to the working group evaluation stage.

Detailed evaluation by working groups

2.52 The tender evaluation working groups (described in Figure 2.1) were responsible for the detailed evaluation against specific criteria and reporting to the Tender Evaluation Board. Tenders were to be assessed against evaluation criteria released to the market as set out below (Box 1).[26]

26 The ANAO has not reviewed the appropriateness of the evaluation criteria. The focus of this audit is on the evaluation process.

Box 1: Published tender evaluation criteria

Clause 6.1.1 of the conditions of tender stated:

> Subject to clauses 5.4 to 5.7 the criteria to be applied for the purposes of evaluation will include the following, and the percentage weightings specified will be used in the technical evaluation process as a guide only and not in any order of importance:
>
> a) past performance of contractual obligations of the tenderer, corporate structure, any proposed approved subcontractors and any related bodies corporate; (10 per cent)
>
> b) the extent to which the tendered solution is assessed as meeting the function and performance requirements stated in the Statements of Work(s), including the tenderer's proposed supply chain solution and capability; (30 per cent)
>
> c) the extent to which the tenderer's management proposal is assessed as meeting the requirements of the Statements of Work(s); (10 per cent)
>
> d) the extent to which the tenderer is compliant with the draft conditions of deed and the assessed level of risk relating to the negotiation of a deed acceptable to the Commonwealth; (30 per cent)
>
> e) the financial and corporate viability of the tenderer and approved subcontractors to fulfil deed obligations; (not weighted)
>
> f) the tendered prices and pricing structure, including payment terms and discounts; (not weighted)
>
> g) the extent to which the tender response satisfies the Industry Requirements, Australian Industry Capability level and any other Australian Industry Capability objectives of the Request for Tender; (5 per cent) and
>
> h) the tenderer's demonstrated technical capability and quality accreditations to meet the requirements of the draft Statements of Work(s) (15 per cent).

2.53 The allocation of responsibilities to each working group was as follows:

- the Commercial and Compliance Working Group assessed tenders against criteria (a), (d) and (g);
- the Technical and Operations Working Group assessed tenders against criteria (b), (c) and (h); and
- the Finance Tender Evaluation Working Group assessed tenders against criteria (e) and (f).

2.54 The Tender Evaluation Plan provided for financial submissions to be separated out from the matters to be considered by the commercial and compliance, and technical and operations working groups, so that these working groups 'did not have visibility of the pricing information and would not be influenced by pricing in their technical and commercial assessments'.[27]

2.55 The Commercial and Compliance Working Group's report ranked tenderers according to each of the three criteria in relation to the statement of work. The report comprises a narrative

27 Tender Evaluation Plan, 18 September 2015, para 3.4.3, p. 9.

for each tenderer, summarising the key benefits, deficiencies and risks for that tenderer. The report also identifies issues for legal review for each tenderer.

2.56 One of the criteria for evaluation by the commercial and compliance working group related to past performance. The working group assessed claimed past performance of tenders based on information provided by companies in their tender submissions. Defence advised the ANAO that:

> To ensure equitable treatment of all tenderers, not just previous suppliers to Defence and to ensure that there were no undue benefits of incumbency, Defence evaluated tenderers based on the merits of each submission, and conducted assessments of the commercial, technical and operational impact and risk of the individual offers. This assessment included the review of past performance information presented by tenderers in their submission.

2.57 There is no evidence in the report of the Commercial and Compliance Working Group that incumbent companies' claims were tested for validity using relevant performance information—that should have been available in Defence's own systems—to inform the assessment of tenderers' past performance.

2.58 The Technical and Operations Working Group reviewed submissions against the statements of work, using an assessment tool developed for the purpose. The report provides a narrative assessment on each tenderer and a scorecard showing a risk rating, numerical score and qualitative rating against each of the criteria (b), (c) and (h) and their subsets for that tenderer. The report also contains detailed spreadsheets listing each individual item for supply and the relevant information on that item by tenderer.

2.59 The Finance Tender Evaluation Working Group produced an analysis of each tenderer's performance for the two financial criteria in the form of a qualitative statement that addressed the key strengths and weaknesses of each tender and the compliance and risk assessments, as required under the Tender Evaluation Plan. The Detailed Finance Evaluation Report provided a summary of the working group's findings, value for money recommendations and a comparison of suppliers across product offerings. It also included:

- tables showing the lowest priced option by product within each Statement of Work; and
- information on comparative savings on a like-for-like basis.

2.60 Defence advised the ANAO that, in relation to the Finance Tender Evaluation Working Group's responsibilities under the Tender Evaluation Plan, the working group did not rank the tenders, but reached 'a common price identification for comparison which was achieved by identifying the lowest priced bids for each location by product type and delivery method' for consideration in the comparative assessment.

2.61 Defence further advised that at the comparative assessment stage, the Finance Tender Evaluation Working Group modelled various supply chain outcomes at the request of the Tender Evaluation Board Chair to inform the final rankings as detailed in the Source Evaluation Report.[28] Defence advised:

> This was required to inform the final rankings as detailed in the [Source Evaluation Report]. The overall VFM assessment identified the optimal composition of the resultant Deeds consistent with the procurement principles of providing strategic value and benefit to the Commonwealth. Defence does not have a written record of this direction.

2.62 Modelling was undertaken but Defence was unable to locate records of the modelling which underpinned the rankings produced in the annexes to the Comparative Assessment Report. In addition, terminology was inconsistent throughout the report as was the presentation of the analysis of the bids.

2.63 The Tender Evaluation Plan required working groups to produce reports for consideration by the Tender Evaluation Board. Each of the working groups produced their report by early October 2015.

The comparative assessment

2.64 The comparative assessment was stage four of the evaluation process. The Tender Evaluation Plan provided that evaluation team members could conduct 'any comparative analysis and risk assessments as necessary' and set out a detailed process for this assessment and determination of value for money. The results of the comparative assessment were documented in the Comparative Assessment Report. The report provided an understanding of how the Board synthesised the ratings and assessments in the working group reports into final recommendations.

2.65 The Tender Evaluation Board was required to undertake a comparative assessment process, as follows:

> (a) determine a preliminary ranking of tenders for each of the three statement of work service product categories, based on the combined assessment outcome across the tender evaluation criteria …;
>
> (b) this preliminary ranking to be used to determine potential outcomes for each of the Statement of Work (by Annex) service product categories that will provide the required totality of the requirements coverage across all locations and/or all products within the individual Statement of Work [SOW] service product category and then consider tenderers ranked second, third etc sequentially until the totality of the Commonwealth's requirements are met for that SOW service product category …; and
>
> (c) having determined an outcome of one or more preferred tenderers for each statement of work and the optimal allocation of required locations and/or products to each tenderer, the TEB will then consider opportunities provided by any preferred tenderer that offers the potential for integration of services across more than one statement of work, or across all three statements of work, and where that multi-SOW solution may be assessed as resulting in enhanced value for money in the delivery of requirements across locations and/or products...

28 The value for money rankings by product are contained in Appendices H-N of the Comparative Assessment Report.

2.66 The following inputs were also considered in the development of the comparative assessment:

- a risk assessment, which included consideration of the tenderers' financial and corporate capacity;
- advice of Tender Evaluation Steering Group Chair, the Legal Advisor and the Fuels Services Branch Senior Desk Engineer.

2.67 To arrive at a value for money comparative assessment the Tender Evaluation Board was required to make comparative assessments using both weighted and unweighted criteria. The Board also needed to synthesise qualitative and quantitative assessments from the individual working group reports before developing its recommendations to the Delegate.

2.68 The Comparative Assessment Report was signed off on 5 November 2015 by the Tender Evaluation Board, comprising the Tender Evaluation Team Chair and the leaders of the working groups. The report set out the value for money assessment, having regard to:

- the degree to which the Tender meets the Technical, Compliance and Commercial Requirements;
- an assessment of each Tender against its offered pricing proposal; and
- an assessment of the risks and opportunities identified with each Tender.

2.69 The report also set out its methodology for arriving at a value for money conclusion and further noted that 'the overall [value for money] ranking for each statement of work is as per the recommendations for each statement of work'.

2.70 The Comparative Assessment Report is a comprehensive document, which reflects the requirements for the comparative assessment set out in the tender evaluation plan. It contains detailed explanations of the methodology for arriving at its recommendations. The report usefully details matters to be raised in the course of negotiations and some recommendations are predicated on negotiated modifications to tenderer contractual requirements.

The source evaluation report

2.71 The Source Evaluation Report was dated 11 November 2015 and signed off by the Delegate on 18 November 2015. The Source Evaluation Report relies heavily on the Comparative Assessment Report. The report summary affirms the value for money approach as adopted by the Board in the comparative assessment—the 'optimal composition of deeds consistent with the procurement principles of providing strategic value and benefit to the Commonwealth'—and includes a ranked table of preferred tenderers for each Statement of Work. The Source Evaluation Report identified potential savings of $10.69 million per annum, representing a 3.2 per cent per annum saving on the existing deed arrangements.

2.72 Defence followed the tender evaluation process and stages as outlined in its Tender Evaluation Plan, producing the required reports. The Comparative Assessment Report contained assessments, final ranking of tenderers for each Statement of Work and recommendations for the award of the tenders. It also included issues to be addressed in negotiations for each of the successful tenders. However, the methodology for determining value for money for the Commonwealth was complex and difficult to follow.

2.73 In its advice to the ANAO, Defence expressed confidence that its tender process was designed to create a level playing field, reduce the benefits of incumbency and maintain competitive pressure:

> Defence evaluated tenderers based on the merits of their submission and an assessment conducted by discrete TEWGs of the commercial, technical and operational impact and risk of the offers presented by tenderers.
>
> All Defence approaches to the market were conducted via AusTender. Competitive pressures were achieved through the open market tender approach to industry, and the use of a minimal number of RFT essential requirements. The outcome of the procurement demonstrates that a competitive environment was achieved in that:
>
> - [there was an] award of a Deed to World Fuel Services for aviation fuel supply at civilian airports, a company that has not previously held a Deed with Defence;
> - Viva Energy became majority supplier of marine fuel (previously BP); and
> - BP became a supplier of land fuel supply (previous supplier was Caltex only).

The finance evaluation report

2.74 The finance evaluation report was signed off on 2 October 2015 by the two team members. The report set out the assessment of the tenders against the two financial criteria, by 'lowest cost option' and alternative scenarios for each product. The report made value for money recommendations for each statement of work category based on the financial assessment. It also contained a table which estimated approximate whole of life contract values for the preferred tenders.

2.75 Defence advised that, subsequent to the 2 October 2015 report, Fuel Services Branch had requested revised financial assessment costing calculations at the time of the Source Evaluation Report development to ensure consistency in the comparative analysis. The request arose from concerns which had been raised about the working group's financial modelling scenarios used to produce like-for-like comparisons in the assessment tables in the October financial evaluation report.

2.76 Revised financial assessment costing calculations were provided to the Board via email and used in the development of the Source Evaluation Report prior to the Source Evaluation Report being signed off on 11 November 2015.

Tender results

2.77 The outcome of the tender was the award of up to $1.9 billion in contracts over five years from 2016–2021.[29] Caltex, the major supplier under the previous contract, was allocated about 46 per cent of this work, worth up to $867.4 million.[30] BP was initially the preferred tenderer for a

29 This was the commitment approval figure on which the contracts were based. Since it is not possible to predict exactly how much fuel will be consumed and the price to be paid at a future time, Defence approves a commitment up to a maximum amount.

30 The fuel Statement of Work included: military specification fuel, civilian airport fuel, marine fuel, major (more than 100 kilolitres) and minor (less than 100 kilolitres) fuel requirements. Caltex was awarded contracts for a portion of every product under the Fuel Statement of Work except Fuel Drum Stock, which was awarded solely to BP.

number of land fuel sites, but withdrew its offer after inspecting a number of sites, with the result that Caltex, as the second preferred tenderer, picked up those sites. All seven companies which passed initial screening were successful in securing Defence contracts, as set out in Table 1.1.[31] Financial commitment approvals were signed in December 2015[32] and Defence signed contracts between December 2015 and February 2016 thereby ensuring the continuation of fuel supplies.

Did Defence achieve value for money from the procurement?

The 2015 fuels tender and evaluation process was designed to produce a value for money outcome. Defence undertook an open tender process, conducted detailed evaluation of tenders, considered price and non-price value, and applied an industry standard fuel pricing methodology.

Defence's failure to negotiate to attempt to achieve lower prices for some components of the fuel pricing formula before supply contracts were signed compromised its ability to demonstrate that value for money was maximised for the Commonwealth.

Formula based pricing and price negotiation

2.78 A key objective of Defence's tender process was to achieve value for money through the use of industry standard pricing formulae as had been used in the 2010 tender and which had delivered 'significant savings'.[33] The formulae were developed prior to the 2010 tender, when Defence sought external advice from the Portland Group[34] on the applicability of its fuel pricing arrangements, to test the suitability of its then pricing formulae and its competitiveness against industry standards.

2.79 The Portland Group Report found that:

- the then ADF formula for petroleum products was largely inconsistent with standard industry practices for large commercial customers, where a significantly increased level of product transparency was the norm; and
- the components and the strengths and weaknesses of the various formulae were not well understood by [Defence's Joint Fuels and Lubricants Agency], including their impact on Defence's costs and the potential risks inherent in the formulae.

31 Of the eight tenders to progress past initial screening, seven of these went on to be awarded contracts. The remaining tender was a consortium bid from two companies that had also placed individual tenders. While the consortium bid was not selected, both parties to the consortium were successful in securing other elements of the bulk fuel tender.

32 Section 23 of the PGPA Act allows entities to enter into financial commitments and arrangements (including contracts) on behalf of the Commonwealth.

33 Endorsement to Proceed, para 9.1.

34 The Portland Group is a professional services company providing consulting services, including procurement and supply chain services.

2.80 Another factor of significance was the volatility of the market and the Portland Report noted that 'for large consumers with transparent pricing formulas…this risk is visible, and can be managed or mitigated'. Defence is considered to be a large consumer and the report therefore advised that it was essential that Defence understood the discrete cost components that reflected the reality of product supply.

2.81 The report further noted that 80 to 90 per cent of the total cost of the delivered product was attributable to product benchmark and taxes and hence not negotiable. Therefore, Defence's ability to negotiate prices would be dependent on its ability to separate out the 10 other factors listed in the report and negotiate on these individual elements of the pricing profile. The Portland Report reveals that of these 10 pricing elements, two (local freight, and storage and handling), had the greatest capacity for negotiation, five elements had some capacity and three had no capacity for negotiation because suppliers were not likely to surrender relevant information.

2.82 Defence amended its pricing methodology for the 2010 procurement in line with the Portland Group's advice by amending its pricing formula to incorporate the separate elements of the product supply chain. Defence retained this methodology for the 2015 procurement. The Wraith Review in 2013[35] noted that the Defence procurement methodology and pricing formulae was 'sophisticated to the extent that better than Terminal Gate Pricing has been achieved to date'.

2.83 Prior to going to tender in 2015, Fuel Services Branch stated in its Endorsement to Proceed that the pricing arrangement used for the 2011–2015 fuel contracts was 'industry standard' and incorporated a 'traceable and flexible' approach to current world-wide fuel prices. This conclusion was reached following the Wraith review and Defence retained the pricing arrangement for the new tender process.

2.84 Defence advised the ANAO that its current pricing methodology is in line with industry standards for wholesale fuel procurement and takes into account market factors. Defence further advised that:

> Subsequent to [the Portland Group] report, the price methodology applied in the Deeds awarded in 2010 mirrored the [Import Parity Pricing] methodology, a methodology used by large commercial customers that covers costs of all elements in the supply chain to import fuels into Australia…For the 2015 procurement, Defence also used the [Import Parity Pricing] methodology in price adjustment formula and engaged a consultant with extensive industry experience to verify that the methodology was relevant and in line with industry standard.

2.85 The Defence Procurement Policy Manual applicable at the time of the 2015 procurement states that a decision to negotiate might be influenced by the prospect of an improved value for money outcome and that because the price of supplies is a potential area for negotiation, it should form part of the negotiation plan. However, Defence advised the ANAO that because the pricing methodology [specified by Defence in the Request for Tender] 'dictated that price negotiation was not an element of achieving improved value for money', price was not included in

35 Spectrum Energy, External Review of the Defence Fuel Supply Chain and Remediation Program, 31 December 2013, (Wraith Review).

the negotiation strategy.[36] In its advice to the ANAO, Defence did not expand on why the pricing methodology determined that price was not a matter for negotiation.

2.86 The Defence Procurement Policy Manual also states that circumstances where price negotiation may be appropriate include where the contract is to provide for cost plus or incentive pricing. Defence did not have a strategy to negotiate certain cost components and subsequently did not seek to negotiate a reduction in tendered prices at the negotiation phase.

2.87 Defence was seeking to purchase high quantities of fuel and is a regular and reliable customer, consuming approximately one per cent of Australia's total fuel and spending over $400 million per year. The tender process provided Defence with up-to-date comparative information, potentially valuable to negotiating lower prices. Due to the volumes consumed, even relatively small price savings achieved through negotiation could have delivered overall savings to the Commonwealth.

Average pricing methodology

2.88 Defence uses an averaging pricing arrangement to flatten the amount of variability in the underlying price, which fluctuates daily on global markets. Defence might benefit from modelling the outcomes from the averaging pricing arrangement against the actual prices over time to identify whether the averaging arrangement is to its financial advantage and whether it should be retained.

Recommendation no.2

2.89 That, for future procurements within the Fuels Services Branch, Defence conducts an independent evaluation of the 2015 fuel procurement process, strategy and arrangements to inform the next procurement process and maximise a value for money outcome.

Entity response:

2.90 Defence accepts the recommendation to apply to the next open market procurement process for bulk fuels, oils, lubricants and fuel card services.

2.91 Defence will engage a fuel industry specialist to conduct the independent evaluation.

36 Defence advice to ANAO, September 2017.

3. Managing the fuel contracts

Areas examined

The ANAO examined whether Defence's contracting and assurance arrangements were appropriate for effectively managing the fuel supply chain.

Conclusion

Defence's contract management would benefit from improved integration of key information systems and reduced manual intervention, including in the calculation of fuel prices.

Defence's ability to provide assurance over the management of its fuel supply chain is limited by infrastructure and information technology deficiencies and insufficient central data analysis. Defence is currently implementing some short term initiatives to improve central oversight, however significant systems level improvement regarding assurance controls is not scheduled to commence until 2022.

Area for improvement

The ANAO has made a recommendation aimed at improving the management of Defence's bulk fuel contracts, with a focus on strengthening assurance arrangements over the fuel inventory.

3.1 This chapter considers Defence's management of contractual arrangements via deeds of standing offer with its fuel suppliers. The deeds set out the details for determining prices, delivery, payment, performance monitoring and quality. The effectiveness with which Defence manages the deeds and the arrangements with suppliers will impact on the quality of service and the value for money achieved under the contracts.

3.2 Procurement Rules require entities to establish and maintain appropriate systems of risk oversight and internal management. Risk is considered with specific reference to the management of fuel volume discrepancies at Defence fuel installations.

3.3 Defence is in the early stages of implementing its Fuels Transformation Program, a long term reform program to improve the operational efficiency of the fuels network. The program is a consolidated program of works to remediate enterprise risk and reduce the cost of the fuels program.

Are contract management arrangements effective in managing the fuel supply chain?

Defence's processes and controls over the calculation of fuel prices do not provide adequate assurance, with manual processes supplementing inadequate information technology systems. Defence's fuel management inventory system is still not fully integrated with Defence's financial management system.

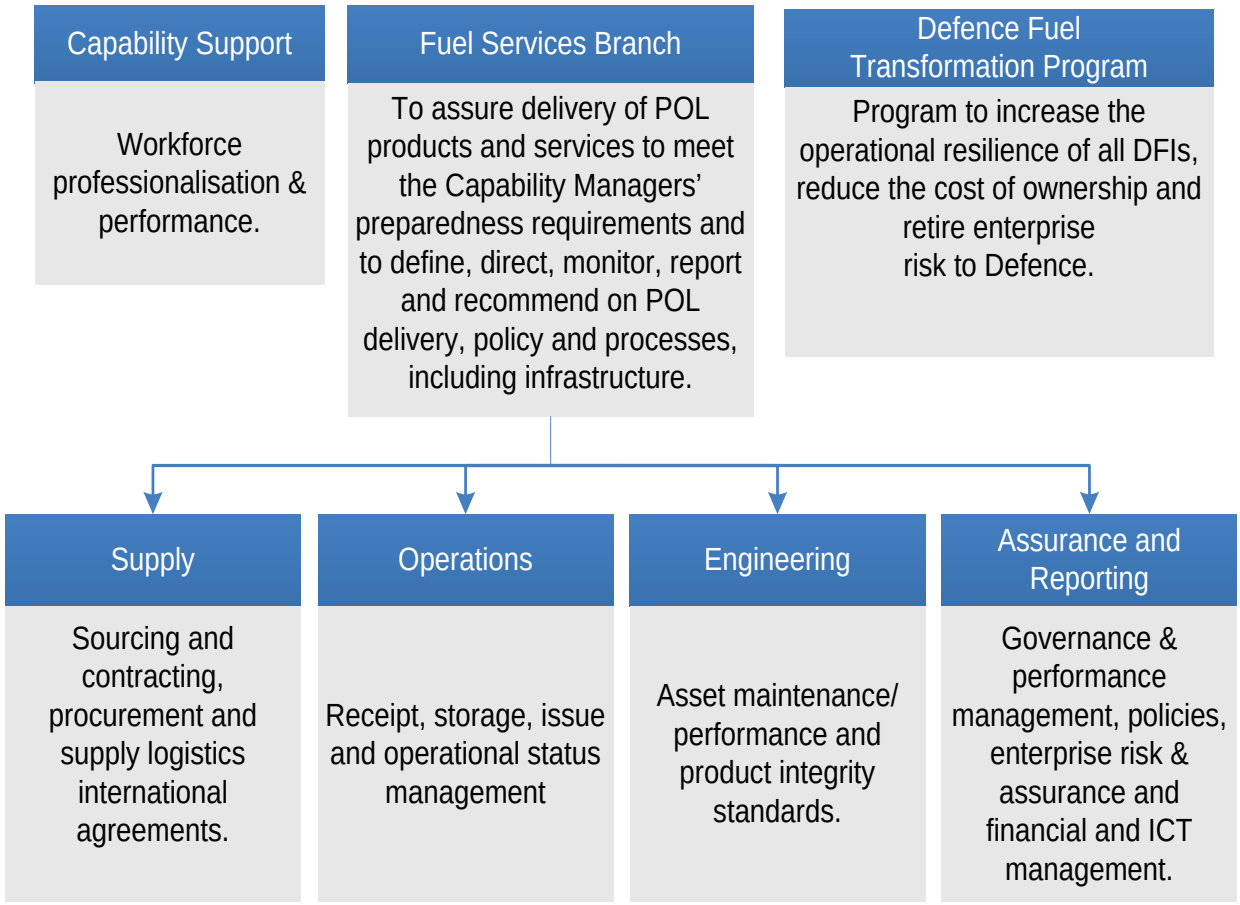
Defence relies on a range of documents to guide contract management and oversight of each supplier's performance. Development of an internal procedural guidance document would assist staff and provide a source of corporate knowledge.

While Defence recognised that it required skills in the fuels services area not immediately available to it on the establishment of the Fuel Services Branch, it continues to rely heavily on contracted services at high cost.

Contract management

3.4 The Fuel Services Branch is responsible for managing the contractual arrangements and for monitoring and review of fuel prices and inventory management. The Fuel Services Branch structure and responsibilities are set out in Figure 3.1.

Figure 3.1: Summary of Fuel Services Branch roles and responsibilities



Source: Defence documents.

Deeds management

3.5 Arrangements for managing the deeds are set out in the individual deeds. The deeds require the contractor, among other things, to keep records and provide to Defence quarterly status reports, attend performance reviews and to develop a risk management register. Defence advised the ANAO that it 'maintains a schedule of key contract administration and governance activities'[37] which are used for deed management purposes. The key documents include:

- the contract manager's master schedule, a register of deeds of standing offer showing dates, value of contract, expiry dates and any change proposals, the dollar value and effective dates;

37 Defence advice to ANAO, September 2017.

- checklists and key performance indicators tracking spreadsheets for both fuels and POL products; and
- administrative arrangements within Fuel Services Branch.

3.6 While Defence tracks the Departmental and supplier activities undertaken in relation to the requirements under the deeds via spreadsheets and checklists, it has not yet developed an internal procedural guidance document within the Fuel Services Branch. Such a document would inform the administration of contracts in a systematic way and provide for the capture of corporate knowledge. Defence advised the ANAO that it is in the process of developing an internal procedural guidance document within the Fuel Services Branch.

Calculation and assurance over prices of fuel

3.7 A major part of the management of the contractual arrangements requires Defence to regularly calculate fuel prices using the fuel price formulae set out in the deeds of standing offer.[38] Defence provides the results to suppliers for their confirmation, prior to formally agreeing the price to be paid for that supply period. The assurance over fuel prices is dependent on accurate manual data input and the confirmation from suppliers that prices are accurate.

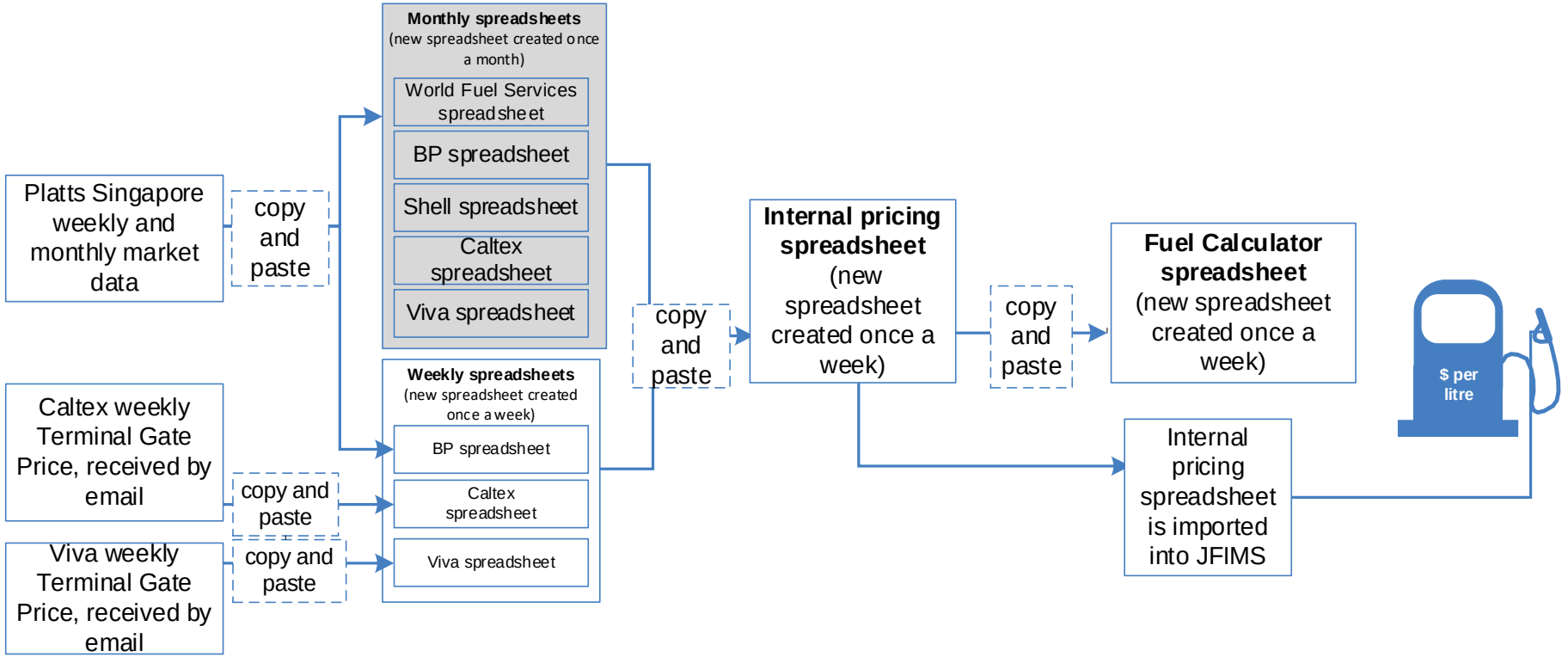
Calculation of fuel prices

3.8 Under the standing offer arrangements, Defence establishes fuel prices according to the contractual formulae in the deeds, with each of its suppliers. The calculations are dependent on factors such as the supplier; the location; the fuel type; and the date. The majority of fuel pricing adjustments are calculated using the average base price of the particular fuel type (such as Platts[39]), for the preceding week or month. The fuel price calculations are obtained through a combination of automated systems and manual effort. A high-level diagram of Defence's process for calculating fuel prices is outlined in Figure 3.2.

38 Under a standing offer arrangement a contract is formed each time the entity purchases a commodity from a supplier. They are an appropriate arrangement for a commodity such as fuel, where the price fluctuates continuously and, in Defence's case, where fuel requirements are irregular.

39 S&P Global Platts is an independent provider of information, benchmark prices and analytics for the energy and commodities markets. See < https://www.platts.com/about >.

Figure 3.2: Defence process for calculating fuel price per litre, per location



Source: ANAO analysis of Defence documents.

3.9 Defence manually calculates the weekly and monthly fuel prices for some 300 locations using spreadsheets, an exercise that is independent of the Joint Fuels Information Management System. The calculation process involves the creation of new spreadsheets each week and/or month, and multiple instances of manual copying and pasting before providing prices to the supplier for comment. Defence then produces the adjusted prices for review by suppliers. Defence has advised that 'the manual copying and pasting of information is intended to ensure commercially sensitive information is managed appropriately, to produce discrete supplier specific files and ensure that commercially sensitive information is disclosed only to personnel conducting price adjustments'. Defence further advised the ANAO that:

> Contractors then validate the adjustments prepared by Defence using their own internal processes/systems; as such any inconsistency in pricing is identified and corrected promptly by both parties (Defence and contractors).
>
> The Defence calculation process ensures a record of each and every price adjustment for each supplier is saved for record keeping and audit purposes.

3.10 In the period from the commencement of the contracts in February 2016 until March 2017, Defence created a total of 370 individual spreadsheets, comprising 3383 worksheets.[40] Defence notes that 'the number of spreadsheets created is commensurate with the frequency of price adjustments, number of suppliers, the contracted price adjustment methodology for each supplier by fuel type, and the number of pricing components of the contracted pricing methodology'. A breakdown of the number of spreadsheets and worksheets created at each stage of Defence's process for calculating fuel prices is provided in Table 3.1.

Table 3.1: The number of spreadsheets/worksheets created, Feb 2016–March 2017

Spreadsheet name	Number of spreadsheets	Number of worksheets
Monthly and Weekly	230	2760
Internal Pricing	69	552
Fuel Calculator	71	71
Total	370	3383

Source: ANAO analysis of Defence documents.

3.11 Consultation with suppliers enables Defence and the fuel supplier to verify the agreed standing offer price to be used for the next supply period in order to avoid significant issues on pricing and invoicing after fuel is supplied.

3.12 Defence maintains that its fuel price calculation arrangements provide adequate assurance. Defence advised the ANAO that:

> The internal Defence documents used to adjust fuel prices were developed in close consultation with each Supplier and to ensure transparency, they are shared with each Supplier immediately following any price adjustment. Suppliers are required to validate the adjusted prices against their own internal processes and will promptly advise when there is discrepancy between the two parties' calculations.

40 Due to the complexity and manual intervention of the price calculation process used by Defence the ANAO was unable to systematically test whether estimated prices were correct.

3.13 The current process for calculating fuel prices, particularly the manual creation of thousands of spreadsheets per annum, increases the potential for input error. Defence advises that there is a process for verifying the prices loaded into the fuels management system:

> Defence does audit the upload of prices into FuelsManager.[41] Since Deed commencement, fuel prices uploaded into FuelsManager have been verified by FSB staff by validating the prices uploaded in JFIMS against the prices contained in the upload file. This process was conducted in working files however individual records were not saved. Since mid Sep 17, FSB have updated this process following development of a Microsoft Excel spread sheet which automates the reconciliation of prices imported into FuelsManager...Check files are now saved as corporate records.[42]

3.14 Defence also advised the ANAO that: all Defence supplier invoices are reconciled to fuel receipts; that there is annual testing of Fuel Services Branch procurement activity under its business process testing controls framework, which includes random sampling of invoice payments; and that Defence Finance conducts random sampling of payment transactions on an ad hoc basis.

3.15 Although the ANAO found no evidence of inappropriate fuel price advice from suppliers, Defence's primary quality assurance mechanism of relying on suppliers to detect and advise on pricing calculation errors exposes Defence to some risk.[43] A more thorough evaluation process over fuel price calculations could provide Defence with a higher level of assurance around the integrity and accuracy of its data and its price determination processes.

Information systems: JFIMS and Roman

3.16 Defence uses two primary information systems to support the management of the fuel inventory and the calculation of fuel prices:

- Joint Fuels Information Management System (JFIMS), which manages demand (volume) and contains some purchase information;
- Resource and Output Management Accounting Network (ROMAN) is the whole-of-Defence financial management system, and includes budgeting, accounting and reporting.

3.17 The relationship between JFIMS, the fuel inventory management system, and ROMAN, the financial management system, is fundamental to assurance of price paid and inventory management. The linkage between the two datasets is important to ensure that the invoiced price and paid price is the same as the fuel price list loaded in JFIMS. Payment is then made in the ROMAN system. However, when data was requested to enable the ANAO to analyse end to end transactions, Defence was not able to provide the linkage required to join JFIMS and ROMAN tables.

3.18 The oil industry has operated integrated and automated fuel management systems since the early 1990s, including automatic fuel gauging and metering software. In 2002, Defence agreed

41 FuelsManager is the commercial name for JFIMS.

42 Defence advice, 12 January 2018.

43 The ANAO sample testing was unable to systematically test whether companies demonstrated any bias in reporting potentially incorrectly calculated prices.

to an ANAO recommendation to develop an integrated fuel management system in order to assist the delivery of consistent, timely data and to make fuel purchasing decisions more effective.[44] In December 2011, nine years after Defence agreed to the ANAO recommendation, JFIMS was implemented.[45] The release of the system was troubled by data, financial and functionality issues.

3.19 At the time of the 2011-12 annual financial assurance audit, ongoing systems limitations within JFIMS had been identified by Defence, including:

- unmet system requirements: relating to integration with ROMAN and other Defence information technology systems (payment was intended to be effected through system-to-system interface with ROMAN); and
- system capability shortfalls: relating to demand forecasting; real-time monitoring and reporting of fuel stocks; discrepancy reporting.

3.20 The ANAO's annual audit of Defence's 2016-17 financial statements identified further deficiencies relating to fuel management such as: 'the untimely recording of consumption and receipts in the JFIMS which results in errors in the book value of fuel calculated by the system; fuel dips not being performed at month and year end which subsequently places reliance on the calculated book value of fuel which is unreliable; and incorrect data used for month and year-end reporting, including negative balances and holdings that are beyond the capacity of fuel tanks'. The ANAO assurance audit report described the deficiencies as 'systemic and [requiring] remediation'.

3.21 Despite the shortcomings described above, Defence advised the ANAO that it considers that current business processes provide reliable data on fuel purchases and consumption:

> The current business processes provide reliable data on fuel purchases and consumption especially given the range of Defence fuel installations in use. Most attention is focused on the 20 main sites accounting for 85 to 95 percent of holdings compared with 80+ sites with relatively insignificant volumes.
>
> The age of the fuel infrastructure and its condition thwarted the original intent for JFIMS to be a single integrated fuels management capability and forced reliance on a mixture of manual and IT systems.[46]

Defence's use of external contractors

3.22 During the course of this performance audit it became clear that the Fuel Services Branch was heavily reliant on the services of specialist contractors. The Fuel Services Branch was established in 2014 with a full-time equivalent (FTE) staffing complement of 45 positions, including five serving personnel positions. Consultant positions are additional to FTE positions.

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44 ANAO Audit Report No.44, *Australian Defence Force Fuel Management*, 24 April 2002, p. 65.

45 In September 2006, the Defence Minister approved the procurement of such a system, stating that the 'project [was] required to introduce a single integrated fuels management capability across Defence to improve the management of its fuel inventory.' In May 2007, Defence released the *Joint Fuels Information Management System Operational Concept Document*, which outlined the capability required to efficiently and effectively manage the procurement, quality control and inventory administration of bulk fuel for the ADF. This included, in part: integration between the fuel management system and ROMAN; forecasting of fuel demand; order, receive and pay for fuel; and discrepancy identification reporting.

46 Defence advice, September, 2017.

3.23 To ensure that the Fuel Services Branch could be staffed by appropriately qualified people with specialist knowledge of fuel chain supply and management, Defence's Fuel Services Branch and its predecessor have relied largely on contracted consultants. Defence has confirmed that five contracts with one firm, totalling more than $20 million, were entered into covering the period June 2013 to June 2018, to provide a broad range of fuel-related services to Defence and a further nine consultants were also contracted over this period.

3.24 While the 2013 Wraith review identified a competency shortfall, it also identified 'significant fuels competency built into end user operations and maintenance'. The report concluded that '[t]his inherent capability provides the opportunity to leverage systems, procedures, skills and competency from the Services into the [Department of Defence] fuels system'.

3.25 Defence has advised the ANAO that there have been two critical areas of knowledge transfer from external expertise to within Defence, in the fuel engineering and fuel assurance areas. Defence further advised that there has been considerable knowledge transfer in the general approach to managing fuel supply chain issues across:

- estate contract management;
- engineering and maintenance management;
- fuel supply agreements;
- implementation/roll out of revised Defence fuel management policy/guidance; and
- supply chain risk management and governance reporting.

3.26 On the establishment of the Fuel Services Branch, Defence had a need for the recruitment of specialist personnel in the fuel services area unavailable to it from within its own ranks. However, the outlay of over $20 million on fuel consultancy services in this area since 2013 from a single firm and the employment of a further nine consultants from other firms, implies a significant reliance on contracted specialist expertise.

Has Defence implemented effective controls to manage fuel volume discrepancies and fraud risks associated with its bulk fuel inventory?

Although Defence has some inventory management controls in place—such as physical security at large fuel installations—key elements of Defence's controls and assurance processes to detect volume discrepancies remain ineffective. Central data analysis is insufficient, and infrastructure and information technology systems require modernisation. These deficiencies have been known about for several years.

Defence is undertaking corrective action to enhance assurance controls and to better manage bulk fuel stocks pending more permanent reforms, which are planned as part of the Defence Fuels Transformation Program.

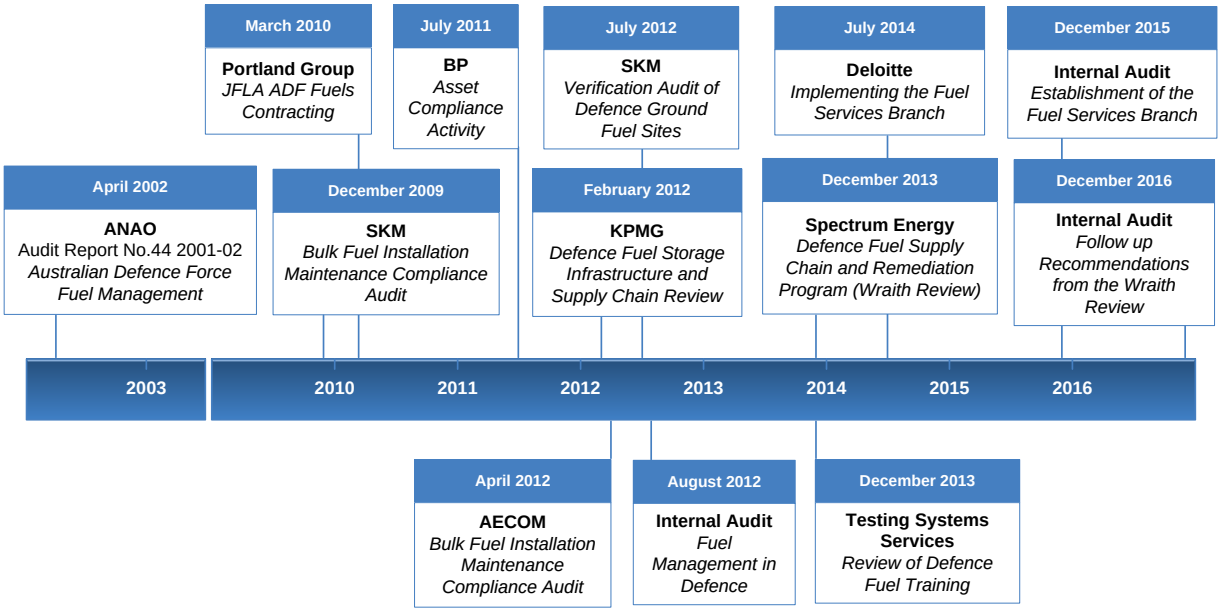
The development of a more contemporary and integrated system for collecting and storing fuel inventory data would strengthen risk management, the control and assurance framework and support more informed fuel purchasing decisions. Improvements to relevant infrastructure, IT and controls under the Defence Fuels Transformation Program are not scheduled to commence until 2022.

Reviews of Defence's fuel supply chain

3.27 Defence's fuel supply chain has been the subject of numerous reviews and audits between 2009 and 2016 (see Figure 3.2—in particular, the December 2013 report *External Review Defence Fuel Supply Chain and Remediation Program* (Wraith Review)). These reviews and audits collectively indicated that limitations in Defence systems increased the risk of fraud, theft or the loss of fuel, finding that Defence had:

- no comprehensive strategic view of fuel storage infrastructure, inventory or fuel consumption patterns and a lack of aggregated fuel management information;
- no assurance of fuel inventory and high exposure to risk, no maintenance records, inconsistent fuel dipping policy, lack of accountability; and
- no formal Defence policy exists for short/long term forecasting and planning (demand, inventory, and supply).

Figure 3.3: Timeline of fuel reviews and audits, 2002–2016



Source: ANAO analysis of Defence documentation.

The 2013 Wraith Review

3.28 A review of Defence's fuel supply chain, the 2013 Wraith Review, found that:

> The existing Defence oil accounting processes across the fuel supply chain and at each [Defence fuel installation] do not measure physical losses by theft or emissions to the environment.
>
> Neither [Defence fuel installations] nor [the Joint Fuel Lubricants Agency] was found to be actively managing losses via oil accounting reconciliation processes. There are no local or central accountability for loss and reactive and proactive loss prevention measures.

3.29 Defence accepted the findings of the Wraith Review (Box 2 below). In 2016 Defence undertook an internal audit of the progress made by the Fuel Services Branch in the implementation of the Review recommendations. The audit concluded that while a good foundation for a sustainable Defence Fuel Supply Chain had been established, the governance framework was relatively immature; and that 'not all recommendations could be implemented as

specified by Wraith or implemented as quickly as required, due to the nature of Defence's business and the broadness of the recommendations'.

Box 2: Wraith Review findings and recommendations (December 2013) (in relation to fuel inventory management and fuel losses)

The Wraith Review findings:

- noting that the collection of reliable and timely data and the prompt evaluation of loss balance trends are necessary elements of a robust fuel inventory management system, Defence's fuel inventory management processes do not measure physical fuel losses;
- fuel losses were not actively managed at the local or enterprise level;
- no one in Defence is accountable for fuel losses or for loss prevention and detection; and
- while there is a high probability of theft occurring, there is no evidence of Defence looking for theft.

The review identified seven actions necessary to improve fuel loss management in Defence bulk fuel supplies:

(a) establish losses of system/tank and implement corrective measures to reduce loss;

(b) develop a loss management scope of works and project plan;

(c) operational staff to take ownership for loss management at each Defence fuel installation;

(d) move to weekly fuel dips with improved (100 per cent) compliance;

(e) implement stock reconciliation at tank/groups of tanks/Defence fuel installations with land temperature measurement;

(f) adopt best practice underground tank loss management system; and

(g) set up for F34 fuels draining minimisation and recovery.

Risk management and current procedures for management of the fuel inventory

3.30 Defence does not have a discrete fuel management risk plan. Defence advised the ANAO that:

> Defence has not undertaken a risk assessment process across fuel management relating to fuel procurement, recording fuel movements at sites or units or financial reporting. Risk is managed by procedures set down in the [Electronic Supply Chain Manual] (VOL 10) for fuel management business process testing for compliance with [Electronic Supply Chain Manual] and ROMAN processes. [Defence] have set procedures for the end of month financial reporting and an independent business process testing framework.

3.31 Management and accounting procedures for the bulk fuel inventory are set out in the Electronic Supply Chain Manual.[47] Procedures in the Manual include the requirement for reconciliation of receipts and issues on a weekly basis and monthly fuel dips, that is, physically checking the tank volumes. Discrepancies at site level are required to be reviewed if movement at the aggregated level is unusual or unexpected—that is if movement is outside the two per cent volume tolerance by fuel type at each site.

3.32 Compliance with fuel network policies and procedures is variable. Defence advised the ANAO that 'fuel inventory management practices…have not always complied with the [Electronic Supply Chain Manual] processes and there have been intervals of poor recording of transactions and dips'.[48] Defence further advised that it is reliant on operating agents in certain small or remote locations to provide fuel dips, which can be less reliable than at the larger sites.

3.33 Defence discovered a large scale theft of fuel at an individual site through an end of month reconciliation in November 2016. The incident, described in Box 3, resulted in an internal audit investigation, which identified significant deficiencies in procedural compliance and physical security at the installation, as well as highlighting the lack of a current IT based central management reporting system that could alert the Fuel Services Branch to discrepancies. In June 2017, the ANAO sought assurance from Defence that the recommendations made in the internal audit report had been implemented and that the issues identified were not replicated across Defence sites.[49] Defence advised that some recommendations—such as the recommendation to conduct site security surveys on all Defence fuel installations—would not be completed until the second half of 2018 or beyond.[50] Defence further advised that, because the nature of the current system did not allow Fuel Services Branch to readily run a central report to identify poor inventory management and accounting practices, local site management is relied on to identify discrepancies, investigate anomalies and input corrective action.

Box 3: Fuel losses at a Defence fuel installation

During the audit the ANAO became aware that Defence was investigating reports of losses of large volumes of fuel at one of its fuel installations. Following an initial investigation into fuel losses of 36 000 litres at this fuel installation, identified in end of month accounting in November 2016[51], physical fuel dip records confirmed the 'misappropriation' of approximately 200 000 litres of aviation fuel, including the 36 000 litres from the fuel installation during the 2016 calendar year.

47 The manual's chapter on Management and Accounting for bulk fuel inventory 'aims to detail the policy and procedures to be used when Demanding, Receiving, Issuing, Sales and Accounting for bulk fuel'.

48 Defence advice to ANAO, 8 June 2017.

49 See Appendix 4.

50 Defence advised the ANAO that it does not intend to conduct site security surveys on all fuel sites, instead, it will conduct such surveys at 'selected sites representative of differing [types of Defence fuel installations] and develop standardised protective security overlay and controls that can be implemented across sites as required'.

51 Defence's end of month accounting close process has the ability to highlight discrepancies in terms of total values but Fuel Services Branch does not yet centrally manage discrepancies in the fuel inventory.

Box 3: Fuel losses at a Defence fuel installation

Defence also identified large variances of aviation fuel between January 2015 and December 2016, totalling over 750 000 litres at the same fuel installation. Defence advised that it was unable to determine whether there were any actual fuel losses in 2015 or in previous years, because the fuel dipping system at that site had been configured to overwrite data on an annual basis.

The fuel loss incident prompted Defence to undertake an audit of its fuel inventory management system. The resulting audit revealed the following major defects:

- a breakdown of fundamental compliance with the Electronic Supply Chain Manual procedures across a number of years, resulting in a lack of suitable local site management of fuel inventory practices; and
- the lack of a current IT based central management reporting system that can alert the Fuel Services Branch to discrepancies.

The Defence audit also identified specific shortcomings in Defence's management of fuel inventory at both the local and the enterprise level, which included:

- instances of physical fuel movements from the fuel storage tanks not being recorded in Defence's fuel inventory management system;
- a pattern of significant and regular fuel discrepancies in the preceding 12 months of data examined by the review;
- shortcomings in Defence's management of its electronic fuel dipping system, including that it was configured to retain only 12 months of fuel data, and a history of unreliability that had gone unchecked;
- the failure to generate exception reports to highlight fuel volume discrepancies;
- the configuration of its fuel management system to reset the variance between the physical dip and the fuel volume in the system to zero at the beginning of each month, a practice described by the 2013 Wraith Review as questionable;
- deficiencies in security arrangements for protecting Defence's fuel stores from harm or fraud[52];
- non-adherence to Defence fuel management procedures; and
- out of date, unclear and incomplete fuel management procedures, and inadequate training for fuel inventory management.

52 For example, no CCTV cameras positioned to detect access to the bulk fuel storage facilities; no protective security measures in place to prevent unauthorised access to the switch for the electronic fuel dipping system thereby allowing the system to be bypassed; poor security of the keys to the facilities; and some entrances to the fuel farm did not have locks fitted. One of the recommendations from the review is that Defence conduct site security surveys at all fuel sites.

Physical security at fuel installations

3.34 Defence advised the ANAO that the focus for 2017 was on educating Defence personnel on security requirements, determining priority sites and estimating potential costs and funding to deliver improved security outcomes. In addition, the Commonwealth Protective Security Framework is being rolled out across Defence from 1 January 2018. This framework will replace the Defence Security Manual and will provide for Commander Joint Logistics (CJLOG) to become the control owner for security relating to the Defence fuel supply chain, with particular attention to Defence fuel installations, which is not within that position's current scope of responsibility. To support these changed security arrangements, Defence has prepared a security manual for the management of security related risks associated with the storage, handling or transport of bulk petroleum fuel within the Defence Fuel Supply Chain. This document will be used by Fuel Services Branch to develop the security requirements for each fuel installation, taking into account their specific characteristics.

3.35 Defence advised the ANAO that the following assurance security controls are currently in place:

- Defence personnel undertake mandatory training on security, fraud awareness and ethics and are held accountable for their actions;
- Defence personnel reference the Defence Security Manual (DSM) to determine the appropriate security measures required, based on risk;
- Defence fuel installations are generally located on Defence bases which have significant access controls and identity management, including: photo identification passes, traffic barriers, security fencing and lighting and security patrols;
- in most situations these installations are also separately fenced with their own access controls including passes, traffic barriers, security lighting and patrols, key safes, alarms and CCTV;
- the fuel installations do not operate automatically and require either operator assistance or a swipe card to be used before any fuel can be moved; and
- there is appropriate segregation of duties at major installations, supported by detailed transaction records for receipts and issues, and end of day dipping.[53]

Planned improvements to management and assurance systems

3.36 Defence has known of the deficiencies in its fuel management and assurance systems for several years. Deficiencies include an underinvestment in fuel infrastructure and inadequate governance and compliance activity. Defence's 2017 Future Fuel Network Implementation Strategy notes that:

> There is a lack of effective and integrated tank telemetry to give real-time visibility of critical [Defence fuel infrastructure] information such as stock on hand and fuel movements. Such weaknesses contribute to imperfect portfolio accounting outcomes, increased fraud and a lack of timely detection of errors.

53 Defence advised the ANAO that these procedures were in place at all Defence installations within Australia as at 3 November 2017.

> … compliance and assurance programs are not supported by systems and adequate reporting controls, increasing the risk of incidents and non-compliances.

3.37 Defence confirmed to the ANAO that there is currently no central management of compliance with tolerances through variance analysis. Defence explained that the data structure of their fuels management software does not allow for this process to be undertaken easily or conducted within reasonable timeframes.

3.38 In a November 2017 minute to the service chiefs the Commander Joint Logistics sought assistance to reinforce with local unit commands, base support managers and with Defence and contracted Operating Agents: the importance of accurate and responsive reporting of all fuel incidents and near misses; effective risk assessments during non-routine activities; and maintaining accurate fuel inventory records and dipping of tanks in accordance with extant policy.

3.39 In addition, Defence advised the ANAO that it is currently working to produce a global report on variances using an interim data warehouse and reporting tool that captures data on a daily basis. The aim is to have this report finalised by no later than 9 February 2018.

3.40 In the longer term – through the Defence Fuels Transformation Program—Defence is seeking to establish minimum IT software and hardware requirements for each Defence installation and to automate fuel monitoring, especially tank gauging, transactional volume data capture, common IT encrypted communications and centralised assurance reporting. Funding for this program has been earmarked in the 2016 Integrated Investment Plan. The program of work is to be undertaken across 2018–19 to 2026-27, with anticipated expenditure of $600 million to $700 million over that period. Defence will focus on retiring immediate workplace health and safety risks and strategic infrastructure upgrades.

3.41 Infrastructure, IT and control improvements are not scheduled to commence until 2022 pending government approval. Defence considers that, while estimated program funding is adequate to accomplish the infrastructure and related hardware/software changes needed, any acceleration of the program may not be able to be supported by industry, thereby limiting the opportunities for accelerating risk remediation.

3.42 While there is still no centralised fuel volume management currently being undertaken by Fuel Services Branch, Defence is taking steps to introduce centralised monitoring and reporting in 2018 with a view to longer term enhancements. Until the necessary reforms are made, Defence will continue to carry both fraud and reputational risk. The ANAO has made a recommendation to improve Defence’s capacity to manage its fuel inventory at its bulk fuel facilities.

Recommendation no.3

3.43 To improve the management of its bulk fuel inventory, Defence should implement arrangements to provide assurance that control arrangements are working as intended.

Entity response:

3.44 Defence accepts the recommendation.

3.45 In accordance with the Defence Fuel Transformation Program, Defence will continue to implement changes to the existing Defence controls framework across fuel inventory management to incorporate:

- *enhanced physical security measures and accountabilities;*
- *enhanced assurance for fuel price calculations, uploads and invoice verification;*
- *centralised monitoring and analysis of fuel transactions, movements and variances; and*
- *up-to-date integrated tank gauging, metering, automated data capture and real time encrypted communications at Defence fuel installations.*

Grant Hehir
Auditor-General

Canberra ACT
19 February 2018

Appendices

Appendix 1 Department of Defence response

Australian Government
Department of Defence

Mr Greg Moriarty
Secretary

Vice Admiral R.J. Griggs, AO, CSC
Acting Chief of the Defence Force

SEC/OUT/2017/341
CDF/OUT/2017/1110

Mr Grant Hehir
Auditor-General
PO Box 707
Canberra ACT 2601

AUSTRALIAN NATIONAL AUDIT OFFICE (ANAO) SECTION 19 PROPOSED REPORT - DEFENCE'S PROCUREMENT OF FUELS, PETROLEUM, OILS, LUBRICANTS, AND CARD SERVICES

Dear Mr Hehir

Thank you for your correspondence, which contained the Section 19 Proposed Report for the ANAO performance audit – *Defence's Procurement of Bulk Fuels, Petroleum, Oils, Lubricants and Card Services*. We thank you for undertaking this audit, and appreciate the opportunity to review and comment on the Section 19 Proposed Report.

Defence acknowledges the issues detected by the ANAO in their Section 19 Proposed Report and agree with the approach moving forward via the proposed recommendations. To rectify these already known issues, Defence has established the Defence Fuel Transformation Program. This program is funded within the Integrated Investment Program and we will be seeking Government endorsement of the Program in mid-2018 to progress the activity.

Attached to this letter are Defence's Proposed Amendments, Editorials and Comments (**Annex A**), Defence Responses to Recommendations (**Annex B**) and Defence Agency Response (**Annex C**). These constitute Defence's formal response to the Section 19 Proposed Report.

Defence remains committed to assisting you with the successful completion of this audit. We look forward to the release of the upcoming Final Report.

***Defending Australia** and its National Interests*

Defence will inform the ANAO of the outcome of the investigation in the Conflict of Interest matter that has been referred to Fraud Control and Investigations Branch in due course.

Yours sincerely,

Greg Moriarty
Secretary

18 December 2017

R.J. Griggs AO, CSC
Vice Admiral, RAN
Acting Chief of the Defence Force

20 December 2017

Annexes:

A. Defence's Proposed Amendments, Editorials and Comments
B. Defence's Response to Recommendations
C. Defence's Agency Response

Appendix 2 Kiah Consulting response

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IN-CONFIDENCE

22nd January 2018

Mr Brurono
Executive Director – Defence Performance Audit
Australian National Audit Office
(by email: david.brunoro@anao.gov.au)

Dear Mr Brunoro,

ANAO Review of the Defence Fuels Procurement

Thank you for the opportunity to make comment on the draft report into Defence's Procurement of Fuels, Petroleum, Oils, Lubricants and Card Services, due to be tabled in February 2018. We were provided with two excerpts: one on Probity management and the other on Defence's use of external contractors.

We have not been provided with the conclusions or recommendations and therefore our comments reflect only on the text provided and inferences made.

The two specific issues raised relating to Kiah are:

- a probity issue with one of the consultants, and
- the engagement of consultants, their cost and their appropriate engagement over public sector staff.

Probity management

A process weakness with the handling of documentation was identified. We confirm that this was not related to Kiah and note that that there is no suggestion of impropriety.

Given our business is largely the bringing of commercial acumen to the public sector, we seek to avoid unnecessary controversy by routinely declaring the history of our consultants. In this case the consultant was a "poacher turned gamekeeper". We seek to be clear that there was no personal gain to be had through influencing the outcome of the contracting arrangements, nor has there been any suggestion of inappropriate behaviour. The industry might not enjoy Defence becoming a more knowledgeable buyer, but prior employment of itself does not constitute a probity issue.

Defence's use of external contractors

The Report comments on the level of consultancy support provided to Fuels Services Branch. It highlights that one company was contracted for around $20m over five years. It is a simple matter to identify through public records that Kiah Consulting is the company in question.

We offer some depth to the Report's observations.

According to the Report, there is the Kiah team and nine other consultants in the Fuels Branch. The Kiah team forms about 50% of the contracted support. We understand that the majority of non-Kiah consultants are independent contractors attracting substantially the same rates as us, or better. We provide a managed service ensuring alignment of consultant activity with the Defence strategy. It includes training and consultant

development, additional support at no cost, oversight of quality and a commitment to an adaptable and continuous workforce. We are surprised that there are any independent contractors.

Of the five contracts awarded to Kiah, two were minor and three were competitively tendered. The first two contracts were in place before the Fuels Branch existed, one to assist in the procurement previously mentioned and the other to do a small piece of work aligning the activities to redress fuels non-compliance issues. We assisted in mobilising the response to the Wraith review, providing interim staffing pending the establishment of Fuels Services Branch.

Having established the core of the Branch, Defence initiated a competitive tender against a clear scope of work. We were successful. That contract had another year to run when it was terminated early by Defence to again compete us in the market. We were successful in one contract and partly successful in the other. We have repeatedly and competitively demonstrated value for money.

Consultants with decades of experience, in our case industry practitioners not theorists, command high salaries. In the early contracts we provided some support staff, they attracted a much lower rate. Over time and the various contracts, the consultant mix and tasking has changed to meet the developing needs of Defence.

The reference to the Wraith Review observation that there are pockets of expertise in Defence that could provide this staffing is mistaken. The Wraith Review was useful in challenging Defence to think differently about its management of its fuel supply, but many of his recommendations were misguided as they lacked the context of Defence primary purpose. This recommendation falls into that category. The staff in question operate fuels facilities and provide the military a deployable capability. To centralise that expertise would denude the operational capability.

The suggestion that consultants can be replaced by public service staff is erroneous in this case. That is a reasonable position where contractors are used as surrogate staff, but use of consultants to inject diverse thinking and industry knowledge is appropriate. In this we think Defence has acted wisely in sourcing industry expertise that is simply not accessible through the public sector. It was, after all, the lack of expertise in the public sector that gave rise to the problems to which Wraith refers.

No view is formed in the Report on value for money. The Kiah team has been at the forefront of the deployment of contemporary risk management, workplace and environmental and safety practices across Defence. This has been led by people who did the same task for the major fuels companies, adapting many of their practices to the Defence environment, at a fraction of what it cost the industry.

More measurably, in just three examples:

- the aligning of the fuel procurement with contemporary industry practices, and negotiation support, assisted in a reduction of annual fuels costs of $10m or more;
- the provision of industry knowledge and commercial advice turned the cost of disposal of "de-specified fuel" to a positive return of $3m pa to the budget; and
- assisting in the consideration of options on complex supply chain decisions has avoided over $200m of unnecessary infrastructure expenditure thus far.

None of this would have been realised without our assistance, or Defence would have surely have already reaped those benefits. Our diversity and experience, in conjunction with the Defence team, has delivered demonstrable value.

We are pleased and proud to work with Defence. We seek to do good work and provide value for money. The numbers, both in competition and return on expenditure, give substance to that claim. Defence has sought support, not taken our word but examined alternatives, used us initially to address an urgent staffing gap and now to provide industry insight and expertise. We have built a team around the Defence problem, and a model of working that integrates Defence and us in delivery with a view to re-establishing a self-reliant Defence capability operating safely at contemporary standards.

We are disappointed that the Report fails to acknowledge that Defence has, in fact, engaged wisely to combine contemporary industry and Defence expertise to deliver some extraordinary and rapid outcomes.

Your sincerely,

John Glenn
Managing Director
Kiah Consulting

Appendix 3 Request for Tender—Statements of Work

Three separate statements of work were attached to the Request for Tender, comprising (i) bulk fuels, (ii) petroleum, oils and lubricants (POL) and (iii) card services. The statements of work were further sub-divided into categories as follows:

- Attachment A-1—statement of work for fuels:
  - military specification fuels deliveries into Defence Fuel Installations (DFIs);
  - civilian airports inclusive of refuelling and defueling;
  - marine fuels direct into vessel;
  - land fuel deliveries into DFIs where estimated annual deliveries exceed 100,000 litres; and
  - land fuel deliveries into DFIs where estimated annual deliveries are less than 100,000 litres;
- Attachment A-2—Liquid fuels, POL (including drum stock):
  - military specification oils, lubricants and allied products;
  - commercial oils, lubricants and allied products; and
  - fuel drum stock;
- Attachment A-3—card services:
  - aviation fuel cards; and
  - commercial fuel cards.

Appendix 4 Fuel products required by the Australian Defence Force

Table A.1 lists the ten different fuel products required by the Australian Defence Force (Defence).

Table A.1: Summary of fuel products used by the Australian Defence Force

Service	Fuel type	Commercial or Military
Navy	Marine diesel fuel	Commercial
	Intermediate fuel oil (IFO180)	Commercial
	Naval distillate (F76)	Military
	Avcat (F44)	Military
Army/Joint	Unleaded petrol (ULP)	Commercial
	Automotive diesel fuel	Commercial
	Ethanol Blended (E10)	Commercial
Airforce	Avgas	Commercial
	Avtur (Jet A1/F35)	Commercial and Military
	Avtur (F34)	Military

Source: ANAO analysis of Defence documents.

Appendix 5 Recommendations from the March 2017 fuel management audit at a Defence fuel installation and target implementation dates

Recommendation		Agree/ Disagree	Target date[a]
Joint Fuels Inventory Management System Discrepancy Notification			
1	An automated discrepancy notification function should be incorporated into Joint Fuels Inventory Management System (JFIMS) to provide an alert to discrepancies that fall outside of tolerance between the physical dip and the book inventory (volume).	Agree	1 Jul 18
2	The automated discrepancy notification should be visible at both the local and enterprise level, noting it should be a summarised report that is received at the enterprise level.	Agree	1 Jul 17
3	The discrepancy notification period (for example weekly, monthly or other) should be based on sound risk management principles and aligned with Fuel Services Branch risk tolerance levels.	Agree	1 Jul 17
Electronic Supply Chain Manual Fuels Policy Review			
4	**Fuel Policy Review Working Group**—A working group should be formed to review Electronic Supply Chain Manual. The working group should consist of key stakeholders.	Agree	1 Jul 17
5	**Industry Representation—**An industry representative with currency in the fuels domain should be included on the working group panel. Defence's rationale for disagreeing with this recommendation: Defence is drafting amendments to the Electronic Supply Chain Manual based on an internal workshop.	Disagree [See Defence rationale at left.]	1 Jul 17
6	**Policy Currency—**The Electronic Supply Chain Manual should align with any change in industry regulations, policy, standards or better practice principles and operations (e. g. Australian Standard 1940—2004: The storage and handling of flammable and combustible liquids has recently been reviewed).	Agree	1 Jul 18
7	**Industry Benchmarking**—A benchmarking exercise against industry procedures, processes and standards should be incorporated into the fuels policy review.	Agree	1 Jul 18
8	**Policy Irregularities and Inconsistencies**—Policy anomalies and ambiguity should be removed and/or clarified. This includes all supporting documents, flowcharts, and forms. Whilst some functional points of contact are located on the Fuel Services Branch intranet webpage, to enhance efficiency and productivity (particularly at the Unit level), this information should be expanded and duplicated in the relevant fuel policy sections.	Agree	1 Jul 17

Recommendation		Agree/ Disagree	Target date[a]
9	**Policy Irregularities and Inconsistencies**—Electronic Supply Chain Manual Policy states 'if a Site/Asset consistently fails to undertake Goods Receipting within (sic) 24 hours (one working day) of having taken full delivery of the fuel then Fuel Services Branch will escalate the matter to Defence Fuels Services Branch' (sic) (Electronic Supply Chain Manual V04S08C21 Para 31). The Electronic Supply Chain Manual does not state which area in Fuel Services Branch is responsible for escalating the matter. Additionally what does "consistently" mean in practical terms. This should be further defined (for example is this two times a month, two times a week or two times a day?).	Agree	1 Jul 17
10	**Policy Irregularities and Inconsistencies—**Policy states 'If an ADF Site has taken delivery of fuel yet they are unable to access JFIMS (i.e. the Defence IT network connectivity at the site is temporarily disabled), then Fuel Services Branch is responsible for completing the Goods Receipting process in the JFIMS and ROMAN (Defence's finance system) within 24 hours (one working day) of the Goods being receipted into the ADF Site.' (Electronic Supply Chain Manual V04S08C21 Para 30). Clarity should be provided to the end user regarding how this process is enabled and implemented (who and how to notify Fuel Services Branch). Policy should be clear which Fuel Services Branch functional area is responsible for completing the Goods Receipting process in the JFIMS on behalf of the Unit.	Agree	1 Jul 17
11	**Fuel Audit Business Process Tool**—The existing fuel auditing tool should be reviewed to ensure that it remains aligned with any changes resulting from the fuel policy review. The fuel audit tool should test key risk areas that have been determined by: • Using sound risk management principles. • Consultation with subject matter experts. • Consultation with key stakeholders.	Agree	1 Jul 17
Consolidated Fuels Management System			
12	Consideration should be given to implementing an integrated fuels management system that will interface SCADA (fuel dipping software) movements into the JFIMS and allow the JFIMS to calculate a continuous balance. This will identify when an investigation should occur into variances that fall outside of defined fuel discrepancy tolerance levels between movements and dips.	Agree	1 Jul 19
13	If the previous recommendation is not implemented, then regular reconciliations (minimum monthly) should be done between SCADA data and the JFIMS movements. Where necessary the JFIMS should be adjusted to show all SCADA movements. Regular data analysis should be done on JFIMS data (minimum monthly) with variances outside of defined fuel discrepancy tolerance levels investigated.	Agree	1 Jul 17

Recommendation		Agree/ Disagree	Target date[a]
Define Fuel Discrepancy Tolerance Levels			
14	A working group with key stakeholder membership should be established to define Fuel Services Branch fuel discrepancy tolerance levels for inclusion in the Electronic Supply Chain Manual. Defence's rationale for disagreeing with this recommendation: Tolerance level set at 2 per cent after consultation with fuel industry specialists.	Disagree [See Defence rationale at left.]	1 Jul 17
15	The working group should include an industry representative with currency in the fuels domain. Defence's rationale for disagreeing with this recommendation: Consultation with fuel industry specialists has already occurred.	Disagree [See Defence rationale at left.]	1 Jul 17
16	Fuel discrepancy tolerance levels should be tailored to suit the process, type of fuel holding or volume of fuel, as variations will occur depending on the site and the storage vessel. The adjacent picture demonstrates the volume difference between a Vertical Storage Tank and a Quality Control and Inspection Tank. Discrepancy tolerance levels should be defined against fuel assets and processes that could include but not be limited to: a) Vertical Storage Tank b) Quality Control and Inspection Tank c) Tankers/Drums d) Issues e) Disposals f) Receipting	Agree	1 Jul 17
17	Fuel discrepancy tolerances should be further defined by a percentage and/or litre value (for example Vertical Storage Tank = the greater of 1 per cent or XYZ litres of the total Vertical Storage Tank fuel holding).	Agree	1 Jul 17
Review Electronic Supply Chain Manual Forms—Electronic Supply Chain Manual forms, documents and flowcharts should be reviewed. The review should include, but not be limited to, the following key elements:			
18	**Streamline**. Reduce duplication of information recorded in the system where possible. To the lay person it appears that much of the same data is repeated on numerous forms. Restructuring and rationalising some of the forms would have the additional benefit of creating efficiencies	Agree	1 Jul 17
19	**Concealment** Fuel policy that is concealed in Annexes and supporting flowcharts should be in relevant overarching Electronic Supply Chain Manual and fuel policy statements and not buried in supporting documentation where it is easily missed.	Agree	1 Jul 17

Recommendation		Agree/ Disagree	Target date[a]
20	**Electronic Supply Chain Manual Recommended Forms to Reflect Policy Requirements**. Whilst forms included in fuel policy are generally 'recommended for use' and 'examples', they should still meet policy minimum requirements. Additionally, the Operating Agent-Manager (OA-M) is no longer referred to as an OA-M; the audit team was advised by Fuel Services Branch Governance and Reporting on 27 Feb 17 that this term is now referred to as the Operating Agent (OA). To avoid confusion, this should be amended in the Electronic Supply Chain Manual.	Agree	1 Jul 17
Fuel Policy Dispensation			
21	Develop a mechanism to enable a request for dispensation in the event that a minimum fuel policy requirement cannot be met. Consideration should be given, but not limited to, the following elements: a) The dispensation authorisation level (i.e. Director General Fuel Services / Commander Joint Logistics). b) Completion of a risk assessment that will form part of the approval process. c) A risk mitigation strategy that is applied that identifies control/s to mitigate the risk/s. d) Formal mechanism to apply for, and to receive, dispensation approval. e) Process to monitor dispensation.	Agree	1 Jul 17
JFIMS Training			
22	Fuel Services Branch in conjunction with Defence Learning Branch should conduct a JFIMS training review to determine currency and confirm that it continues to meet the desired learning outcomes.	Agree	1 Jul 19
23	If JFIMS training is deemed insufficient, then a Training Needs Analysis (TNA) should be undertaken to ensure the IFIMS training package continues to allow employees to attain the skills, concepts and attitudes required within the fuel environment and that it transfers into the operational workplace. Defence rationale for disagreeing with this recommendation: Currently, there are six FuelsManager courses available on CAMPUS (on line). These tailored to the type and level of work performed at the DFI. Additionally, Varec, has been engaged by Fuel Services Branch to undertake training review to ensure all courses are current to functionality. FM-D will be upgraded to V9 and Varec will assist Fuel Services Branch to bring courses up to date.	Disagree [See Defence rationale at left.]	N/A

Recommendation		Agree/ Disagree	Target date[a]
Protective Security			
24	Fuel Services Branch should approach EIG formally to confirm if BIL have been assigned to all Defence fuel installations.	Agree	1 Aug 17
25	If it is revealed that BIL have not been assigned, Fuel Services Branch should formally request that EIG assign BIL to all Defence fuel installations.	Agree	1 Aug 17
26	Site security surveys on all Defence fuel installations should be conducted to ensure that the security overlay is appropriate to the assigned BIL. Defence comment: Fuel Services Branch will conduct audit program at selected sites representative of differing DFIs types and develop standardised protective security overlay and controls that can be implemented across sites as required.	Agree [in part—see Defence comment at left]	1 Aug 18
27	A working group should be established to determine if a standard and consistent protective security overlay should apply across all Defence fuel installations. The working group should include membership from subject matter experts and practitioners in the security and fuel domains (e. g. EIG, DS&VS, JLC Security, Fuel Services Branch Governance, and Defence Fuel Operators).	Agree	1 Aug 17
28	Once the protective security overlay has been determined, Fuel Services Branch should engage DS&VS to discuss viability incorporate these requirements in the Defence Protective Security Framework.	Agree	1 Aug 18
Better Define Functional Areas, Roles and Responsibilities in the Electronic Supply Chain Manual			
29	To make it as easy as possible for the end user, the Electronic Supply Chain Manual should clearly define functional areas and positional contacts where appropriate.	Agree	1 Jul 17
EIG Maintenance and Garrison Support			
30	Fuel Services Branch should engage EIG and request that [the relevant Defence unit] be included in the EMOS contract.	Agree	1 Aug 17
31	The audit team acknowledges that while the EMOS contract is not an Fuel Services Branch responsibility, Fuel Services Branch should make every effort to engage EIG to seek a suitable resolution to the existing issues. This issue has a direct result on efficient and effective operations of the fuel farm, and the risk is shared by numerous stakeholders including EIG and JLC. To meet compliance and resolve rectification works, [the relevant Defence unit] need the ability to report and track jobs.	Agree	1 Aug 17

Note a: Director General Fuel Services Branch has assigned responsibility for the implementation of the recommendations to the Director Fuel Assurance and Reporting.

Source: Defence documents.

Appendix 6 Abbreviations

ADF	Australian Defence Force
CAR	Comparative Assessment Report
CASG	Capability Acquisition and Sustainment Group
CJLOG	Commander Joint Logistics
DFI	Defence Fuel Installation
DSM	Defence Security Manual
EIG	Environment and Infrastructure Group
ESCM	Electronic Supply Chain Manual
FNR	Fuel Network Review
FSB	Fuel Services Branch
FTE	Full Time Equivalent
JFIMS	Joint Fuels Information Management System
JLC	Joint Logistics Command
MilSpec	Military Specification
OLAP	Oils, lubricants and petroleum
PGPA	*Public Governance, Performance and Accountability Act 2013*
ROMAN	Resource and Output Management Accounting Network
SER	Source Evaluation Report