

The Auditor-General
Audit Report No.26 2000–2001
Performance Audit

Defence Estate Facilities Operations

Department of Defence

Australian National Audit Office

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Canberra ACT
22 December 2000

Dear Madam President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Department of Defence in accordance with the authority contained in the *Auditor-General Act 1997*. I present this report of this audit, and the accompanying brochure, to the Parliament. The report is titled *Defence Estate Facilities Operations*.

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

Yours sincerely



P. J. Barrett
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

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Contents

Abbreviations	7
Summary and Recommendations	
Summary	11
Background	11
Conclusion	12
Key Findings	13
Recommendations	17
Audit Findings and Conclusions	
1. Introduction	21
Defence Estate Organisation	21
Estate Operations and Planning Branch	23
The audit	24
2. Corporate Governance	26
Strategic management of the Defence Estate	26
Service Level Agreements	26
DEO budgetary framework	27
FACOPS Program budget	31
Total Estate Management	33
Purchaser-provider arrangements	36
Conclusion	39
3. Contract Management	41
Regional Contract Transition Strategy	41
Contract management in the Regional Estate Centres	43
Approval process and payments of contracts	52
Staff	53
Contract monitoring	56
Access to contractors' records and assets	56
Call Centres	57
Conclusion	58
4. Regional Estate Operations Bid Process	60
Bid process	60
Consistency	62
Clients and the bid process	63
Regional Facilities Committees	64
Asset Maintenance	66
Importance of a region-wide focus	67
Impact of plans for the future	67
Conclusion	68

5.	Financial Management	70
	Financial allocations	70
	Planned expenditure and delivered works	71
	Expenditure targets	74
	Conclusion	79
6.	Defence Estate Management System—Facilities Maintenance	80
	Background	80
	DEMS/FM use and problems	81
	DEMS/FM Development Team	86
	Plans for DEMS/FM	86
	Management of DEMS/FM	87
	Conclusion	88
Appendices		
	Appendix 1: Strategic Plan for the Defence Estate—Facilities Operations	91
	Appendix 2: Purchasing requirements	97
	Appendix 3: Performance audits in Defence	100
	Index	101
	Series Titles	103
	Better Practice Guides	105

Abbreviations

AM	Asset Maintenance
AMF	Asset Maintenance Forum
ANAO	Australian National Audit Office
ASEOP	Assistant Secretary Estate Operations and Planning
CEI	Chief Executive Instruction
CMC	Comprehensive Maintenance Contract
CNN	Central and Northern New South Wales
CSP	Commercial Support Program
DEE	Defence Estate Executive
DEFMIS	Defence Financial Management Information System
DEMG	Defence Estate Management Guide
DEMS	Defence Estate Management System
DEMS/FM	Defence Estate Management System—Facilities Maintenance
DEO	Defence Estate Organisation
DEOPS	Director Estate Operations and Planning
DER	Defence Efficiency Review
DISG	Defence Information Systems Group
DSTO	Defence Science and Technology Organisation
EMW	Environmental Management Work
EOP Branch	Estate Operations and Planning Branch
FACOPS	Facilities Operations
FES	Facilities Executive Summary
FP&EM	Fixed Plant and Equipment Maintenance
GB&FM	General Building and Facilities Maintenance
GRV	Gross Replacement Value
HDE	Head Defence Estate
MDE	Manager Defence Estate
MNW	Minor New Work

NRV	Net Replacement Value
PM	Planned Maintenance
RCTS	Regional Contract Transition Strategy
REC	Regional Estate Centre
RFC	Regional Facilities Committee
ROMAN	Resource and Output Management and Accounting Network
SA	South Australia
SLA	Service Level Agreement
SNSW	Southern New South Wales
SPDE	Strategic Plan for the Defence Estate
SQ	South Queensland
TEM	Total Estate Management
UUM	Urgent Unforeseen Maintenance
WPC	Works Priorities Committee

Summary and Recommendations

Summary

Background

1. The Defence Estate comprises the land, buildings and other facilities that Defence uses across Australia. These facilities are vital to achieving the Defence mission—to prevent or defeat the use of armed force against Australia or its interests. The Estate has a gross replacement value of \$14.8 billion.

2. Management of the Estate was dispersed across the various Groups in Defence until the Defence Estate Organisation (DEO) was created in 1997 to manage the Estate. This was done as part of the Defence Reform Program on a recommendation of the Defence Efficiency Review in 1997. The Defence Efficiency Review suggested that an acceptable timeframe for the implementation of recommended changes was two to three years.

3. The creation of DEO required significant changes in the management approach and practices associated with facilities management. Prior to the Defence Efficiency Review, funding for both capital works and facilities operations came from the Defence Portfolio budget, with funding for facilities operations managed by Defence's individual Groups (administrative equivalent of departmental Programs). Responsibility for maintenance and minor new works rested with the establishment occupier/client, who had complete control of resources allocated for this task.

4. DEO's Facilities Operations (FACOPS) Program delivers general maintenance and minor new works to Defence facilities on a regional basis across the country. DEO's Estate Operations and Planning Branch and its nine Regional Estate Centres (RECs) are responsible for the FACOPS Program. Resources available for the Program have been reduced in recent years. The total DEO budget for 2000–01, which includes funds for capital works, facilities operations and property management, is \$2.6 billion. Of this total, the FACOPS Program has a cash allocation of \$213 million and an additional \$15.6 million for employee expenses associated with the Program's 283 staff.

5. The objective of the audit was to assess the efficiency and effectiveness of selected Defence facilities operations, including tendering and contracting, with a view to adding value with practical recommendations for enhancing operations.

Conclusion

6. DEO has implemented many recommendations arising from the Defence Efficiency Review and has achieved savings through the reduction of duplicated services within each region and from the development and implementation of more efficient delivery methods. Staff numbers associated with the delivery of the FACOPS Program were reduced by more than 50 per cent between 1997 and 2000. This has resulted in ongoing salary savings of more than \$10 million a year.

7. DEO has made a significant effort to develop and implement a strategic, corporate-focused framework for the delivery of maintenance work through the FACOPS Program. Initiatives, such as the Comprehensive Maintenance Contract (CMC), offer economies and efficiencies that earlier approaches and/or methods lacked. Introduction of Total Estate Management (a comprehensive approach to managing estate assets) will provide, among other advantages, firm data on the condition of the Estate that are needed to substantiate maintenance funding bids.

8. Audit findings indicated scope for improvement in various areas of the FACOPS program, particularly in relation to the management of contracts and resources.

9. The significant staff reductions made within a relatively short timeframe have decreased the knowledge base and skills available to DEO. This has been compounded by the introduction of new and significantly different management practices. Not all DEO contract management staff have the appropriate skills to manage large, complex facilities maintenance contracts in the Defence environment.

10. With the creation of DEO, the emphasis was to deliver estate services on a priority basis by region rather than by individual establishment. In practice, this has not always been the case, with variations in regional procedures resulting in a lack of transparency in decision making and with funding not always being applied to identified priorities. Regular two-way consultation between DEO and some clients did not occur, which impacted adversely on DEO's ability to efficiently and effectively deliver the FACOPS Program and on associated client satisfaction.

11. The effectiveness of Estate management could be significantly improved if better information were available to target where scarce maintenance resources should best be spent. Such information includes the capture of actual costs (Output attribution) and the contribution each asset makes to Defence capability. Australian Defence Force input in capability requirements is essential to ensure that Estate management decisions are justified on Defence priority and cost effectiveness grounds.

Key Findings

Corporate Governance (Chapter 2)

12. In response to the DER Secretariat recommendations, a Strategic Plan for the Defence Estate (SPDE) was prepared by DEO in 1998, after extensive consultation with all Defence Groups. Its purpose is to guide short and long-term development of the Defence Estate over the next 20 to 30 years. It provides a broad strategic framework for consideration of Defence Estate issues. Wider dissemination of the SPDE as a planning document has commenced internally in Defence in an effort to increase awareness of ongoing strategic estate management issues.

13. Defence attributes Estate costs to Defence Outputs by applying a complex series of percentages to expenditure recorded in individual cost centres. The allocation of such percentages is not data driven but derived from management judgement. If the FACOPS Program cost data are to be accurately attributed, individual facilities costs need to be directly linked to Defence Outputs and sub-Outputs.

14. Property industry benchmarks for recommended maintenance expenditure indicate that maintenance of the Defence Estate is less than the benchmark by about \$100 million in 2000–01, albeit that the makeup of the industry benchmark is ill-defined. As a result, it appears that needed maintenance is being deferred. Examples of deferment were observed during the audit. The longer-term consequences of deferring maintenance have significant implications for Defence operational requirements, funding requirements and legal responsibilities.

15. Because of reduced resources allocated to the FACOPS Program, DEO is developing systems such as Total Estate Management to gather firm data on the condition of the Estate that are needed to substantiate funding bids and to direct spending to essential tasks.

16. Defence is now structured along Output and Service Provider agency lines. Defence expects the introduction of formal purchaser-provider arrangements for Estate management to bring about further efficiencies in facilities management, but has noted that *'the quantum of these savings cannot be identified as yet.'*

Contract Management (Chapter 3)

17. Inefficiencies in inherited facilities maintenance contracts were recognised by DEO when it was formed in 1997. DEO is working to phase out such contracts by early 2001 and replace them by a new contract form better suited to modern estate management by fewer staff. These maintenance contract reforms accord with the Defence Efficiency Review's expected timeframe for change.

18. Contract management practices in some of DEO's Regional Estate Centres give little confidence that basic procurement requirements are being met in all cases. Continually extending standing offers without testing the market; continuing to use contractors' services when the contractual relationship is unclear; and awarding substantial amounts of work to contractors without seeking other quotes is not a sound basis for providing assurance that basic procurement requirements are being met efficiently and effectively. Indeed, work awarded without reference to relevant contracts indicates poor contract management. Contracts, old or new, need to be actively managed to ensure required performance. Consequently, much more attention needs to be given to contract management and requires skills as DEO moves to large complex contracts managed by fewer staff.

19. Documents relating to procurement decisions, and necessary to support payments, were frequently unavailable to the audit team. Without reference to such documents, it is difficult to assess whether proper procedures had been followed on works projects. Evidence indicated that Purchase Orders were frequently raised with minimal supporting documentation. Some Purchase Orders for more than \$1 million were raised by staff who did not have appropriate authorisations. This is clearly contrary to Defence's Chief Executive Instructions.

20. Staff numbers across EOP Branch, especially in the RECs, have been reduced and subsequent savings have been achieved. The timing of some of these reductions has, however, had an impact on the standard of contract management in the RECs, particularly where the CMC has not been fully implemented. Not all DEO contract management staff have the appropriate skills to manage large, complex facilities maintenance contracts in the Defence environment. Additionally, some staff demonstrated only limited awareness and ability to apply appropriate procedures relating to the commitment and expenditure of public money.

21. There is no systematic monitoring by DEO of contract performance to check work done. Similarly, contracts lack provision for Defence and the ANAO to have suitable access, as necessary, to contractors' records and Commonwealth assets to help check performance and provide adequate assurance about that performance. Indeed this would be a more effective approach for all concerned. Such provision would not usually be necessary for 'products' or 'commodity type' services provided in the normal course of business.

Regional Estate Operations Bid Process (Chapter 4)

22. The framework of the annual FACOPS funds bidding process for facilities works was generally satisfactory, as was EOP Branch's part in assessing bids and assigning allocations. Nevertheless, some improvements could be usefully made. Standardising terminology and processes would allow more-transparent decision-making by EOP Branch staff and greater equity of access to funding for clients. More detailed information in bids for project funds and a more objective and consistent set of criteria for the allocation of project funding priorities, would enhance the assessment of bids and effective allocation of scarce resources.

23. Information of the kind referred to above would also help direct funding according to client needs and Defence capability requirements. Providing clients with clear, consistent and accessible information would assist the RECs in developing better relationships with clients.

Financial Management (Chapter 5)

24. There are limited control processes to ensure that agreed facilities works projects are completed according to priorities identified in the bid process. Currently, funds allocated to RECs are at times spent on lower priority work without consultation and agreement by Central Office. While accepting the need for flexibility given the scale of the Program, it is important that there be clear understanding and communication between the RECs and Central Office in order to ensure effective management and oversight of the pre-determined priorities.

25. There is a continued focus on expenditure to achieve annual budget targets in DEO. Monthly expenditure of funds increased significantly at the end of the financial year. Undue emphasis on spending for the purpose of meeting expenditure targets is not in the Commonwealth's budgetary or contractual interests nor indeed for program efficiency.

Defence Estate Management System—Facilities Maintenance (Chapter 6)

26. The Defence Estate Management System—Facilities Maintenance (DEMS/FM) has the potential to be an effective means of collecting data on the Defence Estate and in delivering the FACOPS Program. It could also enhance decision-making by the RECs and EOP Branch in their management of the Defence Estate.

27. For a number of reasons, it has not reached its potential usefulness. These include technical problems, such as periods of slow performance, that compounded the unwillingness and inability of many DEO staff to make effective use of it. DEO recognises these inadequacies and is taking action to improve the system and to make better use of it.

Response to the audit report

28. In response to the proposed report of the audit, Defence agreed with the ANAO recommendations and advised that Defence Estate Organisation is supportive of the content of the audit and appreciates the consideration that ANAO has given to their views in preparing the audit report.

Recommendations

Set out below are the ANAO's recommendations, with report paragraph references and an indication of the Defence response.

Recommendation No.1
Para. 2.17

The ANAO *recommends* that individual facilities' costs be directly linked to the relevant Outputs and sub-Outputs so that FACOPS Program costs can be appropriately attributed to Defence Outputs in the interests of better management and performance assessment.

Defence response: Agree in principle where it is practical to do so and cost effective.

Recommendation No.2
Para. 3.55

The ANAO *recommends* that DEO review its workforce recruitment, development and retention policies with the aim of ensuring the availability of staff with appropriate qualifications and experience to meet its program objectives.

Defence response: Agree.

Recommendation No.3
Para. 3.58

The ANAO *recommends* that DEO regularly monitor contract work involved in the delivery of the FACOPS Program, through a program of focused reviews, to ensure that work is being delivered as required under contract.

Defence response: Agree.

**Recommendation
No.4
Para. 4.41**

The ANAO *recommends* that, to promote efficient and transparent decision-making by RECs and EOP Branch in the allocation of scarce FACOPS funds, and better relationships with clients, DEO develop:

- a) clear directions on the timing, composition and conduct of the Works Priorities Committee and Regional Facilities Committee processes;
- b) an objective and comprehensive set of criteria for the allocation of project funding priorities;
- c) a single, consistently applied format for the Facilities Executive Summary including concise project information and costings;
- d) clear and consistent definitions and related terminology for the categories of work delivered by the FACOPS Program; and
- e) procedures for providing clients with clear, consistent and accessible information on all relevant facets of the bid process.

Defence response: Agree.

**Recommendation
No.5
Para. 5.28**

The ANAO *recommends* that Defence take action to ensure that the financial focus in its business practices emphasises the achievement of value for money within agreed budgets and to remove undue emphasis on end-of-year spending to achieve budget forecasts.

Defence response: Agree.

**Recommendation
No.6
Para. 6.40**

The ANAO *recommends* that DEO make better use of its DEMS/FM system in the delivery of its FACOPS Program by:

- a) upgrading it cost-effectively, with priority given to linking DEMS/FM to ROMAN;
- b) mandating its use across all regions; and
- c) training staff to use it at a skill level suitable to their individual positions.

Defence response: Agree.

Audit Findings and Conclusions

1. Introduction

This introduction outlines the background to the formation of the Defence Estate Organisation and the location of the Facilities Operations Program in that organisation. It also sets out the audit objective and criteria.

Defence Estate Organisation

1.1 The Defence Estate comprises the land and buildings that Defence¹ uses across Australia. These facilities are vital to achieving the Defence mission—to prevent or defeat the use of armed force against Australia or its interests.

1.2 Prior to 1997, management of these facilities was dispersed among the three Services and other groups in Defence. The Defence Efficiency Review reported in 1997 that management of the Defence Estate should be a single coordinated task, devolved only for tenant responsibilities. It recommended that *‘a Defence Estate Executive should be responsible for all ‘building owner’ functions, which would be managed on a national basis.’*²

1.3 The recommendation was implemented in the Defence Reform Program by the creation of the Defence Estate Organisation (DEO) on 1 July 1997. DEO was expected to be *‘proactive and customer-focused and concentrate on strategic property management which is effectively linked into overall Defence strategic planning.’*³

1.4 DEO’s mission is to shape and manage the Defence Estate to meet Government and Defence needs. DEO is responsible for ‘building owner’ or landlord functions. It manages on a national basis, and on behalf of the Defence Portfolio, all buildings,⁴ infrastructure and property identified as ‘corporate assets’. DEO regards itself as a relatively-new organisation that is still endeavouring to change inefficient ‘legacy’ systems and trying to implement innovative processes, management information systems and reforms in a changing environment in Defence.

¹ ‘Defence’ comprises the Department of Defence and the Australian Defence Force, which in turn comprises the three Services: Navy, Army and Air Force.

² *Future Directions for the Management of Australia’s Defence, Report of the Defence Efficiency Review*, R33, p E-6.

³ *Future Directions for the Management of Australia’s Defence, Addendum to the Report of the Defence Efficiency Review: Secretariat Papers*, p. 236.

⁴ Except those administered by the Defence Housing Authority, which is a Government Business Enterprise.

1.5 As at 30 June 2000, assets under DEO management have a Gross Replacement Value of \$14.8 billion and a Net Replacement Value of \$10.5 billion.⁵ They comprise:

- 383 separate owned properties;
- 3 million hectares of land;
- 100 plus properties identified for potential disposal or being prepared for sale;
- 107 properties affected by heritage classifications; and
- 300 expenditure leases and 500 revenue leases.

1.6 In assuming the role of landlord for the entire Defence Estate, DEO adopted a commercial landlord/tenant approach, taking into account legal obligations, government directives and community expectations.

1.7 Landlord/tenant functions in relation to DEO are defined thus:

- landlord: represented by the DEO, owns all assets/infrastructure and manages the normal landlord functions of repairs and maintenance, investment, reinvestment, acquisition (including leasing) and divestment; and
- tenant/user: represented by the commanding officer of the establishment/unit; retains responsibility for the care, good order, custody and control of assigned assets and infrastructure.

1.8 In the context of the Defence Estate, the landlord function includes the additional requirement to provide maximum appropriate Defence capability within the resources allocated. The tenant function includes the requirement to maximise capability by optimal use of the allocated estate.

1.9 This new structure involves a significant change in the management approach and practices associated with facilities management. Prior to 1997, capital works and facilities operations were funded from the Defence Portfolio budget, with funding for facilities operations managed by Defence's individual Groups. Responsibility for maintenance and minor new works rested with the establishment occupier/client, who had control of resources allocated for the work.

⁵ DEO defines Gross Replacement Value (GRV) of an asset as being equivalent to its Cost of Acquisition or if subsequently revalued, the revalued amount. Depending on the method of revaluation, the GRV may be at replacement value, current market selling price, or current market buying price. Net Replacement Value is identical to the Carrying Value. It is the amount at which the asset is recorded in the accounting records at a particular date after deducting Accumulated Depreciation or amortisation from the GRV.

1.10 To enable DEO to provide estate support services to the different Groups, most resources previously allocated by the Groups to facilities operations were transferred to DEO.

Estate Operations and Planning Branch

1.11 The Estate Operations and Planning Branch (EOP Branch) is one of four branches in DEO. It is responsible for Defence Estate planning (other than strategic planning), the Facilities Operations (FACOPS) Program, management and development of FACOPS commercialisation activities, land use assessment and environmental practice, and technical support services.

1.12 The FACOPS Program delivers general maintenance and minor new works⁶ at Defence facilities around the country. The FACOPS Program has a revised cash allocation of \$213 million⁷ and an additional \$15.6 million for employee expenses associated with the Program's 283 staff.

1.13 The Estate Operations Section manages the FACOPS Program, with staff based in DEO's Central Office in Canberra and at nine Regional Estate Centres (RECs)⁸ located on or near major Defence bases. REC staff are outposted as necessary to major establishments or units to provide the link from commanding officers to the regional Managers Defence Estate (MDEs) and ultimately to the Head of the Defence Estate (HDE).

1.14 The RECs were established to deliver the FACOPS Program efficiently to establishments across Australia. Staff were drawn from the establishments to form the RECs as integral parts of DEO. A new management information system, the Defence Estate Management System–Facilities Maintenance (DEMS/FM), was also introduced to EOP Branch at this time.⁹

1.15 As part of ongoing change in Defence, it is expected that 'purchaser-provider' arrangements for DEO will be introduced by 2001–02.

⁶ Minor new works are new works projects that cost less than \$250 000.

⁷ The original FACOPS Program budget was \$206 million. This amount was increased to \$213 million through the Additional Estimates process in September 2000.

⁸ Originally 11 Regional Estate Centres were established. By mid-1999, this number had been reduced to nine.

⁹ See chapter 6 for further information on this system.

The audit

1.16 The audit of Defence Estate facilities operations was the second in a series of audits of Defence Estate operations. An earlier audit examined Defence Estate project delivery.¹⁰ A third audit to examine Defence Estate property management is expected to be undertaken within the next two years.

1.17 The objective of this audit was to assess the efficiency and effectiveness of selected Defence facilities operations, including tendering and contracting, with a view to adding value with practical recommendations for enhancing operations. The topic had not been addressed in any previous ANAO performance audit. Defence's Management Audit Branch (internal audit) reported on facilities operations in 1997, when the Defence Efficiency Review was under way. Relevant issues raised in that report have been addressed in this audit.

1.18 This audit reviewed the Central Office of EOP Branch and four of the RECs: Central and Northern New South Wales (CNN); South Australia (SA); Southern New South Wales (SNSW); and South Queensland (SQ).

1.19 The following criteria were used in conducting the audit:

- that DEO know who their 'clients' are, and that client needs are addressed, having regard to funding constraints;
- that the process of bidding for funds takes into consideration client requirements and identified corporate priorities;
- that DEO maintenance contracts are tendered and managed in accordance with Commonwealth and Defence purchasing requirements (including Defence's Chief Executive Instructions (CEIs));
- that the FACOPS management information system facilitates informed decision-making; and
- that estate needs are identified so that works can be undertaken appropriately.

1.20 Most of the audit fieldwork was conducted from April to July 2000. The audit encompassed fieldwork at Duntroon, ACT; HMAS *Albatross* and HMAS *Creswell* near Nowra; RAAF Base Williamtown; Singleton Military Area; Gallipoli Barracks, Enoggera; Logistics Base, Bulimba; RAAF Base Amberley; DSTO Salisbury and RAAF Base Edinburgh

¹⁰ Auditor-General, Audit Report No.37 1999–2000 *Defence Estate Project Delivery—Department of Defence*, April 2000.

near Salisbury; Keswick Barracks, Adelaide; and at DEO's Central Office in Canberra.

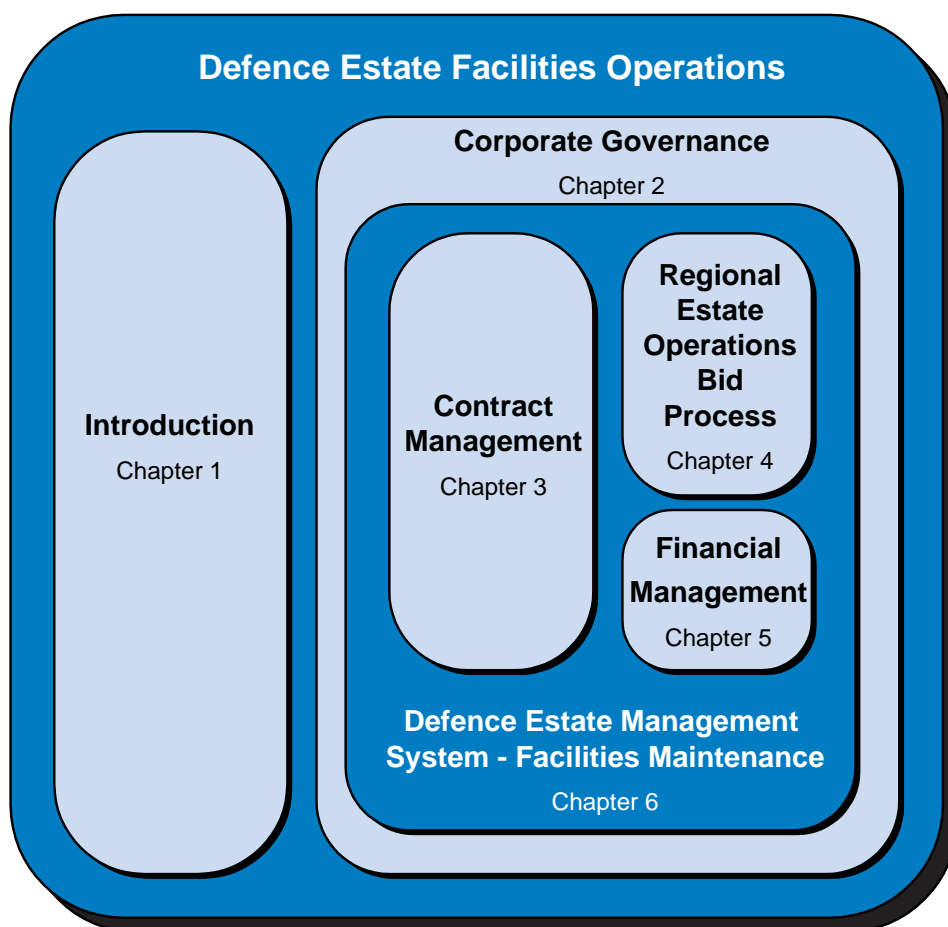
1.21 Audit discussion papers were provided to DEO in August 2000 and discussed in September 2000. The proposed report was provided to Defence in November 2000 for comment. The audit was conducted in conformance with ANAO auditing standards and cost \$174 000.

Report structure

1.22 This report is organised into six chapters, as shown in Figure 1.

Figure 1

Report structure



2. Corporate Governance

This chapter examines the Defence Estate Organisation's corporate governance structure including strategic management of the estate, service level agreements, DEO's budgetary framework, Total Estate Management (a comprehensive approach to managing estate assets) and proposed purchaser-provider arrangements.

Strategic management of the Defence Estate

2.1 The Defence Efficiency Review Secretariat commented that *'stronger links are needed between strategic guidance, capability analysis, preparedness, operational planning and the facilities planning process'*.¹¹ In response, DEO prepared a Strategic Plan for the Defence Estate (SPDE) after extensive consultation with all Groups in Defence. Its purpose is to guide short and long-term development of the Defence Estate over the next 20 to 30 years. It provides a broad strategic framework for consideration of Defence Estate issues.

2.2 The SPDE was endorsed by the Defence Executive in December 1998 and is awaiting consideration by Government. Wider dissemination of the SPDE as a planning document has commenced internally in Defence in an effort to increase awareness of ongoing strategic estate management issues. It is being updated to reflect changes that have occurred in the Estate since its development in 1998. The section relating to facilities operations is at Appendix 1 of this report.

Service Level Agreements

2.3 When DEO was established, Service Level Agreements (or service charters or memoranda of understanding) were to be negotiated between DEO (the service provider) and other Defence Programs/Groups (clients) to define the service expectations of both parties. Client Groups were to define their requirements and priorities for agreement in consultation with the Head of the Defence Estate (HDE). Cascading agreements were to be negotiated at the regional level.

2.4 By early 1998, preparation of Service Level Agreements (SLAs) at the Group level was well under way. SLAs with Air Force and Navy were being endorsed. Draft SLAs with Army and DSTO were being considered. Development of Regional SLAs was left to the RECs and their clients, with guidance from Central Office.

¹¹ *Future Directions for the Management of Australia's Defence, Addendum to the Report of the Defence Efficiency Review: Secretariat Papers*, p. 220.

2.5 By mid-1998, HDE had advised all Managers Defence Estate (MDEs) that it was not mandatory to have SLAs with clients but that, if a client wanted one, the relevant REC was to assist in preparing it. Where a SLA was not considered necessary by the MDE and the client, Central Office suggested that, to ensure that clients were aware of DEO's services, each REC should prepare a client/customer service manual. Such manuals were to provide a corporate overview of DEO, identify the services provided by REC staff and inform clients how to contact them.

2.6 A survey undertaken by the Inspector-General Division on customer-provider arrangements in Defence¹² relating to DEO services found that, as at May 1999:

Client Groups in eight regional areas have not required SLAs, six regional areas have Customer Support Guides and two areas have signed SLAs with Client Groups.

2.7 The ANAO considers that, even though some clients have indicated that SLAs are not required, all Groups need clear communication channels with DEO. A common theme that emerged in discussions with clients during the audit was the importance of communication. Client satisfaction depends to a significant degree on REC and client communications. The development of clearer expectations, specified in a formal agreement such as a SLA, would assist in defining methods of communication at the Portfolio level. The refinement of client service guides, discussed further in chapter 4, would make this process more effective.

DEO budgetary framework

Ownership and accommodation costs

2.8 The *Defence Portfolio Budget Statements 2000–01* set out the Defence budget for 2000–01. The latter provides Defence with financial resources to deliver its five Outputs that combine to form the overall Defence Outcome, that is, the prevention or defeat of armed force against Australia or its interests.

¹² This survey was incorporated into the Program Evaluation Assessment Report *Defence Customer–Provider Arrangements*, January 2000.

2.9 Figure 2 illustrates Defence's new accountability structure and the link between Outputs and Enablers. DEO is part of Corporate Services, and therefore is categorised as an Enabler. As funding is provided at the Portfolio level to the five Outputs, FACOPS Program expenditure needs to be attributed to each Output, by expenditure against individual facilities. The attribution of costs to Portfolio Outputs needs to be data driven as this would assist in disclosing the full cost of facilities used in producing the Outputs.

2.10 Attribution of cost data to Output Managers supports the new Defence Business Model, which took effect from 1 July 2000. This is especially the case for the following two key aspects of Defence's relationship with the Government.

- Government as the purchaser of our outputs; our primary management focus will be on the delivery of outputs to government, largely our Defence capabilities.
- Government as the owner of our business; stronger corporate governance arrangements will be introduced, including clearer accountabilities, to reinforce the focus of our ability to sustain our business's delivery of outputs and achieve budgeted financial results.¹³

2.11 Currently, FACOPS expenditure is attributed to Outputs by means of a complex series of percentages provided by the Capability Output Managers to DEO financial staff. These percentages are applied to expenditure data, captured by cost centre, on some 200 key establishments.¹⁴ Each key establishment is allocated a cost centre under Defence's Financial Management Information System (DEFMIS).¹⁵ At other establishments, the attribution percentages are applied to cost data captured by regional cost centre codes.

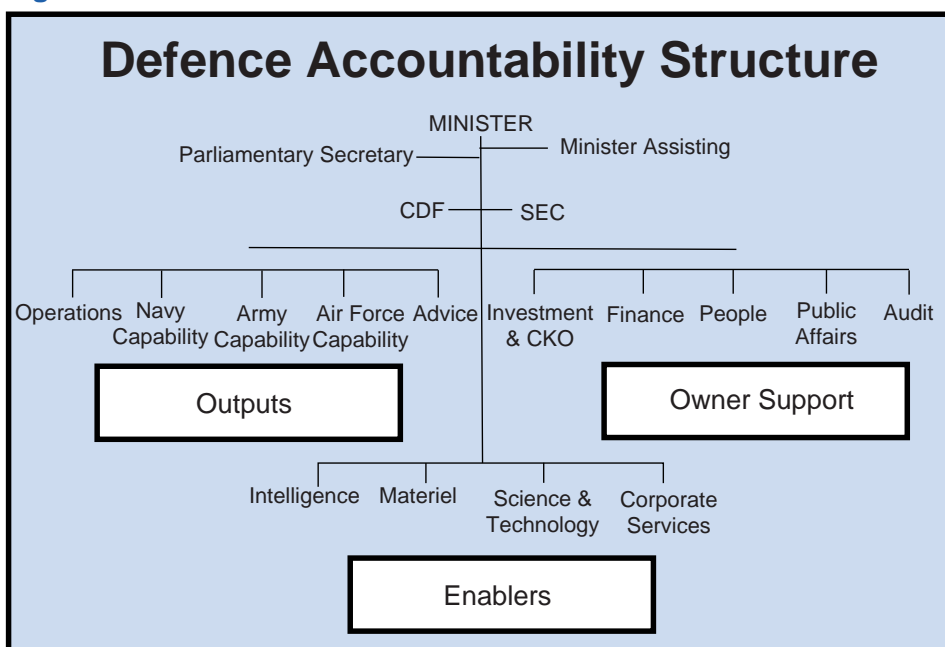
2.12 However, the current methodology is in need of improvement. The attribution rules are being refined because certain items, mainly capital use charges and depreciation, were not being attributed appropriately. These items were being allocated to a few Outputs, rather than being individually attributed to Outputs.

¹³ *The Defence Business Model* presented by Dr Hawke at Defence Senior Leadership Recall Day on 23 June 2000.

¹⁴ An establishment such as RAAF Base Williamtown contains many individual sites, runways, buildings and other facilities.

¹⁵ DEFMIS is being phased out of service. The new financial information management system, the Resource and Output Management and Accounting Network (ROMAN), is being rolled out region by region. REC-SA transferred to ROMAN in April 2000 and REC-SQ transferred in July 2000. The other RECs will follow soon.

Figure 2



Source: Defence.

2.13 There have also been problems with the cost attribution procedures throughout Defence. At the time of the 2000–01 Senate ‘estimates’ hearings, detailed Output costs to support the Portfolio Budget Statements were not available. This was due primarily to changes to Output cost data being made at the last minute. The changes incorporated were not necessarily reflected in lower-level supporting data.

2.14 Each Defence Group generally has two different sets of attribution rules. One is for the development of Budget and Additional Estimates data, based on attribution of Component-level data. The other is for Actual expenditure data, based at lower levels (cost centres). The two different attribution rules can result in very different Output costs. Defence intends to rectify this by raising the level of attribution rules to Component level for both Budget and Additional Estimates data and Actual data.

2.15 The Output costing principles are as follows:

- Group financial data (in the Resource and Output Management and Accounting Network (ROMAN)) and associated Output attribution rules are owned by that Group, and the resulting Output costs are owned by that Group.
- Groups are responsible for accuracy, consistency and completeness of their financial data and attribution rules. Output Managers are to be consulted in developing those rules.
- The Portfolio Group financial data and attribution rules are the responsibility of Defence's Resources and Financial Programs (RFP) Division. The resulting Output costs are owned by RFP Division.
- Attribution rules should be consistent with the financial data.
- Attribution rules are required only at the level of budget development (generally Component level). Lower-level attribution rules (e.g. for Actual expenditure) are used only when budget estimates are also loaded at this level.

2.16 Use of percentages in attributing DEO establishment costs to Outputs is not data driven but derived from management judgement. The ANAO considers that the latter should be used only as a temporary measure, and Defence should endeavour to make the attribution of costs as supportable as possible.¹⁶ For the purposes of capturing and allocating FACOPS Program cost data, it would be preferable for each of Defence's numerous sites, buildings and other facilities to be linked to the relevant Outputs and sub-Outputs. Presently this does not occur. The Defence Estate Management System–Facilities Maintenance (DEMS/FM) has the capacity to capture cost data against individual facilities and link this information to the appropriate user Unit. To date this source of data has not been used for reporting actual expenditure by the nine Regional Estate Centres.

Recommendation No.1

2.17 The ANAO *recommends* that individual facilities' costs be directly linked to the relevant Outputs and sub-Outputs so that FACOPS Program costs can be appropriately attributed to Defence Outputs in the interests of better management and performance assessment.

¹⁶ See Auditor-General, Better Practice Guide (1999-2000) *Building Better Financial Management Support, Functions—systems and activities for producing financial information*, November 2000, Part 3 Costing Systems, for more information regarding techniques.

Defence response

2.18 Agree in principle where it is practical to do so and cost effective.

FACOPS Program budget

2.19 Maintenance of facilities has long been treated as a low-order business issue in Defence. It was relatively easy to defer planned maintenance work; funding for maintenance was often used to fund activities considered to have a higher priority.

2.20 In the long term, however, deferred maintenance can result in asset deterioration and other adverse consequences for the estate, leading to a need for higher reactive maintenance funding and possible asset failure. These longer-term consequences have significant implications for Defence's operational requirements, funding requirements, and legal responsibilities such as those concerned with occupational health and safety and duty of care.

2.21 Funds allocated by the Groups for facilities operations were transferred to DEO on its formation on 1 July 1997. Associated with this action, was a reduction in funds available for facilities operations in the previous year. Table 1 shows that the annual FACOPS budget in 'real' or constant prices (excluding salaries) has been reduced substantially in recent years.¹⁷

Table 1

FACOPS cash budgets in actual and constant prices—\$m

	1993–94	1994–95	1995–96	1996–97	1997–98	1998–99	1999–00	2000–01 (est)	Average
Historical (actual)	294.8	286.8	279.7	215.5	215.4	223.0	230.7	206	244
1999–00 prices	329.0	318.6	296.8	220.9	219.9	225.9	230.7	206	256

Source: SPDE. See Appendix 1 to this report, paragraph 6.

Note: FACOPS budgets exclude salary costs for military and civilian personnel.

2.22 The reduction in the annual FACOPS budget has arisen more from pressure on the overall Defence budget than from rigorous facilities needs assessment. Mechanisms required by DEO to capture information on maintenance requirements systematically, and on associated risks of under-maintenance, are not available.

¹⁷ Not all Estate funding was transferred to DEO; DSTO continued to fund facilities operations at Salisbury—see chapter 3.

2.23 Deciding what is reasonable expenditure on Defence Estate maintenance requires consideration of a variety of factors. These factors include the current use and condition of the asset; criticality of the asset to capability; Gross Replacement Value (GRV); Net Replacement Value (NRV); and environmental considerations.

2.24 The DER Secretariat Papers (1997) noted that FACOPS Program expenditure in 1996–97 ‘represents 2 per cent of [Defence Estate] GRV which is comparable with industry practice (acknowledging that percentage of GRV is a somewhat crude and generalised performance measure).’¹⁸ DEO cites a Property Council of Australia recommendation that 2 to 4 per cent of an asset’s GRV be spent annually on its maintenance—see Appendix 1 at paragraph 11. This benchmark assumes that the property is already in reasonable condition. Maintenance funding below the industry standard would, *prima facie*, indicate that the integrity of the property is decreasing. The benchmark can produce different results, depending on the calculation of GRV.¹⁹

2.25 In accordance with Government requirements, the GRV of the Defence Estate is calculated according to the Deprival Method.²⁰ The FACOPS Program budget amounted to 1.58 per cent of Defence Estate GRV in 1999–00. The 2000–01 budget of \$213 million amounts to 1.44 per cent of the GRV of \$14.8 billion (covering land, buildings and infrastructure). Applying the industry benchmark of 2 per cent indicates to DEO that DEO’s budget is less than the industry benchmark by about \$100 million (Appendix 1 paragraph 18). DEO considers that this shortfall is also reflected in client dissatisfaction as well as their inability to complete necessary work such as asbestos removal. The ANAO notes that the interpretation of the benchmark is not specific as to what should be covered by the 2 per cent. Assuming that the benchmark should include overheads such as employee expenses, the total FACOPS Program budget is still only 1.54 per cent.

¹⁸ *Future Directions for the Management of Australia’s Defence, Addendum to the Report of the Defence Efficiency Review: Secretariat Papers*, p. 215.

¹⁹ Valuations of New Parliament House provide an example of the difference in GRV that can be obtained depending on the terms of reference used in the calculation of the deprival value. The GRV of Parliament House (land, building, plant and equipment) in 1998–99 was \$934 million (*Joint House Department Annual Report 1998–99*, p. 100). Recently, the Joint House Department had the Australian Valuation Office recalculate the GRV of Parliament House using redefined terms of reference to capture the actual reproduction costs required to replace the existing asset. As at March 2000 the current reproduction cost of the asset was assessed at \$1.7 billion.

²⁰ The Commonwealth’s Financial Reporting Guidelines define the Deprival Method of Valuation as ‘the present value to an entity of the future economic benefits that the entity would forgo if deprived of the asset’. The *Finance Minister’s Orders*, at Schedule 2 Part 13—Land, Building, Other Infrastructure, Plant and Equipment, define how the valuation is to be calculated.

2.26 There has been no assessment of the impact on, or the risk to, Defence personnel and capability resulting from funding maintenance at less than the recommended industry standard. The 2 per cent benchmark as a basis for funding is used in the absence of a more rigorous process of risk analysis and capability impact. DEO is endeavouring to move toward a new asset appraisal system (discussed in the section below on Total Estate Management) to address this situation.

2.27 DEO's analysis of approved budget expenditure guidance for DEO's Capital Facilities Investment Program shows that capital reinvestment in the Defence Estate has been reduced in recent years. In 2000–01, the Capital Facilities Investment Program (including 'reinvestment' (refurbishment)) is \$231 million. This is far less than depreciation of the Defence Estate, which is assessed at \$380 million in 2000–01. EOP Branch considers that excess of depreciation over reinvestment will lead to an aging and less efficient Estate, placing additional pressure on the FACOPS Program budget.²¹

2.28 Accurate assessment of funding requirements calls for data on the condition of the Estate. DEO acknowledges that:

*Reliable data on asset value, condition, function and utilisation is essential for total estate management purposes. While it is difficult to assess the validity of existing asset data, the trend in asset growth and in aging is clear enough and has implications for maintenance (which tends to increase with age) and for overall estate management.*²²

2.29 With reduced resources allocated to the FACOPS Program, it is essential that mechanisms be put in place to ensure that spending is directed to the highest priority tasks. Current steps being undertaken by DEO, such as the introduction and application of Total Estate Management principles, will assist in identifying these priority tasks.

Total Estate Management

2.30 DEO has been developing a comprehensive approach to managing the Defence Estate called Total Estate Management (TEM). TEM considers the entire asset life-cycle within a framework of strategic planning and management guidance. It aids resource management both in terms of analytical justification of proposals and better targeting of scarce resources.

²¹ EOP Branch provided figures and details of the decrease in reinvestment on the Estate and the effect on FACOPS funding.

²² Appendix 1, paragraph 23.

2.31 TEM includes Asset Appraisal, which considers the operational phase of the asset life-cycle (the recognised phases are planning, acquisition, operation, and disposal), allowing for the development of a maintenance planning framework that is both visible and justifiable. Asset managers can then plan for the expenditure of resources against the framework.

2.32 EOP Branch needs data to help in preparing impact statements on maintenance timings, particularly in relation to the deferral of maintenance. Asset Appraisal should help provide this data.

2.33 Assessment of maintenance needs was previously based on 'condition appraisal.' Facilities Appraisal Reports were prepared annually. Maintenance contractors were paid to inspect assets and produce reports on maintenance requirements, including cost estimates for the works recommended. Condition appraisal did not always take strategic guidance into account; was at times focused on the short term; did not always consider clients' requirements; and was heavily dependent on the subjective judgment of the contractors undertaking the appraisals. The effect on assets of deferring maintenance was not readily visible at operational and strategic levels, and nor were the changes over time in reinvestment and maintenance funding requirements. A comprehensive approach that considered all aspects of the operation of an asset was rarely taken.²³

Benefits of Asset Appraisal

2.34 A proposed new Asset Appraisal methodology, based on TEM principles, is intended to address these shortcomings. It aims to:

- provide a physical condition assessment of the assets, including the building fabric, plant and equipment, and engineering services;
- provide a budget estimate for short- and long-term maintenance programs;
- assess the suitability of an asset for supporting operational activities;
- decide whether an asset can contribute to long-term objectives;
- develop maintenance plans in line with strategic objectives;
- provide an appreciation of the assets managed;
- ensure assets comply with requirements such as the removal of all asbestos from the Estate within 10 years; and
- identify the consequences and risks to the Estate and Defence Capability Outputs contingent upon when identified maintenance works are undertaken.

²³ The description and assessment of condition appraisal are taken from a Draft DEO Instruction on Asset Appraisal.

2.35 It is proposed that all assets be reviewed over an initial three-year period to form the basis of each REC's works program. The ANAO supports DEO's view that the assets that contribute most to Capability Outputs should be assessed in the first year.

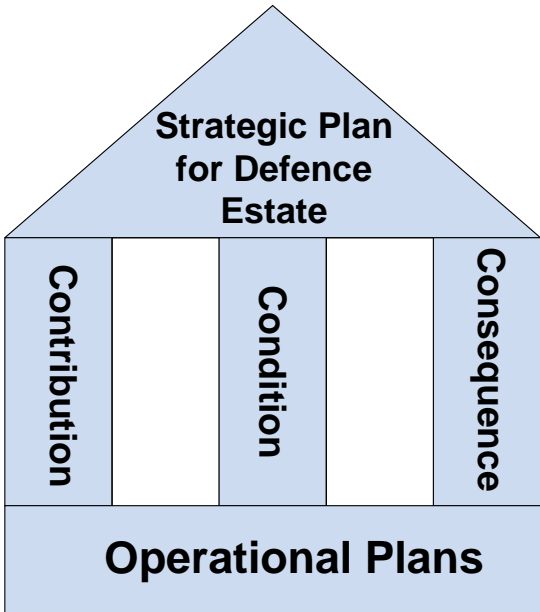
2.36 The Asset Appraisal methodology being developed by DEO is represented by Figure 3. As the figure illustrates, DEO aims to use a three-pillar methodology, overarched by the SPDE and underpinned by operational-level planning documentation, such as Establishment Master Plans and Environmental Management Plans. The assets are assessed against each of the three 'pillars': the *contribution* each asset makes to Defence capability; the *condition* of each asset; and the *consequence* to Defence capability if the asset does not meet agreed performance standards. Australian Defence Force (ADF) input on capability requirements is essential to ensure that Estate management decisions are justified on priority and cost effectiveness grounds.

2.37 The Asset Appraisal methodology will assist in gathering data appropriate for informed decision-making on facilities. DEO's development work on Asset Appraisal encompasses many of the 'promising practices' relating to real property management recommended to the United States military by the General Accounting Office.²⁴ Specifically, these practices concern the need for a single, valid, engineering-based system for assessing the condition of facilities; and for ranking budget allocations on the basis of physical condition of facilities, relevance of facilities to the mission, and life-cycle costing and budgeting.

2.38 The extent of maintenance work on an asset affects the operational cost of ownership and the capacity of the asset to meet its usage objectives. With an increase in Defence budgetary pressures, comprehensive information should be available to make informed decisions on maintenance funding and expenditure. Funding decisions in relation to the Estate need to be made, ultimately, by the Defence Portfolio, with professional property management advice from DEO and military advice from the facilities users, the Capability Output Managers. At this stage DEO lacks sufficient detailed data needed to support such advice.

²⁴ US General Accounting Office *Military Infrastructure—Real Property Management Needs Improvement*, September 1999. Issues facing the US military in relation to repairs and maintenance of infrastructure are similar to those faced by Defence.

Figure3
DEO’s proposed Asset Appraisal model



Source: *Effective Asset Maintenance Programming: The Defence Estate Organisation—A Strategic Case Study*.²⁵

Purchaser-provider arrangements

Internal rents

2.39 The DER report recommended that Defence introduce a system of internal rents:

*R34. A system of internal rents should be introduced to change the culture that facilities are a ‘free good’. This will expose the full cost of ownership and encourage a more business-like approach to holding assets.*²⁶

²⁵ Paper prepared by DEO officers B. Baird, O. Hammond and B. Jorgenson. It was published in the papers for the IIR conference *Strategic Asset Management in Utilities and Petrochemicals* held on 23-24 November 1999. The column titles have been simplified subsequent to discussions with the authors. Previously the *Condition* column was titled *Maintenance Modelling*.

²⁶ *Future Directions for the Management of Australia’s Defence—Report of the Defence Efficiency Review*, March 1997, p. E-6.

2.40 Defence explained to the Senate ‘estimates’ committee in 1998 that the status of the recommendation was as follows:

*Agreed in Principle. This has been further reviewed and rather than move to an internal rent regime, Defence has decided to implement, as part of the new resources management framework, the full cost of ownership, including accommodation costs, for each of its 22 outputs. This arrangement is expected to achieve the culture change sought by this recommendation.*²⁷

2.41 This issue has been re-considered. Purchaser-provider arrangements are to be introduced under Defence’s new Outputs Enabler structure (see Figure 2). These arrangements would be similar to internal rents for DEO. It is envisaged that the Output Executives will purchase services from the Enabling Executives, who will in turn receive their funding from the Output Executives. As explained by the Secretary of Defence:

...there are ‘enabling executives’ whose products or services do not appear explicitly in the PBS. Their role is to provide enabling services to the output executives, through purchaser-provider arrangements—some of which will be explicit from July 2001, others will be implicit in the way we do business.

This is a significant cultural step for Defence, one that has been in transition for some time, and one that the ANAO has been pressing us to take for some time now.

*CDF [Chief of the Defence Force] and I are aware that getting our management information systems talking to each other in a fully integrated purchaser-provider arrangement will take us the best part of the 2000–01 financial year, but that’s no excuse for anyone here to delay thinking in those terms.*²⁸

2.42 A key principle of the new Defence Business Model is that those who are accountable for delivering results will be assigned the resources necessary to achieve those results, and will be held accountable for the effective use of those resources.

²⁷ Senate Legislation Committee on Foreign Affairs, Defence and Trade—Budget Estimates Hearing of 9/11 June 1998, Question Taken on Notice, Hansard p. 100, Senator Hogg ‘Defence Efficiency Review Key Findings and Recommendations: Defence Reform Program Implementation Status—Actions Incomplete at the time of the Additional Estimates 1997-98’.

²⁸ *Defence Governance and Accountability* presentation by Dr Allan Hawke, Secretary of the Department of Defence, at the Senior Leadership Recall Day, 23 June 2000. The Secretary was referring to Auditor-General, Audit Report No.13 1999-2000, *Management of Major Equipment Acquisition Projects Department of Defence*, October 1999, Recommendation No.1.

Purchaser-provider arrangements for DEO

2.43 As mentioned earlier, DEO's mission is to shape and manage the Defence Estate to meet Defence and Government needs. This requires DEO to manage the Estate to meet Portfolio-wide requirements and Government requirements. Management of the Estate is also to meet Defence's capability requirements.

2.44 FACOPS services are of two kinds:

- Non-discretionary, where the Portfolio is the purchaser (noting that Output Managers contribute corporately to determination of the Portfolio requirements and attribution is against sub-Outputs); and
- Discretionary, where the Output Managers are the direct purchasers.²⁹

2.45 Non-discretionary works are undertaken to meet essential requirements such as master planning, legislative compliance, and maintenance. Discretionary works are focused on the operational level and include new works, planned works (including some maintenance projects) and centrally-managed works. In the FACOPS Program budget for 2000–01, \$160 million was allocated to Non-discretionary works and \$46 million to Discretionary.

2.46 DEO has some reservations about the practicability of purchaser-provider arrangements for its FACOPS works and services, particularly those that are Discretionary.

2.47 DEO's view is that the Portfolio is the purchaser, DEO is the purchaser's agent and industry is the provider. From an internal Defence perspective, the Portfolio is seen as the purchaser and DEO as the provider of Non-discretionary works; Output Managers are seen as the purchasers and DEO as the provider of Discretionary works.

2.48 DEO considers that allocating the Discretionary funding of \$46 million into budget packets for Output Managers to decide what works are delivered and how is an unnecessary administrative burden. DEO also considers that the consultative process already in place achieves the aim of having the Output Managers as the purchasers and DEO as a provider. However, the ANAO considers that the consultative process and Service Level Agreements need to be improved (see chapter 4). The consultative process could not be regarded as achieving the aim of a purchaser-provider arrangement until costs are properly attributed to purchasers and until the need for maintenance on each asset is better assessed and agreed between both parties.

²⁹ The definitions of the split between Non-discretionary and Discretionary works were contained in internal documentation provided by DEO.

2.49 Client satisfaction results from the ability of a provider to meet client requirements. The ability of DEO as provider is limited by the availability of resources. It is therefore essential that limited resources be directed to the tasks with the highest priority. To do this successfully, the Output Managers in the ADF need to be integral to the process.

2.50 For both Non-discretionary and Discretionary works, DEO as provider manages delivery of works by sourcing them from industry. DEO reports that 96 per cent of its activities, including the FACOPS Program, are competitively sourced from industry.³⁰ The ANAO notes, however, that not all activities are based on recent competitive pricing and open and effective competition that assures best value for money.³¹ DEO has recognised the inefficiencies of these pre-DER contracts and is working to phase out such contracts by early 2001.

2.51 The ANAO encourages the introduction of a formal purchaser-provider arrangement between DEO and its clients: the Defence Portfolio and the Output Managers. Defence expects the introduction of formal purchaser-provider arrangements for Estate management to bring about further efficiencies in facilities management, but has noted that *'the quantum of these savings cannot be identified as yet.'* Defence has not yet decided what form purchaser-provider arrangements will take in DEO. Regardless of the form it will require several improvements to present procedures, relating to Service Level Agreements with clients, assessment of maintenance needs with clients and attribution of full costs to Outputs. Without these improvements, implementation of the new funding model will not necessarily lead to improved delivery of the FACOPS Program and improvements in the allocation of scarce maintenance funds.

Conclusion

2.52 DEO has implemented Service Level Agreements where clients have expressed a desire to have one. The ANAO considers that DEO should develop Service Level Agreements for all Portfolio level clients. This would facilitate clearly defined communication channels between DEO and its clients.

³⁰ The remainder is represented by in-house personnel and administrative expenses and support for other Enabling Groups.

³¹ Chapter 3 examines the types of contracts in use by DEO for the delivery of outsourced works relating to the FACOPS Program.

2.53 Defence attributes Estate costs against Defence Outputs by applying a complex series of percentages to actual expenditure against individual cost centre codes. The allocation of such percentages is not data driven but derived from management judgement. For the purposes of accurately attributing the FACOPS Program cost data, individual facilities costs need to be directly allocated to Outputs and sub-Outputs.

2.54 Analysis undertaken by DEO indicates that the 2000–01 budget for facilities operations is less than the industry benchmark by about \$100 million. The longer-term consequences of deferring maintenance have significant implications for Defence operational requirements, funding requirements and legal responsibilities, such as those concerned with occupation health and safety and duty of care. The information required to capture data on maintenance requirements, and associated risks of under-maintenance, is presently unavailable.

2.55 Because of reduced resources allocated to the FACOPS Program, DEO is actively developing mechanisms such as Total Estate Management to direct spending to the most essential tasks. The extent of repair and maintenance work on an asset affects the operational cost of ownership and the capacity of the asset to meet its usage objectives. ADF input on capability requirements is essential to ensure that Estate management decisions are justified on priority and cost effectiveness grounds.

2.56 Defence is now structured along Output and Service Provider agency, or Enabler, lines. Introduction of purchaser-provider arrangements for Estate management should bring about further efficiencies in facilities management, but has noted that *'the quantum of these savings cannot be identified as yet.'* Implementation of purchaser-provider arrangements without improving current procedures, however, will not necessarily lead to improvements in the delivery of the FACOPS Program and better allocation of scarce maintenance funds.

3. Contract Management

This chapter discusses the various mechanisms used to deliver the Facilities Operations Program in 1999–00, the management of facilities maintenance contracts and changes to staffing.

Regional Contract Transition Strategy

3.1 When DEO was created in 1997, the disparate facilities management mechanisms formerly used by the three Services and other groups in Defence were to be managed centrally. This gave Defence the opportunity to harvest regional economies and to develop more economical strategies for the management of facilities maintenance contracts. To achieve this, DEO put in place a rolling program of contract renewal and rationalisation across the country.

3.2 To ensure the rolling program's success, each Regional Estate Centre (REC) was tasked with developing a Regional Contract Transition Strategy (RCTS). These were to be the formal planning documents for the REC contract development process. They were to identify both interim and longer-term systems for delivery of the FACOPS Program in each newly-formed region.

3.3 Each RCTS was to consider the best method for managing maintenance in the period from the cessation of old forms of contract, such as standing offers, to the introduction of a new form of contract, the Comprehensive Maintenance Contract (CMC),³² which was being developed. Interim (or extended) contracts were to have an expiry date no earlier than December 1999, with an option for a single 12 months' extension. This allowed for some flexibility in timing the introduction of the CMCs.

3.4 Each RCTS was to be formally approved by the Assistant Secretary Estate Operations and Planning and the Defence Estate Executive prior to the strategy being implemented. This was to assist in national oversight by DEO. Such decisions rely on the accuracy and completeness of information submitted by the RECs in their RCTS.

³² The CMC was developed to improve the way Defence contracts out maintenance services for the Defence Estate.

3.5 An example where this national oversight impacted on the implementation process was where the Director Estate Operations and Planning gave the Regional Estate Centre–South Australia (REC–SA) preliminary approval of its RCTS. The REC then sought expressions of interest from contractors for two contracts in the old form, namely a General Building and Facilities Maintenance (GB&FM) contract and a Fixed Plant and Equipment Maintenance (FP&EM). When the Defence Estate Executive did not endorse this approval, the REC was required to inform potential tenderers that the tender process under way had been cancelled and that a CMC was to be implemented in the SA region. It has taken over twelve months since the decision to cancel tenders was made for the SA CMC to be awarded. The ANAO has been informed that the delay has been attributed to the lengthy timeframe involved in the delivery of a complex procurement process of this nature.

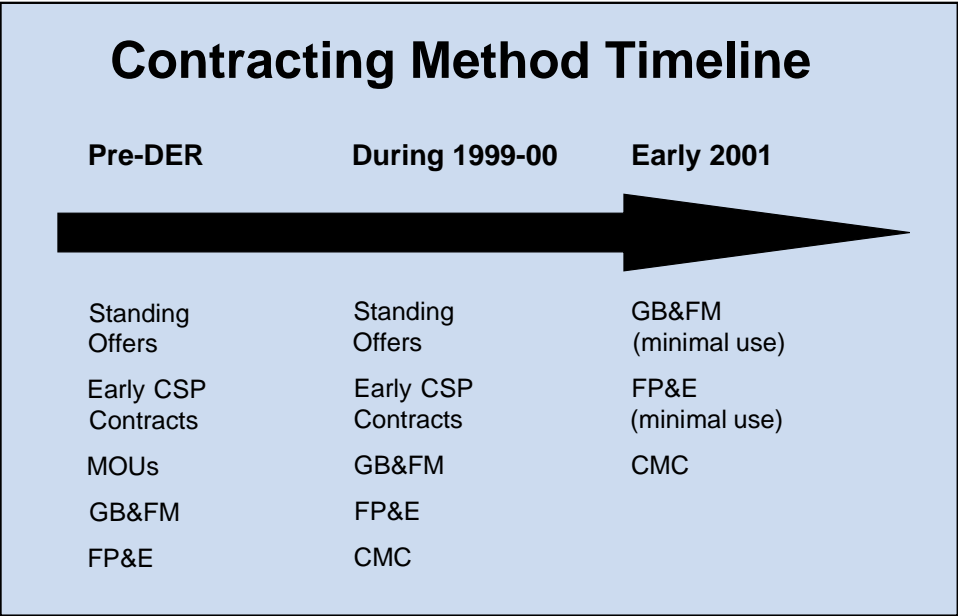
Contract management in the Regional Estate Centres

3.6 The ANAO examined contract management in four of the nine RECs (Central and Northern New South Wales (CNN); South Australia (SA); Southern New South Wales (SNSW); and South Queensland (SQ)). The four varied significantly in their progression down the path of contract renewal and rationalisation. These variations arose from the different contracting arrangements initially in place in each region and the different knowledge bases and capacities of regional staff. The DER suggested that an acceptable timeframe for the implementation of recommended changes was two to three years.³³ Accordingly, each REC is managing a different mix of facilities maintenance contracts in old and new forms.

3.7 Figure 4 shows a timeline of the different contracting methods in place in the FACOPS Program across the Defence Estate.

³³ *Future Directions for the Management of Australia's Defence—Report of the Defence Efficiency Review*, March 1997, p. 55.

Figure 4



Prepared by ANAO from DEO records.

Note: The following is the full description of abbreviations used in this figure.

- CMC—Comprehensive Maintenance Contract
- CSP—Commercial Support Program
- DER—Defence Efficiency Review (1997)
- FP&EM—Fixed Plant and Equipment Maintenance Contract
- GB&FM—General Building and Facilities Maintenance Contract
- MOU—Memorandum of Understanding

Standing Offers

3.8 As indicated in Figure 4, standing offers were still used to deliver facilities work in 1999–00. In some cases this took the form of a panel of contractors. The RECs themselves were unclear about the distinction, but in practice in the FACOPS Program a standing offer is an agreement whereby a firm makes a general offer to do work at specified prices; a panel is a list of approved firms that are given an opportunity to tender for work.

3.9 Prior to the DER, Army (which uses a large proportion of Defence’s facilities) used standing offers and local panels of contractors and consultants for delivery of facilities works. These were transferred to DEO to manage, and some are still current, awaiting transition to a CMC. Details and management of these arrangements varied from region to region. When DEO and the individual RECs were established, full documentation on such arrangements did not always survive the administrative re-organisation. Establishing standing offers or panels is subject to Commonwealth procurement requirements regarding open and

effective competition and best value for money. Many records of the original arrangements managed by DEO are now incomplete. The ANAO did not attempt to assess the way they were established, but did review the way they are presently managed.

3.10 Standing offers for delivery of Urgent and Unforeseen Maintenance (UUM) and panels of contractors/consultants for delivery of minor works and project services were the main delivery methods used in the REC–SQ Greater Brisbane area.³⁴ During initial audit fieldwork in that office, documentation on the most commonly-used standing offers was unavailable, indicating that staff awarded work to contractors without reference to the relevant standing offers documents.³⁵ The specified duration (including extension period options) of standing offers in SQ had often been exceeded without testing the market to ensure open and effective competition and best value for money.

3.11 In the Greater Brisbane area, DEO had standing offers from three contractors for UUM work.³⁶ The offers commenced in 1995 for two years, with options for two one-year extensions. They should therefore have expired by 1999 at the latest.³⁷ But another document indicated that their original expiry date was 30 June 1996 and that the start date was ‘unknown’. They had been extended until 1 September 2000 by an exchange of letters. The additional extensions exceeded those provided for in the original arrangement. It would appear that the original standing offer documents had not been available when the Standing Offer summary file was developed more than 12 months earlier. This further supports the conclusion mentioned above that staff awarded work without reference to agreed standing offer documents.

³⁴ Regional Estate Centre—South Queensland’s (REC—SQ’s) Greater Brisbane area encompasses Gallipoli Barracks at Enoggera and smaller establishments nearby. Outside that area, at RAAF Base Amberley GB&FM and FP&EM Contracts are still in place. Facilities maintenance in the Oakey/Darling Downs region is now delivered through a CMC.

³⁵ During fieldwork in REC–SQ, the ANAO was advised that, if the original standing offer documentation was available, it would be in the REC summary folder detailing the updated standing offer list, copies of extension letters etc. The folder, however, contained only one original standing offer document.

³⁶ One contractor for plumbing work, one for electrical work and the third for carpentry-work.

³⁷ Two of the contracts were for the period 13 November 1995 to 12 November 1997. It seems reasonable to assume that the third contract for UUM work was for the same period.

3.12 Once project work is allocated to standing offer contractors, it is unclear from standard requirements of the standing offer agreement whether works are to be delivered: under the standing offer alone; with each Purchase Order forming a contract; or whether an additional contract document is required, particularly for works valued over \$30 000.³⁸ The ANAO considers that the primary consideration should be that the department and contractor have a clear agreement on the task to be performed, the price and any applicable conditions.

Panel arrangements

3.13 Minor new works projects assessed as ‘complex’ require a more detailed quotation and assessment process—see Appendix 2. Documentation for some REC–SQ procurements showed that selected firms were awarded work on the basis that they were on panels established for this kind of work. At the time of audit, however, specific information on panel formation and composition could be found for only two panels, which were no longer in existence.³⁹ In 1999–00 one firm, apparently on a former panel, was awarded work in excess of \$1 million. The firm was invited to submit quotations on these works on the incorrect assumption that the firm was on a current panel.

Civil engineering standing offers

3.14 REC–SQ had standing offers from three firms to provide civil engineering works. Distribution of work among the firms in 1999–00 was very uneven. One was awarded work to the value of \$510; another was awarded work to the value of \$320 000; and the third was awarded work in excess of \$1 million in value. REC–SQ’s explanation was that the companies were located in different areas of the South Queensland region and thus were used only as required.⁴⁰ However, the first two firms

³⁸ *Policy Guidance on Provision of Minor New Works* (in the Defence Estate Management Guide (DEMG) and disseminated to all staff in July 1999) states that for all works over \$30 000 it is mandatory for a Short Form Facilities Contract for Minor Works to be completed. Yet a standing offer Acceptance dating to 1997 from a contractor who still had a standing offer at the time the ANAO conducted fieldwork at REC–SQ stated that ‘the arrangement which the Commonwealth hereby enters into is a Standing Offer. Any order placed pursuant to this Standing Offer will be deemed to be a contract.’

³⁹ The only reference to one of these panels was a single page recommending five companies for inclusion on a panel for engineering services in the Greater Brisbane area. The document this page originally came from could not be found. There was also documentation on a panel for architectural services that included five companies. SQ region has other panels, and some panel types and members can be identified from Tender Board documentation but there is apparently no official documentation available, and the ANAO could not establish which panels were still current.

⁴⁰ REC–SQ also pointed out the difficulty of finding contractors to carry out works in isolated areas.

were both based in the same town and carried out works in the same regional area. In all the examples of project and financial data relating to these firms that were reviewed by the ANAO, only one firm was ever approached to provide quotations for projects. The value of the individual projects varied, with some costing over \$250 000. In all instances, the ANAO was unable to locate a corresponding Short Form Contract or Facilities Contract for Medium Works.

3.15 Continually extending standing offers without testing the market, continuing to use contractors' services when the contractual relationship is unclear, and awarding substantial amounts of work to contractors without seeking other quotes indicate that basic procurement requirements are not being met. In addition, work awarded without reference to relevant contracts indicates poor contract management.

3.16 The ANAO was advised that use of standing offers in REC-SQ will be significantly reduced with the full implementation of the CMC by November 2000. DEO considers that the implementation of a competitively-sourced Greater Brisbane area CMC is a higher priority than concurrent retesting of the remaining standing offers over a relatively short period. DEO expects that there will be no standing offers in any REC by December 2000.

Commercial Support Program Facilities Operations Contract

3.17 The Commercial Support Program (CSP) was introduced into Defence in 1991. The objective of the CSP was to achieve the best value for money in the acquisition of support services for Defence, and to give the private sector an opportunity to participate in the provision of those services.

3.18 Through CSP, Defence Science and Technology Organisation (DSTO) at Salisbury market-tested their facilities operations in 1995. The service was outsourced from 1 January 1996 for an initial three-year period. The CSP Facilities Operations Contract entered into by DSTO encompassed a management component for the delivery of facilities works; preventative maintenance; minor new works and minor maintenance works. The contract was later amended to include the provision of a fault reporting (including UUM work) service.

3.19 REC-SA took over the management of this contract from DSTO early in 1998. There was minimal contract documentation on file after 31 December 1997. There were 22 contract variations in the initial two years when DSTO had responsibility for the contract, but only three variations were documented on file in the two-and-a-half year period since December 1997 when REC-SA has had responsibility for the contract. The file provided information relating to two contract extensions: the

first for the period 2 January 1999 to 30 June 1999 and the second for the period 1 July 1999 to 30 June 2000. When the contract was initially extended the contract requirement and management fee was changed.

3.20 The changes to the management fee did not correlate with the original contract structure. There is no information on file relating to the changes in contract requirements and the changes in the fees for service paid by REC-SA to the contractor. The ANAO was advised that the changes in contract structure occurred before REC-SA was formed. No information was available on the reasons for the changes. From ANAO analysis of data available, the CSP Contractor was paid a management fee higher than could reasonably be expected for a contract of this nature.

3.21 The contract was financed by both DEO and DSTO. In 1999–00, \$1.34 million from the DSTO Supplies and Equipment budget was allocated to this contract. It is difficult to ascertain what this DSTO funding paid for. The ANAO was advised that it was to cover the entire contract but audit fieldwork disclosed evidence indicating that the preventative maintenance and some minor works components of the contract were paid from DEO's FACOPS Program funds. At the time of audit REC-SA was reviewing the contract.

3.22 This legacy contract was replaced by a CMC for the South Australian region in September 2000. Significant savings have been achieved.⁴¹

General Building and Facilities Maintenance Contracts

3.23 As a result of untying from the then Department of Administrative Services in the early 1990s, Defence decided that it needed new arrangements for delivery of facilities works. Navy and Air Force together developed two forms of contract for the delivery of facilities maintenance services. These were the General Building and Facilities Maintenance Management (GB&FM) Contract and the Fixed Plant and Equipment Maintenance (FP&EM) Contract. DEO is now replacing them with CMCs.

3.24 GB&FM contractors manage unplanned maintenance and building works; planned or directed procurements of plant and equipment; and enabling design work. The work is undertaken by subcontractors engaged under detailed criteria in the contract. GB&FM contractors are specifically used to manage the works and the associated subcontractors. They receive a base amount management fee that can be increased according to the amount and value of works requested.

⁴¹ The value of works under management with the new CMC has increased by at least five times that of the CSP contract for a similar management fee.

3.25 Earlier versions of the GB&FM contract provided for an estimated number of work orders as the measure to be applied in determining a fixed fee. As UUM work orders approached the estimated number, regional staff looked for other means of delivering parcels of work to avoid incurring higher management costs from the GB&FM contractor.

3.26 Audit fieldwork disclosed that a GB&FM contract managed at RAAF Amberley out-station could not be located there or at REC-SQ. The contract had been missing for over six months. This is unsatisfactory, as the contract is still current, with regular payments being made to the contractor.

Fixed Plant and Equipment Maintenance Contracts

3.27 Fixed Plant and Equipment Maintenance (FP&EM) contracts provide for performance-based maintenance of technical plant and equipment. These contractors, unlike GB&FM contractors, may use their own staff, subcontractors, or a combination of both to undertake the work.

3.28 Included under this type of contract are all inspections, monitoring, and preventative maintenance of equipment; latent conditions work; parts/plant replacement; and breakdown repairs necessary for the contractor to deliver defined performance outcomes in accordance with the Maintenance Specification detailed in the contract. Contractors receive a lump sum fee for performing these works.

3.29 FP&EM contracts are based on risk-sharing. The contractor bears responsibility for faults and breakdowns attributable to under-servicing or poor maintenance planning. The REC reimburses the contractor for works above a Reimbursable Work Limit (RWL)⁴² if the contractor proves they resulted from force majeure⁴³ or latent conditions. Work valued above the RWL needs to be approved by the REC before the work is undertaken to ensure that costs are attributed in accordance with the terms of the contract. REC staff need to have appropriate skills and access to the contract to establish whether works above the RWL are the Commonwealth's responsibility.

3.30 FP&EM contracts provide contractors with incentives to establish continuous improvement cycles. The aim is to improve the plant and equipment performance over time, and provide budgeting and reporting mechanisms to highlight capital replacement requirements.

⁴² Under the latest version of the CMC the definition of RWL has been changed to Reasonable Work Liability.

⁴³ Circumstances beyond the contractor's control that excuse fulfilment of contract.

3.31 The reporting mechanism for this type of contract entails the supply of regular monthly reports on:

- types of failures occurring within the fixed plant;
- contractor response times to priority requirements⁴⁴ to faults; and
- variations to the plant and equipment covered under the Maintenance Specification.

3.32 Audit fieldwork disclosed situations where the FP&EM contract was missing, contract amendments could not be readily located, recent monthly reports were misplaced, and current contract administration documentation could not be located. This is unsatisfactory when the contract is current and regular payments are being made to contractors. Without access to the contract and appropriate pricing and costing information, there is doubt about REC staff's ability to certify properly monthly invoices for payment to the contractor.⁴⁵

Comprehensive Maintenance Contracts

3.33 The one-team approach on delivering facilities maintenance, based on collaborative contracting principles, was introduced into Defence through GB&FM and FP&EM contracts. This approach has been extended with the development of the Comprehensive Maintenance Contract (CMC). CMCs in effect combine the GB&FM and FP&EM contracts into a single contract. They are used to engage a single contractor to manage and coordinate GB&FM works, and to manage and action performance-based and scheduled FP&EM maintenance work, for a tendered sum. Contractors are to provide all necessary personnel and resources to undertake the work detailed in the Maintenance Specification.

3.34 CMCs do not cover cleaning and grounds maintenance, which are already covered by Defence Corporate Support's Garrison Services contracts.

⁴⁴ Response requirements are detailed in the Contract Particulars. The classification of works as Immediate, Urgent, and Routine in priority are used consistently throughout the RECs, yet the definitions of these terms vary from contract to contract. But, in all cases, works classified as Immediate are considered to be of the highest priority and must be attended to and made safe within a matter of hours.

⁴⁵ Total monthly invoices vary throughout the year because of payments above the RWL in addition to the fixed monthly fee. To authorise payments, REC staff need a sound appreciation of all the separate components of a monthly invoice.

3.35 DEO expects CMCs to:

- provide value for money for the Commonwealth through fewer, larger contracts;
- optimise the performance of all equipment while being cognisant of the equipment's criticality;
- achieve the optimal life of equipment, and extend its life where possible;
- assist in the evaluation of life-cycle costs for assets;
- provide an improved working environment for DEO clients;
- improve the client-service focus of the DEO and contractors;
- transfer a proportion of the risk from Defence to contractors under an agreed risk-sharing approach;
- develop a strong, long-term working relationship in the form of a strategic alliance between contractors and DEO; and
- improve strategic and operational-level planning with regard to facilities on Defence establishments.

3.36 This contract form offers significant advantages to the Commonwealth. Defence perceives the advantages of properly administered CMCs to include:

- improved planning of maintenance activities and further establishment development;
- the possibility of importing expertise to deliver facilities maintenance;
- lower overheads for the management of contractors through the reorganisation of management structures;
- lower contract prices generated by the use of fewer, larger contracts delivering services at a number of sites; and
- a reduced need for REC staff to manage day-to-day activities, allowing more resources to be applied to long-term strategic maintenance planning.

Savings from CMCs

3.37 CMCs are now DEO's preferred method of contracting for maintenance services. Contractors are no longer paid according to the amount of work done but are paid an agreed amount to maintain certain standards. DEO considers that CMCs produce substantial savings, but these are difficult to quantify. Without data on the costs of previous delivery methods, there is no baseline from which to measure savings. However, recent replacement of GB&FM and FP&EM contracts at RAAF

Base Fairbairn with a CMC indicates the savings that can be achieved. DEO reports that the CMC resulted in a 50 per cent reduction in the management fee for substantially the same scope of maintenance work. DEO is initiating a study into the extent of savings achieved by the introduction of the CMC.

3.38 Due to the inherent nature of a performance-based contract there is an increased risk that only minimal regular preventative maintenance on fixed plant and equipment would be undertaken. This has the potential of more rapid deterioration, leading to a shorter life of the asset. DEO is conscious of the risk that the savings may be so high that the Estate is potentially being under-maintained.

Renewing CMCs

3.39 When CMCs were introduced, a number of sites in a geographical region (e.g. Shoalhaven region, Russell and ADFA/Duntroon) were grouped for the purposes of a separate CMC. CMCs recently awarded cover whole regional areas, such as the SA region and the Western Australia region.

3.40 There is a risk that such large contracts, when their term expires, will simply be extended to postpone the need to repeat the tender and assessment process. In the past some Defence contracts have been allowed to lapse or have been extended because of delays in reletting.⁴⁶ The scheduled expiry of service contracts provides opportunities to test the market so as to ensure the Commonwealth receives best value for money. This involves re-assessing needs, calling for fresh tenders and assessing the tenders.

3.41 Renewing a large CMC contract covering a region would involve a deal of work. To extend maintenance contracts beyond their original term is usually not in the Commonwealth's interests. DEO indicated that such extensions are unlikely as the CMCs have been let for eight years, based on an initial term of three years with options to extend for up to five years. Contractors have been advised that DEO view these as three-year contracts.

⁴⁶ See Auditor-General, Audit Report No.31 1994-95, *Defence Contracting*, 7 June 1995, p. 39.

Approval process and payments of contracts

3.42 The preceding sections in this chapter concerned audit review of works files in the RECs. This section concerns audit review of Purchase Order files in the RECs. These files should contain the documents in the 'Document Checklist' at Appendix 2. The audit disclosed that, in many instances, the documentation was not on file and could not readily be located and that the files held only minimal information.

3.43 The ANAO reviewed a large sample of files at REC-SQ for works individually costing less than \$10 000. In each case (except one) the REC awarded the work to a contractor on the basis of a single written quotation. The total value of works under \$10 000 awarded to contractors in 1999–00 exceeded \$900 000.⁴⁷ Without 'open and effective competition' by market testing, it is unclear whether the Commonwealth obtained best value from these contractors.

3.44 Even files on projects costing over \$30 000 in REC-SQ did not contain all the documentation required. The relevant Instruction (see Appendix 2) provides that, for works costing over \$30 000, it is mandatory to raise a Short Form Contract. In almost all instances, a copy of the Short Form Contract was not on file and there was no indication of its location. On a project valued at approximately \$90 000 for environmental work, the relevant Project Officer was unaware that the Short Form Contract was required and understood that a Purchase Order to the contractor was sufficient.

3.45 The ANAO reviewed an Asset Maintenance (AM) project for pavement maintenance in the Wide Bay Training Area. The project cost was approximately \$414 000. The work was awarded on the basis of a single written quotation because the company had a standing offer with REC-SQ.⁴⁸ The work was let as a schedule of rates and the quotation was assessed against the approved rates contained in the standing offer. Since this work was estimated to cost over \$250 000, approval for the delivery method was sought and gained from Central Office through a Facilities Acquisition Strategy.⁴⁹ However, the Purchase Order Submission was signed by a REC staff member who lacked the appropriate (Procurement Approver) delegation and without citing as required the approval from Central Office.

⁴⁷ ANAO calculation based on information provided by REC-SQ.

⁴⁸ The standing offer documentation does not stipulate under what circumstances quotations should be sought.

⁴⁹ *Defence Estate Instruction 7—Tendering and Source Selection* sets out for procurement of works estimated to cost in excess of \$250 000. Facilities Acquisition Strategies, Tender Evaluation Plans, and Tender Evaluation Board recommendations must be approved by Central Office.

3.46 A project costing \$1.3 million was awarded to a contractor for the provision of smoke detection upgrades for living-in accommodation. The project had gone to tender and the work was awarded using the Short Form Contract. There was no reference on the Purchase Order file to an approved Facilities Acquisition Strategy, Tender Evaluation Plan or Tender Evaluation Board recommendation.⁵⁰ The Purchase Order Submission was not signed by the appropriate delegate (Procurement Approver), nor was there any indication of prior approval for the project from Central Office.

3.47 In REC-SA, REC staff signed all Purchase Orders Submissions, including those beyond their approval delegations. On an AM project valued at approximately \$450 000, all details were on file with cross-references to the approved Facilities Acquisition Strategy and Tender Evaluation Board recommendation. The data available on file indicated that proper procedures had been followed, except that a REC-SA staff member signed the Purchase Order Submission without the appropriate delegation to do so. Other files showed that REC staff signed a number of Purchase Order Submissions, each in excess of \$1 million, without appropriate approval delegation. These related to some of the large ongoing contracts in the region, namely the DSTO Salisbury Facilities Contract and the RAAF Base Edinburgh FP&EM Contract.

3.48 Approval of Purchase Order Submissions by unauthorised personnel and the subsequent raising of such Purchase Orders are contrary to Defence's Chief Executive Instructions made under the *Financial Management and Accountability Act 1997*. The staff involved appeared to be unaware of their responsibilities in relation to the expenditure of Commonwealth funds.

Staff

3.49 Since the formation of DEO on 1 July 1997, there have been substantial staff reductions and significant savings in salaries. The reform targets for DEO staff numbers proposed in the DER⁵¹ were 150 Central Office staff and 375 regional staff. These staff reduction targets have been significantly exceeded—see Tables 2 and 3. Savings have resulted from reductions in the duplication of services within each region, and from more efficient service delivery mechanisms.

⁵⁰ An unsigned copy of the Facilities Acquisition Strategy was found in another file.

⁵¹ *Future Directions for the Management of Australia's Defence, Addendum to the Report of the Defence Efficiency Review: Secretariat Papers*, p. 235.

Table 2
DEO staff numbers

<i>Item</i>	<i>Pre-DER (June 1997)</i>	<i>June 2000</i>	<i>June 2001 est.</i>
APS staff	-	285	300
ADF staff	-	89	72
Total DEO staff	795	374	372

Source: *Future Directions for the Management of Australia's Defence, Addendum to the Report of the Defence Efficiency Review: Secretariat Papers* p 216 and DEO records.

Note: Breakdown of pre-DER staffing numbers is unavailable.

Table 3
DEO salaries—\$m

<i>Item</i>	<i>Pre-DER (1996-1997)</i>	<i>1999-2000</i>	<i>2000-2001 est.</i>
APS salaries	-	18.4	15.9
ADF salaries	-	5.1	5.0
Total DEO salaries	38.5	23.5	20.9

Source: *Future Directions for the Management of Australia's Defence, Addendum to the Report of the Defence Efficiency Review: Secretariat Papers* p 216 and DEO records.

Note: Breakdown of pre-DER staffing numbers is unavailable.

Table 4
EOP Branch staff numbers (including RECs)

<i>Item</i>	<i>Pre-DER</i>	<i>December 1999</i>	<i>June 2000</i>	<i>June 2001 est.</i>
APS staff	-	208	218	227
ADF staff	-	97	65	51
Total EOP staff	635	305	283	278

Source: *Future Directions for the Management of Australia's Defence, Addendum to the Report of the Defence Efficiency Review: Secretariat Papers* p 216 and DEO records.

Note: Breakdown of pre-DER staffing numbers is unavailable.

3.50 Most DEO staff are in EOP Branch, which manages the FACOPS Program. Table 4 shows EOP Branch staff numbers. DEO indicated that staff reductions have had an adverse effect on the ability of RECs to manage the remaining old forms of contract, which require more ongoing management attention.

3.51 DEO has been advised that it is to lose more military positions, specifically from Air Force and Army. DEO has expressed concern that it will lose the corporate memory and experience base currently provided by senior military members. Additionally, the efficiencies gained by co-locating Estate services in 1997 may diminish if the required training of military personnel in construction related activities are duplicated at the operational level. While such loss could be ameliorated by a Knowledge Management System, such a system would take some time and expense to develop and implement.

3.52 It is clear that there will be fewer in-house personnel to manage the FACOPS Program and the new delivery methods such as CMCs. This evolving situation requires a change in the RECs' operational culture. Once the CMCs mature, the focus of REC staff should be on client liaison and planning the FACOPS Program, rather than on the day-to-day delivery and supervision of works as before. Many REC staff positions are being re-defined, and some are being advertised to ensure that staff appreciate the changes required. Rapid staff reductions and the short time staff have had to adapt to changed roles have had an impact on the RECs' delivery of the FACOPS Program.

3.53 It is essential that DEO staff have the appropriate skills, through qualifications and experience, to deliver the services required to fulfil DEO's mission to shape and manage the Defence Estate to meet Government and Defence needs. The examples of contract management cited earlier in this chapter indicate that there is scope for improving procurement and contract management in the RECs. The increasing demands of modern Defence Estate management through larger, more complex contracts also create a need for better contract management. CMCs require DEO to approve certain CMC contractors' sub-contracts, and this creates risks for the Commonwealth.

3.54 DEO finds it difficult to attract appropriate staff. As DEO loses military positions, there is a need to attract professionally-qualified staff and to develop and retain the knowledge base for managing the Estate. A targeted graduate recruitment program may enable DEO to attract suitably qualified personnel and provide an environment from which both DEO and its staff can benefit.

Recommendation No.2

3.55 The ANAO *recommends* that DEO review its workforce recruitment, development and retention policies with the aim of ensuring the availability of staff with appropriate qualifications and experience to meet its program objectives.

Defence response

3.56 Agree.

Contract monitoring

3.57 The large size of the new CMCs, the need for DEO to approve certain CMC contractors' sub-contracts, and reduced in-house staff numbers to manage the contracts all create an increased risk to the Commonwealth. There is no procedure for regular review of contractor performance or for formal review at specified stages throughout the life of a contract.⁵² The ANAO is unaware of the development of any risk management strategy to assess the risk of non-performance by contractors or deterioration of the Estate. It would be preferable for DEO to monitor, through a planned program of focused reviews, contract work involved in the delivery of the FACOPS Program to ensure that work is being delivered as required under contract.

Recommendation No.3

3.58 The ANAO *recommends* that DEO regularly monitor contract work involved in the delivery of the FACOPS Program, through a program of focused reviews, to ensure that work is being delivered as required under contract.

Defence response

3.59 Agree.

Access to contractors' records and assets

3.60 Under the *Auditor-General Act 1997* the ANAO has access to Commonwealth agencies' records and, the ANAO has been advised, to contractors' records that may be needed for an audit. However, in the interests of transparency and efficiency, it would be more effective if at least significant support contracts provided for the ANAO to have access to contractors' records to ensure that adequate processes are in place to protect the Commonwealth's interests. Such provision would not usually be necessary for 'products' or 'commodity type' services provided in the normal course of business. This provision is particularly important with Commonwealth agencies' growing reliance on partnering with the private sector and contractors' quality assurance systems.

⁵² Such reviews are generally undertaken only when past performance is assessed in relation to a tender submission for a new contract.

3.61 In 1997, in the context of the increasing use that agencies were making of contractors to deliver Government services, the ANAO wrote to agencies asking that, in making contracts, they provide for:

- a) the agency to have access to contractors' records, information and assets directly relevant to contract performance to give the agency an adequate level of control and performance monitoring of contractual arrangements; and
- b) the ANAO to have an equivalent level of access (but not an unfettered access to contractors' premises) to enable the ANAO to fulfil its statutory responsibility to the Parliament.

3.62 The ANAO report on the Commercial Support Program recommended that Defence's support contracts provide for Defence and the ANAO to have access to contractors' records, information and assets directly relevant to contract performance.⁵³ Defence agreed that its support contracts would include provision for adequate access to records by the ANAO where appropriate.

3.63 Regardless of ANAO and subsequent Joint Committee of Public Accounts and Audit recommendations,⁵⁴ none of the facilities maintenance contracts, including recent contracts reviewed in the present audit,⁵⁵ provided for suitable Defence or ANAO access.

Call Centres

3.64 DEO has set up Call Centres around the country, either in isolation or as part of the CMC implementation process, to assist RECs with receiving and processing requests for UUM work. These Call Centres are also referred to as Help Desks or Fault Reporting Services.

3.65 Call Centre operations are not consistent across the country. At REC-SNSW, for example, the Call Centre is the central point for the submission of work requests. Individuals at the unit level make their request by phone or fax; the Call Centre then enters the request into the Defence Estate Management System-Facilities Maintenance and assigns it to the appropriate work folder in that system. If the task is high priority, the Call Centre contacts the appropriate contractor for a prompt response. The Call Centre also provides a follow-up and feedback service to the requesting client.

⁵³ Auditor-General, Audit Report No.2 1998-99, *Commercial Support Program—Department of Defence*, July 1998, p. 82.

⁵⁴ Recommendation 5 of the Joint Committee of Public Accounts and Audit Report: *Review of Auditor-General's Report No. 34 1997-98, New Submarine Project*.

⁵⁵ The access clauses in CMCs relate specifically to access being provided for assessment of the CMC contractor by an external contractor to assess whether an option to extend the contract should be exercised.

3.66 At REC–CNN, REC–SA and REC–SQ, Call Centres are one of a number of ways a work request can be submitted. In these regions, the units have people tasked, in addition to their regular duties, to consolidate and enter the work requests into DEMS/FM, or to fax the requests to the Call Centre. As a general rule, the Call Centre is called only if the work request is classed as being of immediate priority.

3.67 DEO would improve client satisfaction across the country if it clarified Call Centres’ operational procedures and made all Call Centres’ operations consistent.

Conclusion

3.68 Inefficiencies in inherited facilities maintenance contracts were recognised by DEO several years ago. Strategies have been put in place that will see such contracts phased out by the end of 2000 and replaced by a new contract form better suited to modern estate management by fewer staff. EOP Branch’s maintenance contract delivery reforms are consistent with the DER’s expected timeframe for change.

3.69 However, current contract management practices on older forms of contract, including approving and paying contractors, in some of DEO’s regional estate centres give little confidence that they provide open and effective competition and best value for money in all cases. Good practice in contract management requires, for example, ready access to the completed signed contract and associated documentation when authorising payments. Contracts, old or new, need to be actively managed to avoid inefficiencies. Contract management needs to be improved as DEO moves to large complex contracts managed by fewer staff.

3.70 Documentation relating to procurement decisions, and required to support payments, was frequently unavailable. Without the documentation it is difficult to assess whether correct procedures had been followed on works projects. Purchase Orders were frequently raised with minimal supporting documentation. Some Purchase Orders for more than \$1 million were raised by staff who did not have appropriate authorisations. This is clearly contrary to Defence’s Chief Executive Instructions made under the *Financial Management and Accountability Act 1997*.

3.71 Staff numbers across EOP Branch, especially in the RECs, have been reduced and subsequent savings have been achieved. The timing of some of these reductions has, however, had an impact on the standard of contract management in the RECs, particularly where the CMC has not been fully implemented. Staff remaining in DEO need to have the appropriate skills to manage large, complex facilities maintenance contracts in the Defence environment.

3.72 Access clauses within these contracts should be strengthened to provide for DEO and ANAO to have suitable access, as necessary, to contractors' records and Commonwealth assets directly relevant to contract performance.

4. Regional Estate Operations Bid Process

This chapter examines how the Regional Estate Centres develop and submit bids for funding and consult with clients throughout this process. Areas where improvements could be made are identified.

Bid process

4.1 As part of the planning process for the FACOPS Program, the Regional Estate Centres (RECs) submit bids to EOP Branch for annual funding. The FACOPS Program is compiled from two separate bidding processes: the Asset Maintenance (AM) bid, which comprises planned maintenance projects and Environmental Management Works (EMW) estimated to cost more than \$250 000; and the FACOPS bid, which comprises all other items in the FACOPS Program.⁵⁶

4.2 Each REC submits its bid via the Defence Estate Management System–Facilities Maintenance (DEMS/FM).⁵⁷ Bids are made under each Expenditure Group and account code. AM bids should itemise individual projects, include a Facilities Executive Summary (FES) for each project, and rank them in order of importance. FACOPS bids should give a breakdown of individual cost centre items and, where necessary, itemise individual projects and rank them in order of importance.

4.3 The current bid process is designed to enable longer-term planning. Bids must be submitted in the form of a three-year program (including any outstanding liability) with financial phasings.

4.4 RECs are required to submit AM bids to the Director Estate Operations and Planning (DEOPS) by 1 December of the financial year preceding program delivery, and FACOPS bids by 1 March of the financial year preceding program delivery. FACOPS allocations are proposed by DEOPS. The proposed AM allocation is devised through the Asset Maintenance Forum (AMF), which reviews and ranks all AM bids.⁵⁸ The AMF met for the first time in 2000. Previously, AM and FACOPS bids were both submitted by 1 March of the financial year preceding program delivery.

⁵⁶ The current bid process is outlined in DEI 5/1/4 *Management of Regional Estate Operations Bidding Process*.

⁵⁷ Until the bids for 2000-01, bids were submitted via an electronic spreadsheet.

⁵⁸ The AMF has four members from EOP Branch and one member from DEO 's Resources and Policy Branch.

4.5 The recommended FACOPS and AM allocations are submitted to the Assistant Secretary Estate Operations and Planning and the Head of the Defence Estate (HDE) for approval. Initial funding guidance for the approved AM program is issued to RECs in March, and for the approved FACOPS Program in May.

Regional formulation of bids

4.6 The way RECs formulate their bids has changed due to the change in the bid process. Broadly speaking, regional Managers of Defence Estate (MDEs) base their REC's bid on contract obligations, historical data, and specific regional needs.

4.7 When formulating bids for Minor New Works (MNW), MDEs seek client input. Projects of this type, that is, new works costing less than \$250 000, are identified in accordance with clients' requests, justified in relation to strategic and operational requirements, and assigned one of five priority ratings.⁵⁹ Each year, the list of unfunded projects is ranked in order of importance by the REC, or in consultation with clients through Works Priorities Committees (WPCs) at sub-regional level and Regional Facilities Committees (RFCs) at regional level. The agreed list of projects then forms the basis of the bid. Planned Maintenance (PM) projects (planned maintenance costing less than \$250 000) are developed in consultation with clients, often through the annual facilities appraisal process (see Para. 4.37).

4.8 AM and EMW go through the same development process as MNW projects, but are not necessarily included for discussion at regional forums.

4.9 The ANAO reviewed the 1999–00 and 2000–01 bid processes in Central Office and four RECs: Central and Northern New South Wales (CNN), South Australia (SA), Southern New South Wales (SNSW) and South Queensland (SQ). The framework of the bid process was generally satisfactory, as was EOP Branch's assessment of bids and allocation of funds. Review of the way that some bid components are formulated brought to notice several issues, as indicated below.

⁵⁹ Currently, the ratings are Priority 1—Work required to support capability and operational requirements, or urgent remedial works designed to avoid environmental liability; Priority 2—Occupational Health and Safety (OH&S), security, environmental and pollution control works (support and substantiation required from the relevant authorities); Priority 3—Living-in accommodation; Priority 4—Working accommodation which supports normal base/establishment functions; Priority 5—Other, e.g. recreational facilities. Clients assign priority ratings in the first instance, but these ratings may be changed by DEO staff or in Regional Facilities Committees meetings.

Consistency

Terminology and definitions

4.10 There is a lack of consistency in both terminology and processes across the regions. Terms used to describe the same work types vary from region to region. Some of the Expenditure Groups and account codes under the current bid process no longer correspond with terms in general use in the regions. It is not clear whether consistent definitions of work types are used across all regions.

4.11 Clear and consistent terminology and definitions throughout DEO would be desirable. DEO is attempting to address this through the compulsory use of DEMS/FM and the terminology defined in the DEMS/FM Documentation Manuals.

Regional Facilities Committees

4.12 There is a general lack of clarity and consistency across the regions as to which project types go to RFCs for consideration; who sits on RFCs; what procedures are needed before RFCs are held; how decisions are made at RFCs; and whether RFCs are held at all.

4.13 Concerns have been expressed to DEO in the past about the composition and conduct of RFCs, and there are still issues that need to be pursued. A consistent approach to RFCs across all regions would promote transparency in the process and equity of access to funding. RFCs are discussed in more detail below.

Facilities Executive Summaries

4.14 Facilities Executive Summaries (FES) are to support AM project bids. They must provide enough information for DEOPS to decide whether the priority rating of the project is justified, whether the project should be funded, and the appropriate year of delivery in the three-year rolling program. The format and content of FES are inconsistent across the regions.⁶⁰ DEO would benefit from having one clear model for the FES, and mandating its use by all regions.

⁶⁰ Though DEI 5/4/1 describes the current bid process, a draft version of it was circulating prior to submission of the 1999-00 bids. A FES Outline and sample FES were the same in the draft as in the final document, and most regions based the FES in their 1999-00 and 2000-01 bids on either one or the other.

Clients and the bid process

Information provided to clients

4.15 DEO clients should be able to gain a good understanding of the bid process and their own role in it from information readily available from the RECs. At present, such information does not appear to be available to clients without further consultation with REC staff. In keeping with DEO's focus on client service, clients need to be clearly informed of RECs' work processes. This would enable clients to decide when, and if, they need to consult their REC on bid-related matters.

4.16 Each region has a site on 'Defweb' (the Defence Intranet), and three of the regions reviewed had a client guide. But these provide only basic information and are not always easy to understand. It would assist clients if the RECs made their websites and guides comprehensive and presented information clearly and systematically. Process flowcharts would be a useful addition. In the interests of efficiency and national consistency, a single client guide for all regions could be made available on DEO's homepage.

Client input into the bid process

4.17 Client input is sought in the development of MNW, PM, and AM projects, though the level and type of client input into project development vary from region to region.

4.18 Client input into developing project proposals increases the likelihood of an appropriate, cost-effective and satisfactory project outcome. It also increases client satisfaction and 'ownership'. However, responsibility for development and submission of documentation relating to requests for AM, MNW, and PM projects should rest with REC staff and clients jointly. Though clients should be required to justify their need for a particular project and to detail their specific requirements, they should not be expected to write technical project submissions.

4.19 Client input is sought into the bid process for MNW and PM at a number of points. This is to be commended, despite the differences in the way that client input is sought from region to region.

Client satisfaction

4.20 Client satisfaction is recognised as important at both regional and national levels. The desire to gain immediate client satisfaction explains why the RECs continue to bid for reactive maintenance funds according to historical allocations despite overall budget reductions in recent years.

Reactive maintenance issues usually have a direct impact on clients' day-to-day environment.⁶¹ Clients thus tend to report such problems as they occur and expect them to be fixed quickly.

4.21 RECs can gain client satisfaction by seeking client input when developing project proposals and bids for MNW and PM. Failure to keep clients informed of issues relevant to them was noted to be a source of client dissatisfaction in the regions studied. Conversely, however, clients need to keep the RECs informed of issues that affect or will affect Estate management. For example, a request by clients for an office fit-out due to departmental restructure can cause difficulties for DEO if the extra work was not identified during development of the regional bid.

Regional Facilities Committees

4.22 The primary purpose of Regional Facilities Committees (RFCs) is to ensure that client Groups have input into the rankings of MNW and PM projects to be included in regional bids, and that Portfolio-wide interests are represented. The format, agenda, and composition of RFCs are left to MDEs, provided that the MDE chairs the Committee; client Groups are adequately represented; DEO staff at the Committee represent only DEO; and Command inputs are sought. Voting at RFCs is discouraged, as voting by client representatives could be considered to remove MDEs' responsibility for the FACOPS Program.

4.23 Analysis of RFC procedures in the four regions studied revealed that:

- not all regions hold RFCs;
- where regions do hold RFCs, processes may differ;
- there is a perceived lack of formality in the process;
- justifying individual project bids and priority ratings can be difficult;
- there is perceived and actual competition between Groups for funding;⁶² and
- the level of information communicated to clients after RFCs varied from region to region.

⁶¹ Problems addressed through reactive maintenance include leaking taps, broken door handles or windows, faulty hot water systems, and urgent OH&S issues.

⁶² In one region, projects from one Group were consistently accommodated before projects from other Groups. The remaining projects were spread relatively evenly between the other Groups. Projects were evidently not ranked according to genuine need but rather so that each Group was perceived to be getting a 'fair share' of funding. The basis for decision-making should be the justification for individual projects and the priority rating assigned to them.

4.24 The present WPC/RFC process involves considerable effort for little return to clients and REC staff. Most of the works ranked through the process will not be done, and new projects with a higher priority rating that arise throughout the year must be accommodated at the expense of projects on the ranked list. Allocations covering these types of work have always been very limited. Further, MDEs are able to shift funds between account codes and Expenditure Groups, which means that funds initially allocated to MNW and PM projects might not be spent on them.

4.25 The WPC/RFC process helps to facilitate client input and raise client satisfaction but its lack of formality leaves it open to abuse and diminishes the return to the Defence Estate and the clients from the effort involved. Client satisfaction with the level of consultation by local REC staff was generally highest in SNSW, where no RFC meeting was held in preparing the 2000–01 bid.⁶³ DEO should consider whether there is benefit in retaining the present WPC/RFC process.

4.26 If the WPC/RFC process is to continue, there should be clear directions on when WPCs and RFCs must be held and their composition and conduct. There also should be a clear annual statement to clients on the role of WPCs/RFCs in the FACOPS Program, the procedures governing them, and the importance of unit representation on them.

4.27 The current system of priority ratings is too broad to be effective. An objective and comprehensive set of criteria for the current five project priority ratings would assist in ranking projects under consideration. Classifying all facilities on establishments according to type or area and giving each classification a broad priority rating relating to operational capability may also assist.⁶⁴ ADF input into identifying the contribution to capability that each facility makes would appear necessary.

⁶³ REC-SNSW provides monthly briefings to its major clients. Yet some clients who did not receive these monthly briefings noted that there were no clear communication channels between themselves and REC staff. These clients reported a significant level of dissatisfaction with REC-SNSW.

⁶⁴ Inspector-General Division, Management Audit Branch, Audit Report *Facilities Operations (FACOPS)* October 1997, Annex C pp. 30-36 'An Example Methodology for Codifying Building Appraisal and Prioritising Tasks'. The United States General Accounting Office (GAO) report *Military Infrastructure—Real Property Management Needs Improvement* September 1999 assessed facilities management methodologies employed by each of the four Services. The GAO report also notes some 'promising practices' utilised by other organisations, and includes descriptions and analyses of the systems each Service uses to rank maintenance works. Material contained in these two reports may assist DEO in developing a more rigorous priority ratings system.

Asset Maintenance

4.28 EOP Branch has funded Asset Maintenance (AM) at over 10 per cent of total FACOPS allocation for the past three financial years. It considers that funding AM at this level reflects the importance of carrying out maintenance on a more cost-effective and longer-term basis. The AMF (paragraph 4.4) recommends projects for funding on the basis of the priority rating given to them by the regions and especially on the supporting documentation provided in the FES. Examination of the FES attached to the AM projects granted funding in 1999–00 and 2000–01 revealed:

- inconsistency in the format of FES submitted (paragraph 4.14);
- a general lack of cost breakdowns; and
- a general lack of detailed information.

4.29 It is important that RECs, through FES, clearly demonstrate that they have a sound understanding of what component works AM projects will require, and that their cost estimates are based on that understanding. Standardising the format of FES and improving information provided in them would demonstrate better why a project should be funded and allow more informed and transparent decision making. EOP Branch could consider providing:

- stronger guidance to the RECs on the required format and content of FES;
- feedback and guidance to the RECs in preparing FES; and
- advice to the RECs that inclusion of projects in the AM program and their priority are based on the quality of the FES submitted.

4.30 Providing more-detailed information in the FES would entail more development work for the RECs and more consultation with clients. More assessment by EOP Branch staff and the AMF would also be required. Yet, with the recent establishment of the three-year AM rolling program, projects likely to be granted funding in future have already been identified. With this increased time-frame for the development of AM bids, submission of better project bids and an increase in the information provided to EOP Branch in FES should be readily achievable. Increased expenditure on the development of AM bids in the short term could prove more cost-effective in the long term.

4.31 The introduction of the AMF process is commendable, since it formalises the process of granting funding to AM projects, allows for wider input from across DEO, and provides a more transparent decision making process.

Importance of a region-wide focus

4.32 A review of the FACOPS Program in 1997 by Defence's Management Audit Branch found that two of the benefits of regional administration of the Program could be '*consistent and equitable allocation of funding to sites within a region, subject to objective application of standards*', and '*a more effective client service*.'⁶⁵ Part of the reason for the establishment of DEO was to enable the delivery of estate services on a region-wide basis and to continue the shift away from delivery of estate services by individual Groups. There are indications in the regions that the previous arrangements are still having an impact on DEO, with some RECs giving better client service to particular Groups.

4.33 Procedures therefore need to be strengthened or revised across all RECs to ensure that regional bids and the ranking of projects are focused on support of operational capability for all Groups across the whole region, and are seen to be so focused. Increased consultation with clients would play a significant part in this.

4.34 Some clients have said that uniformed REC personnel of one Service were unable to appreciate the specialised facilities needs of the other Services. RECs need to liaise with their clients more effectively, but the Portfolio as a whole has an obligation to familiarise itself with DEO/REC procedures and communicate its particular requirements to RECs more effectively.

Impact of plans for the future

4.35 Implementation of purchaser-provider arrangements for DEO (see chapter 2) could have a significant impact on the FACOPS Program. In the interests of cost-effectiveness, Groups and the commanding officers of establishments would be required to identify those facilities most necessary to support operational capability and Defence objectives and consider the future of less-significant facilities. This could prompt a more rigorous priority rating system and bidding process for FACOPS services.

⁶⁵ Inspector-General Division, Management Audit Branch, Audit Report, *Facilities Operations (FACOPS)*, October 1997, p. 8.

4.36 Asset Appraisal will also have an impact. Asset Appraisal involves the development of a plan providing maintenance and management information for each asset, covering such areas as maintenance requirements, a recommended works program, maintenance costs, asset life, and the effect of not carrying out maintenance. These activities are covered by the previous 'condition appraisal' system. However, the two systems differ in that Asset Appraisal also recognises budgetary and operational imperatives; that is, the result of Asset Appraisal should be a maintenance program that is linked better to forward planning and Defence capability.⁶⁶ With this system being refined, changes in the current bid process may become necessary. In particular, clients may no longer be required to identify projects they want to have considered in the formulation of regional bids, and the need for the WPC/RFC process may be reduced or obviated, at least with regard to PM.

4.37 Yet MNW cannot be planned for in most instances, and the amount of funding available for such works will always be limited. In such circumstances, RECs will still need to play a role in balancing the needs of their various clients, even with the introduction of a more rigorous priority rating system. The forum for discussion that the WPC/RFC process provides may continue to be the most appropriate means of identifying and ranking MNW for inclusion in bids and works programs.

4.38 DEO should be encouraged to consider the appropriateness of current practices in light of the possible introduction and refinement of new management systems as discussed throughout this audit report.

Conclusion

4.39 The framework of the bid process, with client input, is generally satisfactory, as is EOP Branch's part in assessing bids and allocating funds. Formulation of some bid components by the RECs was less satisfactory. Standardising terminology and processes across the country would allow more transparent decision-making by EOP Branch staff and greater equity of access to funding for clients. More-detailed information in project bids and an objective and consistent set of criteria for the allocation of project funding priorities would allow bids to be assessed, and scarce funding to be directed according to client needs and Defence capability, with greater consistency than is currently the case.

⁶⁶ DEO, *Effective Asset Maintenance Programming: The Defence Estate Organisation—A Strategic Case Study*. See chapter 2 above for more information on this issue.

4.40 Providing clients with clear, consistent and accessible information would assist RECs in developing better relationships with their clients. The establishment of the AMF and the early submission dates for bids should improve the assessment of regional bids and the delivery of the FACOPS Program.

Recommendation No.4

4.41 The ANAO *recommends* that, to promote efficient and transparent decision-making by RECs and EOP Branch in the allocation of scarce FACOPS funds, and better relationships with clients, DEO develop:

- a) clear directions on the timing, composition and conduct of the Works Priorities Committee and Regional Facilities Committee processes;
- b) an objective and comprehensive set of criteria for the allocation of project funding priorities;
- c) a single, consistently applied format for the Facilities Executive Summary including concise project information and costings;
- d) clear and consistent definitions and related terminology for the categories of work delivered by the FACOPS Program; and
- e) procedures for providing clients with clear, consistent and accessible information on all relevant facets of the bid process.

Defence response

4.42 Agree.

5. Financial Management

This chapter examines financial management practices in Defence Estate facilities operations. Specifically it examines the development and allocation of the regional FACOPS Program budget within the financial management framework, including assessment of actual expenditure against the budget.

Financial allocations

5.1 Chapter 4 discussed the way that regional bids are developed and submitted to Central Office for funding allocation. EOP Branch consolidates the bids and assesses an appropriate distribution of funds on a national basis. Regardless of the RECs' bids for funds, the total allocation of funds must remain within the FACOPS funding 'guidance' (funds allocation) provided by Defence's Resources and Financial Programs Division through DEO's Facilities Resources and Programming section.

5.2 In addition to assessing the bids on a national basis, consideration is given to various industry benchmarks when determining the allocation of funds across the Estate including:

- the ratio of Net Replacement Value (NRV) to Gross Replacement Value (GRV) as an indicator of the age and condition of an asset. Assessment is undertaken by region and across the whole estate against the industry standard of 70 per cent;
- assessment of historical expenditure and potential funds allocation as a proportion of GRV and in relation to the industry standard of 2 per cent⁶⁷; and
- overall assessment of the above data taking into consideration other facilities related tasks such as approved capital reinvestment activities.

5.3 EOP staff use these empirical models as a basis for funding allocation, recognising that other factors such as condition and age of the asset, actual use of the facilities and environmental considerations also need to be taken into account. DEO's introduction of the revised Asset Appraisal system in 2001–02 should allow impacts on the estate to be quantified, from a financial as well as an operational perspective.

⁶⁷ The 'industry standards' referred to are general 'rule-of-thumb' empirical models that numerous organisations use in funding of facilities maintenance activities. ANAO's inquiries were unable to elicit information on these percentages or how they were assessed. Chapter 2 provides more information on this issue.

Planned expenditure and delivered works

5.4 As discussed in chapters 3 and 4, there is consultation at both the REC and EOP Branch levels on allocation of FACOPS Program funds across the whole Defence Estate. The ANAO examined works program budgeting and planning processes in relation to actual delivery of works and expenditure of funds in the regions.

5.5 ANAO analysis indicates that there is limited alignment between approved budget allocations and actual expenditure. This analysis was based on final allocation and expenditure data for 1999–00 rather than on the RECs' proposed works programs.⁶⁸ There were some significant mismatches between allocation and expenditure in the samples tested. The ANAO sought clarification from EOP Branch.

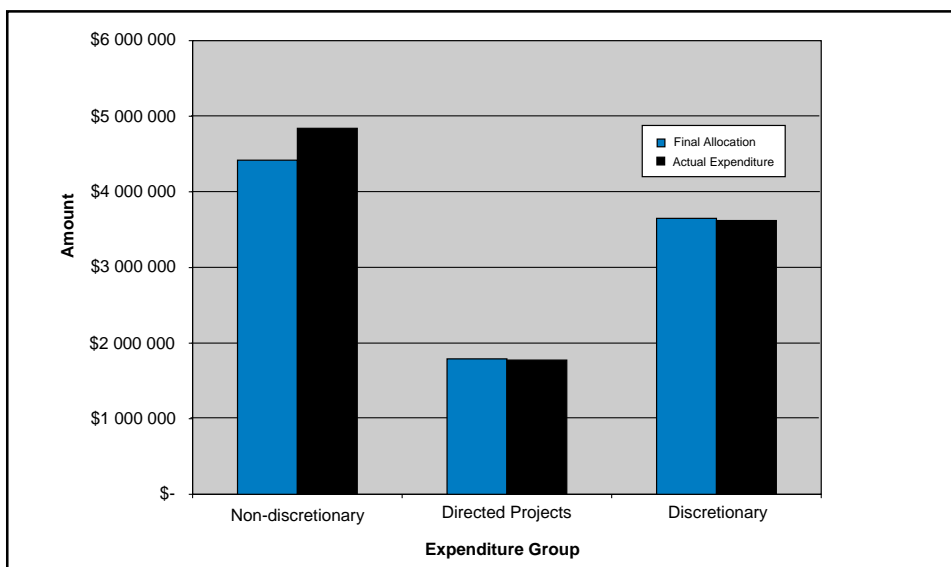
5.6 Managers of DEO's Regional Estate Centres (MDEs) may move funds only within each of the three Expenditure Groups: Discretionary, Non discretionary and Directed Projects. MDEs seeking to vary this guidance must gain approval from Central Office. To test whether the RECs do so, the ANAO tested the RECs' total expenditure according to Expenditure Groups.

5.7 Figures 5, 6 and 7 illustrate budget allocation and expenditure in each Expenditure Group for REC–CNN, REC–SNSW and REC–SQ.

⁶⁸ REC work plans were only partially complete, and thus could not be used for this analysis. A maintenance program cannot be fully planned, especially when resources are used on a reactive basis; yet one would expect that there is at least a broad plan against which works are bid and delivered. Such plans were not available in all RECs reviewed.

Figure 5

Budget allocation and expenditure —REC—CNN—1999–00

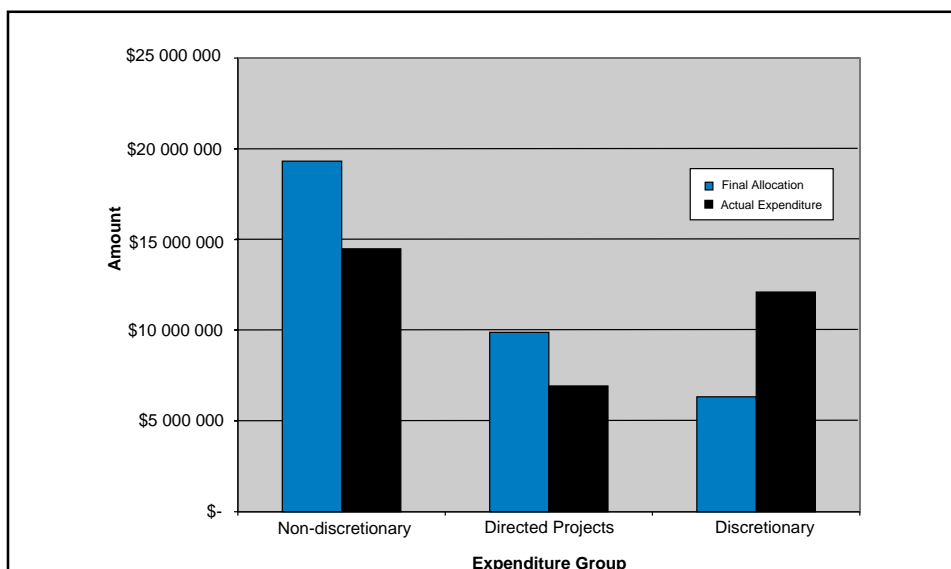


Prepared by ANAO from DEO data.

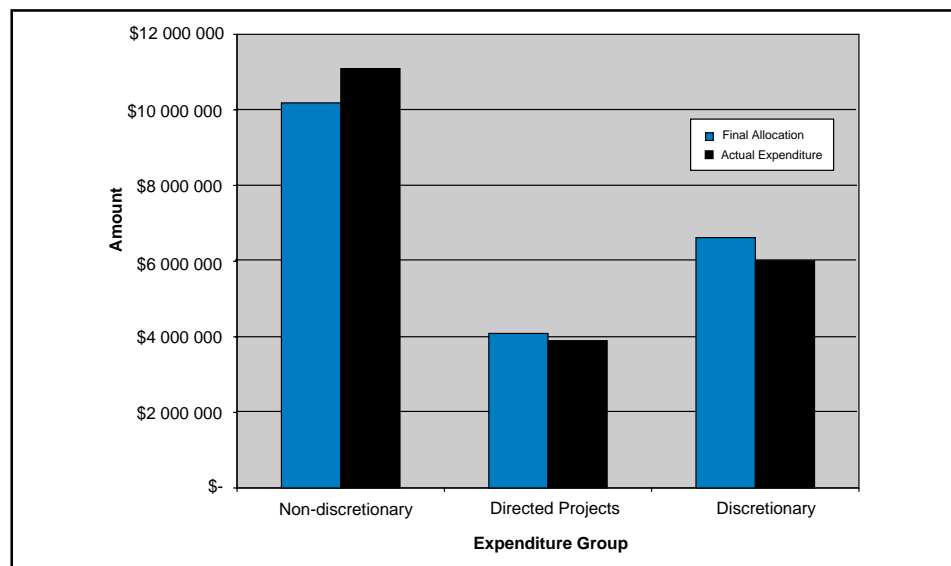
5.8 Figure 5 shows that REC–CNN expenditure in 1999–00 in Expenditure Groups for Direct Projects and Discretionary works corresponded closely with budget allocation advice from Central Office. Expenditure exceeded guidance for Non-discretionary tasks by over \$400 000.

5.9 Figure 6 shows that REC–SNSW expenditure in each Expenditure Group varied significantly from budget allocation advice. Underachievement for Non-discretionary works against allocation amounted to \$4.8 million, but allocation advice was exceeded by almost \$3 million for Directed Projects and \$5.8 million for Discretionary works.

5.10 Figure 7 shows that REC–SQ expenditure exceeded allocation advice for Non-discretionary works by over \$900 000 and but was almost \$200 000 less than allocation advice for Directed Projects and \$600 000 less for Discretionary works.

Figure 6**Budget allocation and expenditure—REC—SNSW—1999–00**

Prepared by ANAO from DEO data.

Figure 7**Budget allocation and expenditure—REC—SQ—1999–00**

Prepared by ANAO from DEO data.

5.11 It is unclear whether data displayed in the three Figures above indicate that these RECs do not attend to allocation advice from Central Office or that Central Office does not modify its financial data in accordance with approved variations for the RECs. Some 26 Allocation Variation Advice notices were issued to RECs over the year. The value of continual allocation advice provided to the RECs is questionable if compliance with the advice is not mandatory.

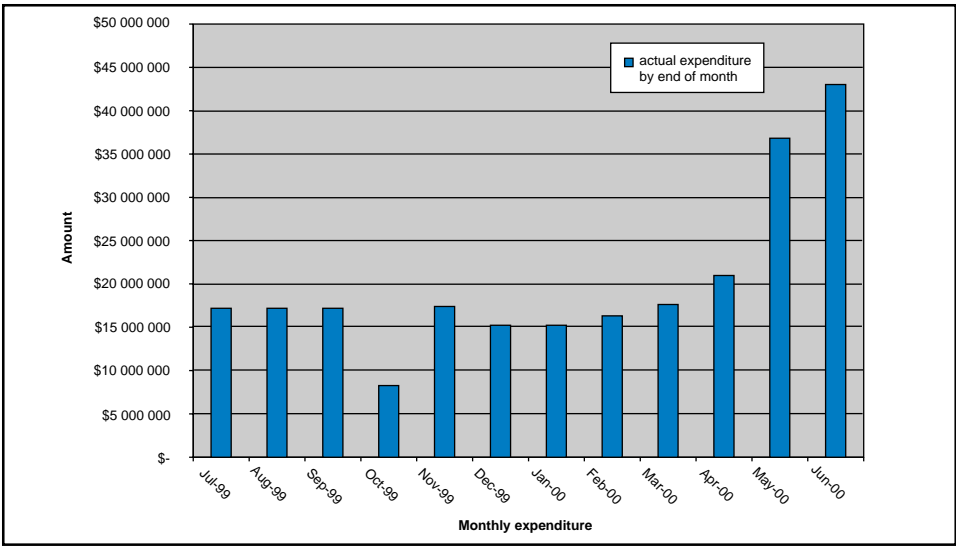
5.12 The work by the RECs in developing detailed bids and by EOP Branch in consolidating the bids, allocating funds and monitoring expenditure becomes nugatory if RECs can shift funds to lower priority work.

Expenditure targets

5.13 DEO Central Office practice is to press the RECs to spend their funds. Documentation issued by EOP Branch in March 2000 indicated Central Office's concern of an underspend against forecasts in regions in the Planned Minor Maintenance and Minor New Works account codes.

5.14 Data for expenditure in 1999–00 indicate that expenditure focussed on the last three months of the year to meet annual expenditure targets. Figure 8 illustrates national monthly FACOPS Program expenditure in that year.

Figure 8
National monthly FACOPS Program expenditure—1999–00



Prepared by ANAO from DEO data.

Note: Separate data for July and August 1999 and January 2000 were unavailable. In Figure 8 the ANAO has allocated total expenditure in July, August and September evenly across those months, and allocated total expenditure in December and January evenly across those months. Data were obtained from EOP Branch reports issued to the regions on an as-required basis, beginning in September 1999.

5.15 Figure 8 indicates that there was a rush to expend funds in the final three months of the year before remaining parliamentary appropriations lapsed at 30 June. REC staff indicated that it is immaterial when funds are expended, since expending funds results in projects being delivered to clients. The ANAO considers, however, that the practice of exhausting appropriations before they lapse is undesirable unless there is a commensurate advantage for the Commonwealth. So much expenditure in such a short time raises concerns that projects are chosen, designed and delivered in haste, and that the Commonwealth may therefore not be receiving value for money. It is also unclear how so many projects being managed in such a short time frame can be managed effectively.

5.16 EOP Branch recognises this expenditure rush as a problem, as shown by their work to begin the delivery of Asset Maintenance projects in the RECs before 2000–01.⁶⁹ But it continues to promote the view that the RECs should spend their FACOPS Program budget fully. EOP Branch notified all MDEs in February 2000 of the amounts that they needed to spend to meet their end-of-year expenditure targets, and asked them to propose a strategy for meeting those targets.⁷⁰ EOP Branch also asked MDEs whether they were likely to have funds remaining that EOP Branch could reallocate to other RECs. Some RECs' received reallocated funding because they were able to spend it on high-priority elements of the following year's program. Funds were allocated between RECs to achieve budgeted outcomes even though this added to the expenditure rush that EOP Branch recognises as a problem.

5.17 In 1999–00 five RECs overspent approximately \$4.7 million with EOP Branch's approval. EOP Branch considered it disappointing that \$3.8 million was overspent without approval, but that, overall, the expenditure of approximately \$8.5 million beyond the original FACOPS Program budget was *'very good'*.

5.18 EOP Branch indicated to the ANAO that expenditure over-achievement (an over-spend) was a positive outcome because it contributed to the overall achievement of budget targets by the Defence Portfolio. It also placed the FACOPS Program in a better position for the next financial year's funding reductions by minimising the Outstanding Liability of contracts already let.

⁶⁹ In addition, the newly-introduced rolling three-year budgeting system for the FACOPS Program should facilitate planning of procurement activities on a continuing, rather than annual, basis.

⁷⁰ As at 11 February 2000, CNN needed to expend nearly \$0.848 million per month to meet its end of year financial target; SA needed to expend nearly \$1.46 million per month; SNSW needed to expend nearly \$4.88 million per month; and SQ needed to expend nearly \$1.906 million per month.

5.19 DEO has advised the ANAO that *'higher defence strategies and their timing such as forward loans, Timor funding, one-off [FACOPS Program budget] cuts and portfolio adjustments in priorities'* had an impact on the FACOPS Program expenditure trends in 1999–00.

Findings in earlier audits

5.20 Spending for the purpose of meeting expenditure targets is not in the Commonwealth's budgetary or contractual interests. This issue has been raised in several ANAO reports on Defence, most recently in the report on Defence Estate Project Delivery in respect of the 1998–99 budget.⁷¹ At the time that report was being tabled in Parliament, Defence senior management were pressing DEO and the RECs to meet their budgeted financial targets. In that audit report, the ANAO made several recommendations to Defence aimed at avoiding a focus on a rush in end-of-year expenditure to meet annual budget targets. Three of these recommendations were as follows:

Recommendation No.4

The ANAO recommends that Defence reinforce the Chief Executive's Instructions against expending excess funds at the end of the year without commensurate advantage to the Commonwealth, by reassessing budgetary incentives (internal and external) and clearly articulating better practice in this area so that Defence's staff fully understand their responsibility in acting in the Commonwealth's interest.

Recommendation No.5

The ANAO recommends that DEO promote efficient and effective use of resources in the context of performance assessment of managers and key indicators for DEO by revising its criteria and indicators to focus on achieving value for money within an agreed budget and remove undue emphasis on achieving budget forecasts.

Recommendation No.6

The ANAO recommends that Defence review its training program for personnel involved in the approval, certification and payment of accounts to ensure that all such personnel are aware of their responsibilities in the making of such payments and in the proper management of Commonwealth funds.⁷²

⁷¹ Auditor-General, Audit Report No.37 1999-2000, *Defence Estate Project Delivery—Department of Defence*, April 2000.

⁷² Auditor-General, Audit Report No.37 1999-2000, *Defence Estate Project Delivery—Department of Defence*, April 2000, pp. 53-59.

5.21 Defence agreed to the recommendations but this audit indicates that the action that has been taken to implement them has had little effect.

5.22 The ANAO drew EOP Branch's attention to the recommendations. EOP responded that, in relation to Recommendation No.4, bringing forward high priority works from the next year's program is in the best interests of the Commonwealth and that therefore the recommendation is being implemented. In relation to Recommendation No.5, EOP branch responded that the term 'undue' is not appropriate to FACOPS because DEO is meeting a Departmental expectation to manage budgetary outcomes.

5.23 When the earlier audit report on DEO (Project Delivery) was about to be tabled, the ANAO wrote to Defence on the issue of end-of-year spending. Defence advised in June 2000 that every effort was being made to discourage end of financial year expenditure surges in Defence. It said that resource management areas had been advised to manage revenue and expense budgets and not focus on cash spending. Additionally, the relevant Chief Executive Instruction had been revised to reflect this.

5.24 The revised Instruction⁷³ contains some changed wording but the pertinent section on early/late payments remains essentially unchanged. The ANAO found that staff at RECs were not aware that an updated version of the Instruction had been issued.

Defence Business Model

5.25 Defence has continued focus on cash spending in the new Defence Business Model, which took effect from 1 July 2000.⁷⁴ One of the two key aspects of Defence's relationship with the Government in the Model is as follows:

*Government as the owner of our business; stronger corporate governance arrangements will be introduced, including clearer accountabilities, to reinforce the focus of our ability to sustain our business's delivery of outputs and achieve budgeted financial results.*⁷⁵

5.26 DEO's continued focus on annual budget achievement, as indicated by FACOPS Program expenditure in 1999–00, remains an issue to be addressed. The recommendations from the earlier report remain valid.

⁷³ Chief Executive Instructions part 10, chapter 2—End of Financial Year Arrangements 1999-2000.

⁷⁴ See chapter 2.

⁷⁵ *The Defence Business Model* presented by the Secretary (Dr Hawke) at the Defence Senior Leadership Recall Day on 23 June 2000.

US Defense procurement spending

5.27 The US General Accounting Office (GAO) has expressed similar reservations about US Defense's use of annual procurement spending as a measure supporting a Defense performance goal and a key agency outcome. GAO commented that:

Procurement spending is an input, rather than an outcome. Measuring the amount of money spent does not ensure that the right items are being bought or that they are being bought in the most efficient manner. For example, a major acquisition program that experienced a significant cost increase could actually help measure performance, even though actual capabilities did not increase.⁷⁶

Recommendation No.5

5.28 The ANAO *recommends* that Defence change the financial focus in its business practices to emphasise achieving value for money within agreed budgets and to remove undue emphasis on spending to achieve budget forecasts.

Defence response

5.29 Agree.

⁷⁶ The GAO reported that US Defense stated that one of six key agency outcomes from 1999 to 2001 was that the US maintains technological superiority in key warfighting capabilities and that the performance goal for this outcome was to transform US military forces for the future. One of three measures to support this goal was Defense's annual procurement spending, reported in the following terms:

Annual procurement spending

- 1999 goal: \$48.7 billion
- 1999 actual: \$48.7 billion (Goal met).

The GAO commented as follows:

Procurement spending is an input, rather than an outcome. Measuring the amount of money spent does not ensure that the right items are being bought or that they are being bought in the most efficient manner. For example, a major acquisition program that experienced a significant cost increase could actually help measure performance, even though actual capabilities did not increase. The same is true for a decision to make a major investment in a weapon system that provides only a marginal improvement in capabilities. Efficiency measures based on cost could help provide a clearer picture of performance.

(GAO report of 30 June 2000 to Committee on Governmental Affairs, US Senate, 'Observations on the Department of Defense's Fiscal Year 1999 Performance Report and Fiscal Year 2001 Performance Plan' Enclosure I [GAO/NSIAD-00-188R DOD's FY 99 Performance and FY 01 Plan]).

Conclusion

5.30 There are limited control processes to ensure that agreed facilities works projects are completed according to priorities identified in the bid process. Currently, funds allocated to RECs are at times spent on lower priority work without consultation and agreement by Central Office. While accepting the need for flexibility given the scale of the Program, it is important that there be clear understanding and communication between the RECs and Central Office in order to ensure effective management and oversight of the pre-determined priorities.

5.31 There is a continued focus on expenditure to achieve annual budget targets in DEO. Monthly expenditure of funds increases significantly at the end of the financial year. Undue emphasis on spending for the purpose of meeting expenditure targets is not in the Commonwealth's budgetary or contractual interests nor indeed for program efficiency.

6. Defence Estate Management System—Facilities Maintenance

This chapter examines the Defence Estate Management System—Facilities Maintenance. Specifically it examines the use of the system, its current problems, planned solutions and proposed enhancements.

Background

6.1 The Defence Estate Management System (DEMS) is being developed to incorporate DEO's business applications into one framework. DEMS is to provide personnel at all levels and locations in DEO with accurate, timely and relevant estate management information. One element of this framework is the Defence Estate Management System—Facilities Maintenance (DEMS/FM).

6.2 DEMS/FM is based on a commercial off-the-shelf system that has been extensively modified to meet DEO's specific needs. It is designed to standardise DEO's facilities maintenance software and create a comprehensive asset register of all Defence Estate property. It was introduced in 1997 and is managed by DEO while maintained and operated by an external contractor.

6.3 Effective management of the Defence Estate requires accurate and relevant data. DEMS/FM is intended to be a single, authoritative source of asset data. Data needs to be entered into it and confirmed only once. It can then be used in support of estate management activities at any point in the asset cycle (planning, acquisition, operation, and disposal). DEMS/FM was introduced into the Regional Estate Centres (RECs) to provide staff with a common application for managing their facilities activities. Central Office should be able to review data input into the system.⁷⁷

6.4 DEMS/FM runs on servers located in the central Defence Computer Bureau. The servers are accessed from workstations on the Defence Restricted Network (DRN) across the Defence Wide Area Network (WAN) or from the Internet via Defence-supplied Internet Service Provider accounts. Defence users of DEMS/FM need have only a suitable web browser on their desktop to run the application.

⁷⁷ There have been few such reviews because of the limited amount of data in DEMS/FM.

6.5 DEMS/FM was previously available only through the Defence Intranet but DEO obtained special authority from the Defence Security Branch to open DEMS/FM to Internet access. This means that maintenance contractors can now access DEMS/FM from outside Defence sites. DEMS/FM access via the Internet is subject to strict user guidelines, and failure to comply with these guidelines can result in the removal of access.

6.6 Contractors can use two interfaces to access DEMS/FM: an interactive interface that enables them to access DEMS/FM direct; and a file exchange interface that allows Work Requests (WRs) to be processed between DEMS/FM and other computer systems. The Works Processing Module has been specifically designed to enable contractors to manage WRs and prepare invoices through DEMS/FM.

DEMS/FM use and problems

6.7 DEMS/FM is used by REC staff to varying degrees. It was initially used for delivery of Urgent and Unforeseen Maintenance. It is still mainly used for the delivery of such works, though work requests of all types should be, and can be, processed through it. The 2000–01 regional bids were required to be developed on and submitted to Central Office through DEMS/FM. This was so that the information could be utilised in the planning and reporting of the Program as required in the accrual budgeting process.

6.8 Problems with the use of DEMS/FM by the RECs are of a technical or user nature, as indicated below.

Technical problems

6.9 All regions reported that the performance of DEMS/FM is often very slow. This is due to connectivity problems rather than to the processing speed of the DEMS/FM software. Defence Information Systems Group (DISG) consider that the connectivity problem (which affects the whole Defence WAN) was caused by the introduction of new encryption technology in the Defence WAN. DISG hopes to solve this problem later in 2000 with different encryption technology.

6.10 DEO found that slow performance of DEMS/FM was a problem before the introduction of the new encryption technology. This is because performance of the Defence WAN is also affected by the capacity of the links between geographically dispersed sites and the WAN 'backbone'. The links to some RECs and DEO out-stations do not have a bandwidth sufficient to transmit data at the volume and speed required for effective use of the Defence Intranet, and therefore of DEMS/FM. This may also cause the frequent disconnections from the DEMS/FM server reported by some DEO users.

6.11 The number of individuals using the Defence Intranet nationally compounds the connectivity problem in the links between RECs and DEO out-stations and the Defence WAN. At particular times of the day, traffic on the WAN increases significantly and can have a serious impact on DEMS/FM and other applications. DISG informed DEO that links throughout the WAN would be upgraded in the next financial year when funds become available.

6.12 Technical problems have seriously affected the ability of DEO and its contractors to make efficient and effective use of DEMS/FM. Slow performance continues to be a serious issue but responsibility for resolving the problem lies mainly with other areas of Defence, and speedy resolution is not in DEO's power alone. Accordingly DEO might usefully identify the risks that would arise from delays in resolving these difficulties within a specified time-frame, and highlight their conclusions to the relevant areas in Defence.

6.13 The Assistant Secretary Estate Operations and Planning (ASEOP) noted late in 1999 that good communications capability for DEMS/FM was essential for its successful implementation and acceptance by DEO staff and clients. He said that, because DEMS/FM did not have such capability, DEO suffered as a result. The very short period in which DEMS/FM was defined and implemented was mentioned as a factor. ASEOP told MDEs in 1998 that the use of facilities maintenance applications other than DEMS/FM was to cease.⁷⁸

⁷⁸ ASEOP Minute to MDEs "Cleansing Facilities Databases (EOP 715/98)", 12/10/98.

User problems

User skills

6.14 Many DEO staff have been reluctant to use DEMS/FM. Given the technical difficulties with the system described above, this is not surprising. The low skill level with DEMS/FM of most REC staff compounds the problem. A “DEMS/FM Proficiency Questionnaire” was recently circulated to REC staff to assess their training and development needs. Responses showed that most REC staff were unable to use DEMS/FM to fulfil all the core duties of their positions.⁷⁹ Though a number of REC staff received training in use of DEMS/FM when the system was introduced, there has not been a general flow-on of that initial training to other REC staff. A general unwillingness for individuals to self-train by experimenting with the system may also be a factor. The low skill level with DEMS/FM of most REC staff, in combination with the continuing evolution of the system, highlights the need for additional training for DEMS/FM users.

6.15 DEMS Documentation Manuals are readily available on ‘DEMS Web’, the DEMS homepage. Step-by-step instructions and flowcharts are available for every required action. They are used to varying degrees by individual staff.

Legacy applications

6.16 Due to their various difficulties with DEMS/FM, some RECs have continued to use other applications to manage their facilities works. This has contributed to the limited use of DEMS/FM in some regions, as time and resources have been diverted from developing staff skills in its use. The use of ‘legacy’ applications has been strongly discouraged, but ANAO fieldwork revealed that at least two of the regions studied still use legacy applications alongside DEMS/FM.

⁷⁹ E.g. 85 per cent of surveyed staff in business positions were unable to attach Purchase Orders to projects and view and print project and financial reports; 83 per cent of surveyed staff in planning and operational positions were unable to enter and update projects, funding estimates, bids, allocations and liability phasings, and document approvals; 81 per cent of surveyed staff in planning and operational positions were unable to print reports on contractor performance.

DEFMIS/ROMAN

6.17 DEFMIS, the main financial management information system, is to be replaced with a new system, ROMAN.⁸⁰ There is no means of transferring financial data direct from DEFMIS into DEMS/FM; as a result, financial data must be entered into DEMS/FM manually. In combination with the low level of DEMS/FM use by most RECs, this has resulted in a low level of financial data input to the system specifically designed for estate management. DEO intends to set up a link between DEMS/FM and ROMAN to enable the automatic transfer of financial data from ROMAN to DEMS/FM. This is considered a high priority task.

6.18 At the time of audit, DEO's financial information was drawn from three sources: DEFMIS, ROMAN and PMKEYS (which contains payroll and personnel information). DEO considers that the difficulties caused by the use of three separate systems are compounded by Defence's ongoing project to modify the systems so that they report on an accrual accounting rather than cash basis. As a result, DEO has had considerable difficulty in validating their financial data. An internal DEO document stated that DEO's financial data is never absolutely accurate, and that it is not uncommon for DEFMIS and ROMAN to vary by several million dollars, with no way of judging which system is more accurate. This has had an impact on DEO's ability to manage accurately its expenditure against pre-determined budget targets.

6.19 The 1999–00 Defence financial statement audit by the ANAO also identified major control and system deficiencies within ROMAN and PMKEYS. The ANAO found that the functionality of the corporate systems and in some cases the supporting staff skills were inadequate to provide meaningful and timely financial data and reports to Defence management.

Region-specific use

6.20 Each region's *Regional Strategies, Actions, and Performance Indicators for 1999–00* document states that DEMS/FM is to be populated and used daily to contribute to client service levels.

⁸⁰ DEFMIS stands for 'Defence Financial Management Information System'. ROMAN stands for 'Resource and Output Management and Accounting Network'.

6.21 Actual use made of DEMS/FM varies significantly from region to region. In February 2000, for example, REC-CNN⁸¹ made just under 1000 work requests through DEMS/FM; REC-SA made just over 500; REC-SNSW made almost 3500; and REC-SQ made just over 1500. In July 2000, REC-CNN made just over 500; REC-SA made about 750; REC-SNSW made about 2750; and REC-SQ made about 1300.

6.22 It is difficult to quantify each REC's level of use of DEMS/FM and the size and completeness of its asset register on DEMS/FM, but it appears that most RECs are not using the system as much or as effectively as they could. Commitment to the system by individual staff seems to be a major factor in how widely it is used in each REC.

6.23 DEO data does show that use of DEMS/FM for processing work requests has been increasing since it was introduced. In 1999–00 almost 140 000 work requests were processed in DEMS/FM. Yet, without comparative data on the total number of work requests in the RECs in that year, the proportion of work requests processed in DEMS/FM cannot be quantified.

DEMS/FM access

6.24 A high proportion of client units has a designated member who liaises with DEO on its behalf, and they can access DEMS/FM to enter work requests and check their status. With the continuing introduction of Call Centres throughout the RECs, there seems little point to this process, as two of the services that Call Centres provide are entering work requests in response to phone calls and faxes, and keeping clients informed of their status.⁸²

6.25 Limiting DEMS/FM access to DEO staff and contractors specifically trained to use the system, and who have ready access to assistance with the system, seems a more sensible approach for RECs to adopt.

Effects of DEMS/FM problems

6.26 Best practice organisations consider all relevant costs, including maintenance costs, in the regular assessment of their assets. Without systematically recording and using facilities maintenance data, the RECs are unable to make informed decisions in managing the Defence Estate.

⁸¹ Regional Estate Centre—Central and Northern New South Wales.

⁸² See chapter 3 section on Call Centres.

6.27 When DEMS/FM is used inconsistently across the regions, the extent of inaccurate FACOPS Program data in it is unknown. It becomes difficult to assess the true condition of the Defence Estate and the effectiveness of the FACOPS Program in financial and physical terms. Comprehensive recording of FACOPS Program data is essential for informed decision-making by RECs and DEO, as well as the Defence Portfolio.

DEMS/FM Development Team

6.28 DEO formed a DEMS/FM Development Team to continue the development and implementation of DEMS/FM. The Team has visited each REC and is seeking to assess technical difficulties at each DEMS/FM site. A report on DEMS/FM performance at each site will be provided to DISG to help decide whether any short-term solutions are possible. The Team is also analysing DEMS/FM user practices in the regions. This will allow DEO to develop and implement new standard business processes across all regions.

6.29 The Team has provided limited training on certain aspects of DEMS/FM operations to REC staff and contractors during the visits. The intention was primarily to decide on the appropriate level of training for each region and to develop documentation for REC DEMS/FM contacts to use in training fellow REC staff. The Team has consulted the RECs on specific problems and proposed enhancements to DEMS/FM during its visits.

6.30 The ongoing plans for improving the functionality of DEMS/FM and standardising its use across all regions demonstrate a desire to improve management practices that the ANAO considers positive.

Plans for DEMS/FM

6.31 DEO intends to continue using the services of its external contractor to improve the operation of DEMS/FM. DEO's proposed enhancements include:

- a) accommodation of accrual accounting and reporting against Output Attributions, and GST requirements, in line with changes in Government and Defence policy;
- b) development of an interface between DEMS/FM and ROMAN, to allow transfer of financial data between the two systems (though this will be difficult until ROMAN is fully implemented);
- c) development of a Project Tracking Module to monitor financial progress of individual projects;

- d) upgrade of the DEMS/FM Internet interface to allow project data to be displayed, to process work requests more effectively, to display data from supporting applications, and to improve data transmission between RECs and Central Office;
- e) modification of DEMS/FM to allow data to be collected for Asset Appraisal and life-cycle costing; and
- f) minor upgrades and enhancements to improve system functionality.

6.32 These changes to DEMS/FM are designed to make the system user-friendly, ensure that all REC business can be carried out on it, and capture Defence Estate data. Increased use of DEMS/FM and a better ability of RECs to plan and track delivery of the FACOPS Program is the desired result.

Management of DEMS/FM

6.33 As mentioned above, DEMS/FM was introduced in 1997. DEO originally engaged a contractor to prepare a comprehensive study of the information technology requirements of all aspects of the newly-created DEO. DEO engaged the contractor to manage DEMS/FM in 1997, and the contractual relationship still continues.

6.34 The contractor recently provided a consultant's report on DEO's business and information flows and a Proposal for continued Management and Development of the Defence Estate Information Systems. The Defence Estate Executive endorsed both in May 2000. The contractor has been engaged to undertake various enhancements to DEMS/FM at a cost of \$535 000 in 2000–01.⁸³

6.35 In the Proposal, the contractor noted as a benefit of continuing with its services that *'DEO's requirements are not defined to the point where another agency would be able to tender for the required upgrades. ... A change of contractor would mean a delay of at least twelve months in implementing project tracking for EOP Branch and electronic upload of data to ROMAN.'*

6.36 DEO has continued the relationship with the contractor partly because DEMS/FM is based on a proprietary application that is not widely used. This means that few contractors could administer the system effectively. Though data will continue to be processed in DEMS/FM through the proprietary application, the user interface will be made more user-friendly by means of another application. The latter application will involve introducing generally-available software into DEMS/FM and will make it possible for other contractors to manage the system.

⁸³ This figure is broken down thus: \$440 000 contractor costs; \$45 000 current commitments; \$25 000 Internet accounts; \$25 000 training/travel.

Conclusion

6.37 DEMS/FM has the potential to be an effective means of collecting data on the Defence Estate and delivering the FACOPS Program. It could also enhance decision-making by the RECs and EOP Branch in their management of the Defence Estate.

6.38 For a number reasons, it has not reached its potential usefulness. These include technical problems beyond DEO's ability to rectify, such as periods of slow performance, that compound the unwillingness and inability of many DEO staff to make effective use of it. The speed of its development and introduction may have contributed to users' difficulties.

6.39 DEO is seeking to improve the system and to make better use of it. Every effort should be made to ensure that improvements to DEMS/FM are efficient and cost-effective.

Recommendation No.6

6.40 The ANAO *recommends* that DEO make better use of its DEMS/FM system in the delivery of its FACOPS Program by:

- a) upgrading it cost-effectively, with priority given to linking DEMS/FM to ROMAN;
- b) mandating its use across all regions; and
- c) training staff to use it at a skill level suitable to their individual positions.

Defence response

6.41 Agree.



Canberra ACT
22 December 2000

P. J. Barrett
Auditor-General

Appendices

Appendix 1

Strategic Plan for the Defence Estate—Facilities Operations

The following extract from the Strategic Plan for the Defence Estate⁸⁴ relates specifically to facilities operations.

PART 7–7 FACILITIES OPERATIONS

Introduction

1. The Facilities Operations appropriation provides for the day-to-day operation and maintenance of facilities together with the delivery of minor new works (i.e. projects less than \$250 000). The appropriation is presently structured⁸⁵ to account separately for work above and below \$250 000 and comprises two notional items:

- **Asset Maintenance.** This includes planned specific maintenance and major unforeseen maintenance greater than \$250 000.
- **Facilities Operations.** This includes all repairs and maintenance other than the Asset Maintenance category shown above. It covers items such as operation of facilities, maintenance of fixed plant and equipment, urgent and unforeseen minor maintenance, planned minor maintenance, minor new works, maintenance of office fitout, furniture and fittings (related to new minor building refurbishment or construction) and hire of facilities.

2. Maintenance has traditionally been treated as a lower order business issue: it is often regarded as unproductive; unimportant; and unglamorous. It has been relatively easy to defer planned maintenance activities in the short term and allow the maintenance backlog to increase. Repairs and maintenance funding tends therefore to be a soft target in the battle for resources. The long-term consequences of deferring maintenance are asset deterioration and possible failure which has implications for operations, occupational health and safety (OH&S) and duty of care. This section attempts to address the difficult issue of establishing the Facilities Operations (FACOPS) funding liability.

⁸⁴ SPDE was prepared by DEO in 1998. This extract is from a later revision. SPDE is being revised further.

⁸⁵ Under accrual accounting and budgeting, different thresholds are to apply which will impact on current arrangements. For example, expenditures greater than \$25 000 will be regarded as a capital investment expense.

3. In recent years there has been a change in the ADF disposition with more major operational units and infrastructure located in Northern Australia. There has been no corresponding reduction in the southern bases and accordingly, the estate has continued to grow in value by around \$300 million PA. New infrastructure is generally more highly serviced and complex, with greater requirement for compliance with more stringent legislative requirements for environmental and OH&S matters.

4. Since DRP, FACOPS funding has been reduced by one third and staff resources supporting FACOPS have fallen in the order of two thirds. Savings arising from the implementation of the comprehensive maintenance contracting philosophy have allowed further reductions in FACOPS funding to be accommodated without any perceived adverse impact on the estate. This may not be sustainable because of recent large reductions in the capital infrastructure renewal program. A reversion to purchasing practices prevalent before DRP could impose a diminution of purchasing power if the move to purchaser provider is not carefully managed. Further detailed analysis of the operational capability impacts needs to be undertaken before a definitive FACOPS funding level can be established.

Historical Expenditure

5. Present maintenance funding arrangements are driven largely by historical expenditure levels and this militates against a structured approach to maintenance planning. Funds availability, rather than needs assessment, dominates planning and this results in maintenance being conducted on an ad hoc basis largely in response to user complaints. Such an approach can be wasteful of scarce maintenance resources because expenditure is not well targeted.

6. Historical FACOPS expenditure is set out in Table 7-7-1:

TABLE 7-7-1

FACOPS Expenditure—\$M

\$/FY	93-94	94-95	95-96	96-97	97-98	98-99	99-00	00-01 (est)	Average
Historical (actual)	294.8	286.8	279.7	215.5	215.4	223.0	230.7	206	244
1999-00 prices	329.0	318.6	296.8	220.9	219.9	225.9	230.7	206	256

7. The dramatic reduction in funding in FY96-97 took little cognisance of the capability impacts flowing from the reduction because there is little that can substantiate the need for funds except empirical models. Maintenance underfundings, in the past have caused a spate of

mishaps recently in the utilities and petrochemical industries and this serves to highlight the risk Defence has taken in arbitrarily cutting maintenance to below industry recommended levels.

8. The recent initiatives of implementing the requirements of environmental management plans, policy to remove asbestos and legislative responsibility to upgrade fire detection in living in accommodation cannot be met from within current funding levels without impacting on maintenance elsewhere within the Estate. Even partial funding reduces maintenance on assets that are integral to the capability for projection of military power.

9. GRV is used as a measure in quantifying maintenance funding requirements by attempting to establish a link between investment and operating costs. Apart from \$/m²—a similar measure—broad indicators do not exist. A detailed engineering analysis of individual assets could produce more reliable data but, with 25 000 assets in the Defence estate, this would be a major undertaking. In time, the Defence Estate Management System (DEMS) together with accrual accounting, should produce better management information.

10. The DER Report noted that FACOPS expenditure in FY96–97 represented about 2 per cent of GRV which was assessed as being comparable with industry practice.⁸⁶ The Report also acknowledged that percentage of GRV was a somewhat crude and generalised performance measure. The next four paragraphs attempt to validate the DER assessment.

The Link between Asset Value and Maintenance Costs

11. Industry relies on empirical formulae to estimate order-of-magnitude maintenance funding needs at the macro level. The Sherman-Dergis Model⁸⁷ predicts maintenance expenditure of 2.6 per cent GRV over a 50-year life. This compares with the Property Council of Australia which recommends that maintenance should be within the range 2–4 per cent of building replacement value per year. The Overseas Property Group uses an ‘industry average’ of approximately 2 per cent per annum of the value of the property, assuming that the property is in reasonable condition at the start of the process.⁸⁸ The Victorian Commission of Audit, in 1993, estimated the cost of holding the State’s stock of assets (ignoring finance charges and employee costs) was 4 per cent of the value of assets held.⁸⁹

⁸⁶ Addendum to the *Report of the Defence Efficiency Review—Secretariat Papers* p. 215.

⁸⁷ Kaiser, Harvey, PhD. *The Facilities Manager’s Reference*. R.S. Means Co Inc Kingston 1989.

⁸⁸ OPG. *Proposal for the Implementation of User Pays* 24 February 1997.

⁸⁹ ANAO *Asset Management Handbook* 1996 p. 9.

12. Rawlinson's 'Australian Construction Handbook' is a widely used source for Australian building costs. The 1998 edition gives an annual maintenance cost of \$23/m² for a low-rise office building which Rawlinsons estimate has a construction cost of \$1200/m². This equates to an annual maintenance cost of 2 per cent GRV.

13. In assessing the Commonwealth office estate, the Commonwealth Property Committee set the following benchmarks for annual expenditure on retained office properties:

- Minor Maintenance 4 per cent of gross rent (ie $0.04 \times 0.075 \times \text{GRV}$) = $0.003 \times \text{GRV}$ or 0.3 per cent GRV.
- Periodic Maintenance 3 per cent of building value.
- Total Maintenance 3.3 per cent GRV (excluding major upgrades at mid-life).

14. The above analysis supports a figure no less than the DER figure of 2 per cent GRV as a reasonable benchmark for annual maintenance costs. However, the benchmark assumes that assets are in reasonable condition and are being fully utilised for their intended purpose. This is not always the case.

15. No formal mechanism existed to determine the impacts or to properly assess the risk profiles to personnel and capability by funding maintenance at less than the industry accepted norms. The asset appraisal policy being developed within the DEO will provide the basis for such assessment. Firm data will become available to allow the required level of funding to be determined and benchmarked against comparable industry sectors.

Value and Size of the Defence Estate

16. GRV and NRV are shown in Table 7-7-2:

TABLE 7-7-2

Present Estate Values—\$ billion

<i>Date</i>	<i>30 Jun 1996</i>	<i>30 Jun 1997</i>	<i>30 Jun 1998</i>	<i>8 Mar 2000</i>
GRV	12.720	12.675	12.601	14.606
NRV	9.189	8.975	8.667	10.420

17. Since FACOPS is influenced more by GRV than NRV, the present under-funding problem in FACOPS will become more critical over time. The ratio of NRV to GRV is also an indicator of the age and condition of an asset. The present ratio is 69 per cent but will deteriorate to 63 per cent in five years' time if projections and asset values are correct. This indicates that the estate is not only growing but also ageing.

18. Based on the GRV as at 08 Mar 00, building maintenance and repair should be about \$292 million [2 per cent] for FY00–01. The FACOPS appropriation also includes Minor New Works (and provision of associated furniture) and hire of facilities and therefore a FACOPS allocation of about \$305 million⁹⁰ would appear to be justified, particularly noting the average annual FACOPS funding level was \$312 million in the six-year period prior to the DER. Even taking account DER savings, the present allocation of \$206 million in FY00–01 indicates a significant level of under-funding (some \$100 million per year) and this is borne out by client dissatisfaction with discretionary funding levels and anecdotal evidence from the regional Managers Defence Estate who consistently express concern at the under-funding. The requirements of meeting EMP works and asbestos removal are two areas that highlight the shortfall.

19. One way of reducing FACOPS expenditure is to reduce the size of the estate. This can be achieved by restricting new investment, or increasing property disposals, or through demolition of unwanted assets. A major reduction in GRV would be needed, however, to make any impact on FACOPS expenditure; a \$2 billion reduction (16 per cent) in GRV would be required to give a \$40 million annual saving in FACOPS. This issue is explored further in Chapter 8.

20. A further initiative is to point expenditure onto assets based on capability contribution. The annual asset appraisal examines building condition as a determinant in evolving the maintenance program. Doctrinally, assets make differing contributions to capability and would provide different levels of advantage to an enemy should they become unusable. Should expenditure be targeted to capability contribution the ADF would be required to input the relative target values. It would also recognise that buildings with shorter useable life and making lower relative contributions to military effort would be maintained at a relatively lower level.

21. Judgements regarding the value and size of the Defence Estate need to be treated with caution because of the way the GRV is calculated. The growth in GRV, however, does give a clear indication of trend line and points to an increasing demand for FACOPS expenditure in line with the growth in GRV over and above an assessed current shortfall of some \$100 million per year. There is pressure either to reduce the rate of GRV increase and to achieve significant reductions in the order of at least \$3 billion in GRV terms or accept the liability for additional FACOPS expenditure.

⁹⁰ \$305 million comprises \$292 million plus an allocation of \$1.5 million for F&F and MNW for each of the nine DEO Regional Offices. These regional F&F/MNW allocations are less than historical expenditure and are based on EOP Branch assessment of what is regarded as reasonable.

Other Issues

22. The introduction of accrual accounting will require a review of the Facilities Operations appropriation structure which presently includes Minor New Works (MNW). The MNW ceiling of \$250 000 far exceeds the non-current asset reporting threshold of \$25 000 and some funding might therefore need to be provided in future through the Capital Appropriation.

23. Reliable data on asset value, condition, function and utilisation is essential for total asset management purposes. While it is difficult to assess the validity of existing asset data, the trend in asset growth and in ageing is clear enough and has implications for maintenance (which tends to increase with age) and for overall estate management. Priority should be given to further development of the Defence Estate Management System (DEMS), and to the universal application of Asset appraisal—a maintenance planning process. Other measures to improve management are available through application of ‘Total Estate Management’ principles. Total Asset Management is discussed in Chapter 8 which deals with managing the size and shape of the Defence Estate.

Appendix 2

Purchasing requirements

Commonwealth purchasing framework

1. Commonwealth purchasing requirements are set out in regulations, guidelines and instructions issued under the *Financial Management and Accountability Act 1997*. Specifically these are the Financial Management and Accountability Regulations, the Commonwealth Procurement Guidelines and each agency's Chief Executive's Instructions.
2. Broadly stated, the regulations require that a person approving a proposal to spend public money (including under a contract) must be satisfied that the proposal is in accordance with Commonwealth policies and will make efficient and effective use of public money. The regulations require procurement officers to have regard to the Commonwealth Procurement Guidelines issued by the Finance Minister.
3. The Commonwealth Procurement Guidelines give detailed guidance on procurement. They state that Government policy requires agencies to seek value for money in procuring goods and services, and that open and effective competition is a central operating principle for all Commonwealth procurement. They also give guidance on fair and ethical dealing.⁹¹
4. Certain details of contracts to the value of \$2000 or more are to be published in the *Commonwealth Purchasing and Disposals Gazette*.

Procurement requirement in Defence and DEO

5. Procurement delegations, issued by the Defence Chief Executive, are governed by the guidelines contained in the *Defence Reference Book 47—Manual of Financial Delegations*. In undertaking a procurement there are three mandatory delegations which can only be exercised by duly delegated officials. These are:
 - Proposal Approver—Proposal Approval is the delegation to approve a proposal to spend public money. The delegate declares that a proposed procurement does not contravene Commonwealth policies, and that efficient and effective use of public money will be achieved.
 - Procurement Approver—Procurement Approval is the delegation to approve the method of procurement. The delegate declares that the chosen method of procurement promotes open and effective competition to the extent practicable.

⁹¹ *Commonwealth Procurement Guidelines: Core Policies and Principles*, March 1998.

- Liability Approver—Liability Approval binds the Commonwealth to making a payment of public money. The delegate declares that the purchase represents the best value for money obtainable, and that funds are available for the purchase.

6. The Defence Chief Executive's Instructions are supplemented in DEO by Defence Estate Instructions. DEO's Central Office issued the *Defence Estate Instruction—Provision of Minor Works* to all DEO staff in July 1999. The *Instruction* is available in the Defence Estate Management Guide. It provides instruction to purchasing officers on the procurement of minor works (works costing less than \$250 000) on DEO's behalf. It also covers the procurement of minor consultancies (costing less than \$50 000) for companies external to the DEO Project Services Consultancy Panel.

7. The DEO Project Services Consultancy Panel, the DEO Legal Panel and the Defence Environmental Panel are panels of pre-approved contractors engaged on three-year contracts for the provision of specific services. Depending on the particular arrangements governing each panel, DEO seeks quotes from or offers work to panel members before approaching other contractors.

8. This *Instruction* defines all works in DEO estimated to cost less than \$250 000 as simple procurement. Simple procurement generally covers the purchase of standard services or 'off the shelf' items where there is minimal risk, and value for money considerations are limited to price, convenience, and practicality. Exceptions to the definition are made when the Procurement Approver decides that the works project is complex enough to require either a Select Tender approach (where a minimum of three to five firms are selected to tender) or a Complex Procurement approach (a two-staged approach comprising an Invitation to Register followed by a Request for Tender).

9. Use of the Short Form Facilities Contract for Minor Works is mandatory for works costing in excess of \$30 000 and is recommended for works below \$30 000 as appropriate. The full Facilities Contract for Medium Works may be used for more complex projects below \$250 000, but in most cases the Short-Form Contract is considered adequate.

10. The *Instruction* outlines the requirement of proper documentation of procurement decisions, as follows:

Commonwealth purchasing principles of accountability, professionalism, probity and visibility need to be supported by well-documented decisions. Purchasing officers need to ensure that documentation is kept in a logical sequence and written in clear, concise language so that a clear audit trail can be followed.

11. The *Instruction* includes a checklist of documentation to be kept on file—see below.

Documentation Checklist

- a copy of the user request;
- market assessment information, e.g. brochures, records of conversation;
- a copy of the Purchase Order Action Request proforma containing:
 - authorisation that the proposed purchase will make efficient and effective use of public money;
 - method of procurement authorisation; and
 - authorisation to spend money, including funds availability certificate;
- a copy of the proforma used to document oral quotations;
- a copy of the intended evaluation criteria (this may comprise only a couple of criteria, but selected before obtaining offers, oral or otherwise);
- a comparative statement (where applicable);
- a copy of the purchase order;
- Commonwealth Gazette notice (where applicable); and
- Administration details, invoices, delivery dockets.

Appendix 3

Performance audits in Defence

Set out below are the titles of the ANAO's previous performance audit reports on the Department of Defence and the Australian Defence Force (ADF) tabled in the Parliament in the last five years.

Audit Report No.8 1995–96
Explosive Ordnance (follow-up audit)

Audit Report No.11 1995–96
Management Audit

Audit Report No.17 1995–96
Management of ADF Preparedness

Audit Report No.26 1995–96
Defence Export Facilitation and Control

Audit Report No.28 1995–96
Jindalee Operational Radar Network Project [JORN]

Audit Report No.31 1995–96
Environmental Management of Commonwealth Land

Audit Report No.15 1996–97
Food Provisioning in the ADF

Audit Report No.17 1996–97
Workforce Planning in the ADF

Audit Report No.27 1996–97
Army Presence in the North

Audit Report No.34 1996–97
ADF Health Services

Audit Report No.5 1997–98
Performance Management of Defence Inventory

Audit Report No.34 1997–98
New Submarine Project

Audit Report No.43 1997–98
Life-cycle Costing in Defence

Audit Report No.2 1998–99
Commercial Support Program

Audit Report No.17 1998–99
Acquisition of Aerospace Simulators

Audit Report No.41 1998–99
General Service Vehicle Fleet

Audit Report No.44 1998–99
Naval Aviation Force

Audit Report No.46 1998–99
Redress of Grievances in the ADF

Audit Report No.13 1999–00
Management of Major Equipment Acquisition Projects

Audit Report No.26 1999–00
Army Individual Readiness Notice

Audit Report No.35 1999–00
Retention of Military Personnel

Audit Report No.37 1999–00
Defence Estate Project Delivery

Audit Report No.40 1999–00
Tactical Fighter Operations

Audit Report No.41 1999–00
Commonwealth Emergency Management Arrangements

Audit Report No.50 1999–00
Management Audit Branch—Follow-up

Audit Report No.3 2000–01
Environmental Management of Commonwealth Land—follow-up

Audit Report No.8 2000–01
Amphibious Transport Ship Project

Audit Report No.11 2000–01
Knowledge System Equipment Acquisition Projects in Defence

Audit Report No.22 2000–01
Fraud Control in Defence

Index

A

- Asset Appraisal 33-36, 68, 70, 87, 94-96
- Asset Maintenance (AM) 52, 53, 60-63, 66
- Assistant Secretary Estate Operations and Planning (ASEOP) 82
- Australian Defence Force (ADF) 35, 39, 40, 54, 65, 92, 95, 100

C

- Call Centres 57, 58, 85
- capability 12, 15, 22, 26, 28, 32-35, 38, 40, 61, 65, 67, 68, 78, 82, 92-95
- Central and Northern New South Wales (CNN) 24, 42, 58, 61, 71, 72, 75, 85
- Chief Executive Instruction 77
- client satisfaction 12, 27, 39, 58, 63-65
- Commercial Support Program (CSP) 43, 46, 47, 57, 100
- communication 15, 27, 39, 65, 79, 82
- Comprehensive Maintenance Contract (CMC) 12, 14, 41-44, 46-49, 51, 55-57, 59

D

- Defence Efficiency Review 11, 12, 13, 21, 24, 26, 32, 36, 37, 39, 42, 43, 53, 54, 93-95
- Defence Estate Executive (DEE) 21, 41, 42, 87
- Defence Financial Management Information System (DEFMIS) 28, 84
- Defence Information Systems Group (DISG) 81, 82, 86
- Defence Science and Technology Organisation (DSTO) 24, 26, 31, 46, 47, 53
- Director Estate Operations and Planning (DEOPS) 42, 60, 62

F

- Facilities Executive Summary (FES) 18, 60, 62, 66, 69
- Fixed Plant and Equipment (FP&EM) 42-44, 47-50, 53

G

- General Building and Facilities Maintenance (GB&FM) 42-44, 47-50
- Gross Replacement Value (GRV) 22, 32, 70, 93-95

H

- Head Defence Estate (HDE) 23, 26, 27, 61

I

- industry benchmarks 13, 70

M

- Manager Defence Estate (MDE) 27, 64

N

- Net Replacement Value (NRV) 22, 32, 70, 94

O

- output managers 28, 30, 35, 38, 39
- outputs 13, 17, 27, 28, 30, 34, 35, 37-40, 77

P

- purchase orders 14, 53, 58, 83

R

- Regional Contract Transition Strategy (RCTS) 41, 42
- Regional Facilities Committee (RFC) 18, 64, 65, 68, 69
- Resource and Output Management and Accounting Network (ROMAN) 18, 28, 30, 84, 86-88

S

Service Level Agreement (SLA) 27

South Australia (SA) 24, 28, 42, 46,
47, 51, 53, 58, 61, 75, 85

South Queensland (SQ) 24, 28, 42,
44-46, 48, 52, 58, 61, 71-73, 75, 85

Southern New South Wales (SNSW)
24, 42, 57, 61, 65, 71-73, 75, 85

Strategic Plan for the Defence Estate
(SPDE) 13, 26, 31, 35, 91

sub-Output 13, 17, 30, 38, 40

T

Total Estate Management (TEM) 12,
13, 26, 33, 34, 40

W

Works Priorities Committee (WPC)
18, 65, 69

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