



Australian Government

Department of Defence

THE RESPONSE TO THE REPORT OF THE DEFENCE PROCUREMENT AND SUSTAINMENT REVIEW

THE
MORTIMER
REVIEW

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THE MORTIMER REVIEW

FOREWORD

In May 2008, the Government commissioned an independent review of the Defence Materiel Organisation (DMO) and the effectiveness of Australia's defence procurement systems, led by Mr David Mortimer AO.

In response to the Defence Procurement and Sustainment Review (the Mortimer Review), the Government has endorsed a plan that will change the way Defence develops, acquires and sustains military capability. The DMO will launch a radical change program to become more business-like in supporting its Defence customer.

The Government's response highlights the scale of change needed to improve procurement. As the Mortimer review pointed out, these changes build on a strong record of reform since the 2003 Kinnaird Review.

Four key principles underpin our approach. First, the Defence Organisation must become more accountable to Government and more transparent in managing the billions of dollars invested in building military capabilities.

Second, DMO must strengthen its capacity to give Government independent advice on the cost, risk, schedule and acquisition strategies for major capital equipment.

Third, DMO needs a stronger business-like culture to deliver projects on-time, on-budget and to Defence's requirements.

Fourth, the already strong relationship between Defence and DMO must be further strengthened. The key priority is meeting Defence's military capability needs and, by achieving that goal, keeping Australia secure.

The 20 point plan set out here shows the steps that Defence and DMO will take to deliver on these principles. The plan presents the high points of a reform agenda that is captured in more detail in the Government's response to the Mortimer Review's 46 recommendations.

I would like to acknowledge the considerable efforts of the Hon Greg Combet, AM, MP, in his previous capacity of Parliamentary Secretary for Defence Procurement, in contributing to this plan.

Joel Fitzgibbon

Minister for Defence

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SECTION 1

STRENGTHENING THE DEFENCE ORGANISATION'S ACCOUNTABILITY AND TRANSPARENCY

1. DIRECT APPROPRIATION OF SERVICE FEE TO THE DEFENCE MATERIEL ORGANISATION (DMO)

DMO's total service fee will be directly appropriated to the DMO. This will cover Australian Public Service (APS) staff, military staff and administrative costs and give CEO DMO the flexibility to manage and control the DMO budget.

Further study will be given on the best way to handle risk if Defence is not able to supply the agreed number of ADF personnel to work in DMO.

Cost systems that allow greater price transparency will in time allow direct appropriation for so-called "free of charge" items currently provided to DMO by Defence.

2. DIRECT APPROPRIATION OF MAJOR CAPITAL ACQUISITION FUNDING TO DMO

Further work will be done by Defence and DMO to develop a practical plan for direct appropriation to DMO for major capital acquisitions. A number of budgeting, financial reporting, and governance issues will need to be resolved in order to develop such a model. The model must also ensure that savings and efficiencies are reinvested in Defence via the Defence Strategic Investment Reserve.

The model will be based on the following principles:

- A direct appropriation to DMO for the acquisition cost of the equipment plus DMO's share of approved project contingency.
- The appropriation for other Fundamental Inputs to Capability (FIC) (such as sustainment costs, support from the Defence Science and Technology Organisation (DSTO) and estate costs) will remain with Defence.
- Contingency relating to project elements not the responsibility of the DMO will remain with Defence.

Government will decide whether to implement direct appropriation of major capital equipment funding to DMO after reviewing a report on the practicalities of implementation. Direct appropriation could occur in 2010-11 following consideration of the practicalities in the budget development process.

3. A CONSOLIDATED SET OF CLEAR BUDGET FIGURES

An essential part of being accountable to Government and transparent in the way we do business is that Defence and DMO should agree a consolidated set of budget figures showing the combined financial situation of both entities. This will give Government a clear and complete picture of the complex financial interactions between DMO and Defence. Defence's Chief Financial Officer will work with DMO to produce a consolidated budget as part of the annual budget cycle.

4. CLEAR PROJECT DIRECTIVES

The scope, cost and schedule of Defence equipment acquisitions will be better defined in the business cases considered by Ministers (or the National Security Committee of Cabinet - NSC) through the Two Pass process. There will be greater consistency and tighter control of changes between Ministerial approvals at the highest level, and the management of project implementation on a day to day basis. This will ensure that key project characteristics and outcomes are identified at the outset, and carried through to completion, or reviewed and changed if necessary through a disciplined process involving Government.

To assist in developing greater clarity in the capability planning process a Project Directive, based on the project approval decisions made by Government, will be issued immediately following Government approval at Second Pass. A draft Directive will be included in the submission to Government. The Project Directive will provide the top level direction from the Chief of the Defence Force to the Capability Manager to introduce the full operational level capability into service by the date agreed upon by Government. It will articulate the respective roles of the Defence Groups, the Services and DMO in delivering their elements of the project.

DMO, supported by Defence Groups and Services, will have formal responsibility and accountability for developing estimates, information and advice relating to the cost, schedule and risk of equipment acquisition upon entry of a capability into the Defence Capability Plan and for developing the acquisition strategy. The Chief Defence Scientist's responsibility for providing independent advice on technical risk remains unchanged.

Defence, with the assistance of the DMO, and drawing on the Capability Managers' expertise will draft project directives, promulgating the Cabinet and Ministerial approvals. These will inform the development of all relevant capability and project management documents and plans – with the directive being the authoritative document.

Proposed changes to these directives that alter specific scope, cost or schedule parameters agreed by Ministers or NSC will need to be considered by Government. Changes within the project parameters agreed by Government can be considered by Defence if there is no adverse change to the risk profile of the project or the whole of life costs. Specific arrangements for consideration and approval of project changes will be developed by Defence in consultation with the Department of the Prime Minister and Cabinet, the Treasury, and the Department of Finance and Deregulation. The Minister for Defence and the Minister for Finance and Deregulation will approve the thresholds for consideration of project changes, following consultation with the

Prime Minister and the Treasurer.

5. CLARIFY THE MATERIEL ACQUISITION AGREEMENTS (MAA)

MAAs will be developed consistent with the approval decisions made by Government. They will define more specifically the responsibilities and deliverables between DMO, Capability Development Group and the relevant Capability Managers. They will include details on the deliverables in terms of capability, supplies, specifications, cost, schedule and customer furnished supplies.

MAAs will also clarify when the responsibility for the new capability passes to the Capability Manager from DMO in line with Government decisions.

6. PROVIDE CLEARER ADVICE TO INDUSTRY

DMO, supported by CDG, will consult with Industry to find ways to improve advice on cost estimates to industry in the Defence Capability Plan. It is important to strike a balance between the Government's requirements for transparency with the need to protect Defence and the Commonwealth's commercial interests in contract negotiation.

7. PLAN FOR MORE OFF-THE-SHELF (OTS) PROCUREMENT

As has been the case since the 2003 Kinnaird Review¹, Off-the-shelf (OTS) options will be considered as an option for all procurements. Defence will provide Government with clear information on the costs and benefits of OTS options for all procurements.

IMPROVING DMO'S INDEPENDENT ADVICE AND ACCOUNTABILITY TO GOVERNMENT

8. STRENGTHEN THE CAPABILITY DEVELOPMENT PROCESS

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

- The development of regular Defence White papers and an overhauled and strengthened Defence Planning Guidance process to ensure tighter alignment between strategic guidance, capability decisions and resources.

¹ Defence Procurement Review 2003 [the 'Kinnaird Review']. In addition to military off the shelf items, Defence and DMO acquire many 'off the shelf' items that are not specifically military, such as clothing.

- Clarifying the roles and responsibilities of each part of the Defence Organisation in capability development terms, with the Capability Development Group (CDG) remaining the coordinating authority for developing submissions for Government.
- Better defining the roles and memberships of key capability committees.
- Confirming that DMO is responsible and accountable for developing military equipment costs and schedule estimates and risk analysis and developing and implementing an acquisition strategy. DMO will also be responsible for analysing industry's capacity to deliver the required capability.
- Clarifying the roles of each Group and Service in developing Fundamental Inputs to Capability (FIC).
- Strengthening the roles of Capability Managers in coordination and integration of all FIC.
- Establishing better planning connections between Capability Development and key enabling Groups such as the Defence Science and Technology Organisation and the Chief Information Officer Group.
- Ensuring that capability and commercial advice are developed in tandem through the project.
- Ensuring early consultation with the Department of Finance and Deregulation on options, cost estimates and project risks.

9. STRENGTHEN THE LINKS BETWEEN STRATEGY AND CAPABILITY DEVELOPMENT

Defence will implement a strategic planning process that institutionalises the links between strategic guidance, force structure, capability priorities and resource strategies that have been developed during the White Paper process. This process accords with Government's desire for more regular White Papers, and ensures that Defence's capability and enterprise activities remain strategy-led.

Of particular note, the future development of the ADF will be driven by an improved force structure and capability development process within Defence. The central feature of this will be stronger linkages between strategic guidance, force development and capability decisions. Regular White Papers, and three key planning documents – the Defence Planning Guidance, the Defence Capability Strategy, and the Defence Capability Plan will be key to this new system.

10. STRENGTHEN DMO'S ROLE AT THE NATIONAL SECURITY COMMITTEE (NSC) OF CABINET

We will ensure that DMO presents its independent advice on cost, schedule and risk of equipment acquisition in NSC submissions and presents an acquisition strategy within the submission. CEO DMO will advise on cost, risk, schedule and acquisition strategy for major capability submissions.

BUILD A STRONGER BUSINESS-LIKE CULTURE IN DMO

11. MORE FLEXIBLE STAFF MANAGEMENT

The Secretary of Defence has devolved a wide range of Human Resource-related powers and functions to the CEO DMO, who may exercise these powers in his own right. These powers provide a high degree of autonomy to enable CEO DMO to govern DMO to achieve identified business outcomes and to provide flexibility on employment matters.

The Secretary of Defence has a stewardship responsibility as the Defence Portfolio Head to ensure that APS Values and the Public Service Act are complied with across the portfolio. In this respect the Secretary will be kept informed of SES employment decisions and receive from CEO DMO an annual stewardship report covering the DMO workforce. This in no way diminishes CEO DMO's authority to exercise decision making within the DMO workforce.

12. BETTER WAYS TO ATTRACT THE RIGHT STAFF

DMO will seek to employ more commercially experienced and skilled personnel – especially at the SES level. CEO DMO will have authority and responsibility for managing DMO's budget and staff, and will have the flexibility, where necessary, to pay above average public service wages to attract appropriate people.

13. BETTER WAYS TO MANAGE STAFF NUMBERS

Although it is a matter for the Government to decide, the Secretary and CDF have indicated to Government that they support DMO moving to a total labour cost model rather than work within restrictions on staff numbers. This will give CEO DMO the flexibility within his budget – within the limits set by government – to recruit as necessary to meet requirements for delivering capital equipment projects and sustainment services to Defence.

14. BUILDING A MORE BUSINESS-LIKE CULTURE

CEO DMO will write a plan for building a more business-like and commercial culture in DMO. The plan will:

- Set quantifiable key performance indicators and measures of success.
- Identify the individuals who will be accountable for delivering the cultural change plan.
- Specify necessary structural changes within DMO.
- Set appropriate time-frames for measuring progress.
- Develop an appropriate reporting framework for Ministers and the Parliament.
- Be released publicly by mid-2009.

15. CREATE A GENERAL MANAGER, COMMERCIAL POSITION

DMO will recruit a Senior Executive Service Band Three General Manager – Commercial, who will have extensive private sector experience. That person will support the CEO DMO to bring about the necessary cultural change in the DMO. They would also play a major role in the development of the acquisition strategies for major projects and ensuring sound commercial advice is provided throughout the capability process.

ENHANCING THE DMO-DEFENCE RELATIONSHIP

16. DEVELOP A DMO – DEFENCE CHARTER

A Charter will be jointly developed between DMO and Defence to clarify their respective authorities and responsibilities and to ensure that DMO's key priority is to provide Defence with its operational and military capability requirements as agreed by Government, thereby helping to keep Australia secure. In practice this will amount to an updating of the Defence DMO *Memorandum of Arrangements* established in 2005 and its suite of underpinning agreements including agreements on Materiel Acquisition; Materiel Sustainment; Defence Services; Shared Services and on the Military Workforce.

17. WRITE A PERSONAL CHARTER FOR CEO DMO

A Charter (which supplements the Ministerial Directive) outlining the personal responsibilities for CEO DMO and his direct accountabilities to the Secretary of Defence and the Chief of Defence Force will be drawn up and approved by the Minister for Defence. This will set clear authorities and accountabilities and set benchmarks for performance both in terms of DMO's core business and more specifically for CEO DMO's delivery of the plan to make DMO more business-like.

18. STRENGTHEN THE ROLE OF THE CAPABILITY MANAGERS

The Capability Managers are the Chiefs of Navy, Army and Air Force, the Vice Chief of Defence Force (for joint capability projects) and the Deputy Secretary Intelligence, Security and International Policy (for selected Intelligence, Surveillance and reconnaissance projects) and the Chief Information Officer for certain Information and Communications Technology (ICT) projects². They play a critical role in ensuring that all necessary inputs required to build a capability are brought together. The roles of the capability managers

² ICT is an important sub-set of Defence capability development. In broad terms embedded communications systems that form an integral part of platforms or sensor systems are part of the capability development and acquisition processes described in this paper. Other forms of ICT including those that support Defence non-Specialist Military Equipment military and administrative activities are considered in the *Defence White Paper ICT Companion Review*. That review will propose different capability development and acquisition methodologies for those systems, not least to take into account the very rapid technological evolution of ICT.

need to be further clarified and better articulated. This will be done through the improvements to the capability development process outlined at initiative number 7.

More regular White Papers and improved Defence planning processes will further strengthen the role of the Capability Managers. The new Defence Budget Management Model will provide senior leaders with greater authority to manage their budgets and non-financial inputs. Capability Managers will agree appropriate service support levels and transfer funds accordingly to the relevant internal Defence provider.

A key concern is to resolve the potential conflict between the responsibility of the DMO to deliver approved equipment, and the Capability Managers to advise on whether approved equipment is fit for operational use at the time it is delivered. It is essential that any change in circumstances which indicates that approved equipment might no longer be judged suitable for operational use, or can not deliver value for money, is advised to Government at the earliest opportunity. Whether to continue with a project in these circumstances should be a decision for Government. Capability Managers must include whole-of-life implications and independent advice from the CEO DMO on the cost, risk and schedule implications for projects in their advice to Government.

19. EXPLORE CREATING A PROFESSIONAL CAREER STREAM FOR ACQUISITION SPECIALISTS

To strengthen the ADF's skills in the areas of acquisition, Defence and DMO will explore the possibility of creating a professional career stream for acquisition specialists. Like the Corps in military service (for example, Infantry, Armour and Artillery) this professional career stream could provide a more attractive career management framework for personnel interested in specialising in this area. This is a complex matter that engages the interests of the Services and it will take some time to develop a proposal for Government consideration.

20. REVITALISE THE DEFENCE PROCUREMENT ADVISORY BOARD (DPAB)

The DPAB has been an excellent source of advice to DMO since its inception in 2003. It has provided a useful mechanism for DMO and Defence to access industry expertise and consult with Central Agencies. Defence will embark on a broad program of strategic reform in 2009, and the establishment of a Defence Strategic Reform Advisory Board is proposed. If agreed, this Board would be chaired by a person from the private sector with the appropriate skills and experience to advise on a significant reform program in a large and complex organisation. The Board would comprise an appropriate balance of internal and external members, including the Secretaries of the Department of the Prime Minister and Cabinet, the Treasury, the Department of Finance and Deregulation; and the Secretary of Defence, the Chief of the Defence Force and the CEO DMO. To ensure that strategic reform is pursued on a whole of portfolio basis, the Board will encompass the functions of the DPAB as described in the Mortimer Review.

SECTION 2

RESPONSE TO THE REPORT OF THE DEFENCE PROCUREMENT AND SUSTAINMENT REVIEW - THE MORTIMER REVIEW

RECOMMENDATIONS

AGREED:	42
AGREED IN PART:	3
2.2 Subordinate Committee of the NSC	
4.7 DMO-Defence functional split on warehousing	
5.4 Direct funding to DMO for major capital equipment	
NOT AGREED:	1
5.1 Executive Agency Status for DMO	

The Government's response to the Mortimer Review (the Review) is based on the principles of clarifying lines of accountability and enhancing the transparency of capital equipment procurement decisions. We will strengthen the capacity of the Chief Executive Officer of DMO to provide Government with clearly and separately identified advice on cost, risk, schedule and acquisition strategies for major capital equipment. We will develop a more business-like culture in DMO by implementing a major program of organisational and cultural change. There will also be substantial change within Defence, most particularly in the Capability Development Group, that will improve the way the Defence Organisation does business. We will also work to further strengthen the close relationship that exists between DMO and Defence, in particular codifying the authorities, roles and responsibilities of the Defence Capability Managers, the DMO and other Defence stakeholders throughout the procurement process.

DMO is a vital input to Defence, without which we would not have the military capabilities necessary to defend Australia and its national interests. An essential feature of DMO's more business-like approach will be an unwavering focus on delivering its customer's requirements, the customer in this case being the Defence Organisation, and through it the Government and people of Australia.

This section sets out the Government's detailed responses to the 46 recommendations of the Mortimer Review. It should be read in conjunction with the previous section, which sets out the key elements of the reform program for DMO, the capability development areas in Defence and for enhancing the DMO-Defence relationship as a whole.

RECOMMENDATION 1.1

Defence should prepare an annual submission detailing current and future capability gaps and the priority for their remediation for Government consideration and approval. This submission would be developed by the Capability Development Group.

AGREED

- Defence will implement a strategic planning process that institutionalises the links between strategic guidance, force structure, capability priorities and funding that have been developed during the White Paper process. This process accords with Government's desire for more regular White Papers, and ensures that Defence's capability and enterprise activities remain strategy-led.
- The classified Defence Planning Guidance will provide Government-endorsed direction on strategy, force structure and investment priorities on an annual basis. This direction will drive concurrency planning, preparedness planning and investment in both capability and enterprise enablers that will ensure Defence maintains the ability to meet Government's strategic needs for the ADF within agreed funding levels. This strategic planning process will be led by Strategic Policy Division, supported by the Capability Development Group and with the close engagement of other organisational elements such as the VCDF Group. The Defence Capability Strategy and the Defence Capability Plan will also be central elements of this new system and overseen by the Government in a way that has not previously occurred.
- We believe that a Government-endorsed, strategy-led and force structure focused decision making process, with clear and unambiguous advice to the enterprise about its investment and capability management strategies will address the Review's observation that "there are always more capability gaps to be filled than available resources". Any discussion of capability gaps in Government public documents will need to pay close regard to the proper handling of classified information.

RECOMMENDATION 1.2

Defence should increase the rigour with which projects are assessed for entry into the Defence Capability Plan (DCP). Capability Development Group (CDG) should develop the relevant information for a project's entry into the DCP and it should focus on achieving more disciplined cost, schedule and risk information for a project's entry. The information provided to Government should allow an informed decision on a project's suitability for entering the DCP.

AGREED

- More rigour must be applied to cost, schedule and risk information relating to proposals entering the DCP. We note the Review's comment that Defence has applied "significant effort" to improve the rigour underpinning the DCP and that there is a need to take this work further. We will build on this work following Mr Mortimer's recommendation.
- Projects enter the DCP up to ten years ahead of approval. The cost provision made at entry is based on the best information available at the time and based on exemplar technologies and similar capabilities. Projects are developed and refined over time. In that process a range of options are developed and explored, new approaches may become feasible, and scope and costs are refined. Sometimes better ways of achieving the capability emerge or the priority may change. Within this context we assess that we can improve our early scoping of cost, schedule and risk information on projects to be included in the DCP. Part of this process will be early and sustained engagement with industry.
- There is a particular need for accuracy in Defence Capability Plan cost estimates over the forward estimates period. To improve accuracy of the Commonwealth budget estimates, Defence will revise project cost estimates as better information becomes available and, at the least, once a project enters the forward estimates period.
- The CDG will lead on this task, supported by DMO and other Groups where appropriate. Defence will establish an internal "tiger" team to address how to improve performance in this area, with initial results to be reported to Government by the end of the second quarter 2009. This process will require closer and earlier engagement of DMO and the Department of Finance and Deregulation in the capability development area, including establishing better quality cost estimations.
- Defence's Strategic Policy Division, the Defence Science and Technology Organisation (DSTO) and the Defence Capability Managers in the form of the Service Chiefs, Vice Chief of Defence Force (on joint capabilities and on the impact of net personnel and operating costs), Deputy Secretary for Intelligence, Security and International Policy and, where appropriate, the Chief Information Officer (CIO) will also need to be closely involved in a more rigorous development of the DCP.

RECOMMENDATION 1.3

The Defence Chief Finance Officer (CFO) should assure the affordability of the Defence Capability Plan, including its impact on future personnel and operating costs, as part of the annual Defence budget considerations. To achieve this, the Defence Chief Finance Officer would audit the cost and schedule estimations within the Defence Capability Plan as developed by Capability Development Group to ensure they are as practical and as accurate as possible.

AGREED

- We agree with the intent of this recommendation. Assuring the affordability of the Defence Capability Plan is a task that relies on cost and schedule estimation skills of the DMO and CDG and others. In isolation the CFO is not in a position to make professional judgements about these matters, but can collate the contributions of the Groups and Services.
- We propose that a statement to be made in each DCP, developed by the CFO Defence and jointly signed by the CEO DMO, Chief Capability Development Group (CCDG) and CFO, which agrees that the accumulation of projects (and their future operating costs) in the DCP are affordable and achievable within forecast budget guidance given by Government. Such a statement would demonstrate that appropriate oversight has been provided to the DCP by all the relevant areas in Defence. This statement would also need to outline potential sources of change to capability costs.
- CFO, CEO DMO and CCDG will develop a statement on DCP affordability to be incorporated into the next public DCP in 2009.
- A crucial part of this process will be to ensure that Defence and DMO are able to present a single, combined set of budget figures annually, notwithstanding that there will also be separate appropriations for some parts of the DMO budget. A consolidated set of budget figures will add greater transparency to the total defence budget for Government planning purposes.
- Our focus will be on providing Government with information for budget decision making based on a consolidated position in addition to the current agency based data. The lead for this will be with CFO Defence, in consultation with CFO DMO.

RECOMMENDATION 1.4

The public Defence Capability Plan should contain sufficient information on project scope and timing to enable industry to develop strategic business plans, and the explicit cost bands presently disclosed should be replaced by a measure relative to the DMO Acquisition Category framework.

AGREED

- CEO DMO and CCDG will work on applying the DMO Acquisition Category framework methodology to the next public version of the DCP in 2009. We note that there will always be a tension between the need for transparency to assist business to plan for projects and the need for Defence to maintain a capacity to achieve good contract outcomes for the Commonwealth. We will consult with defence industry to help identify the best way to provide information on projects without undermining the Commonwealth's capacity to pursue value for money.

RECOMMENDATION 2.1

Government approval of major Defence projects should occur through a tailored application of the two-pass process. For simple acquisitions where project definition is complete, Government may decide that Defence Capability Plan entry satisfies first pass requirements. If the complexity or cost of a project is high or project definition is uncertain, a minimum of two passes should be employed.

AGREED

- We will develop appropriate measures to ensure that the two-pass process is used for complex and costly procurement tasks and explore options to speed decision-making on less complex procurements. It should be noted though, that the two-pass process (indeed, multi-pass in some very complex cases) has been a successful approach for Government consideration of acquisition projects.
- The extant two-pass approval process already allows for combined First and Second Pass approval for less complex projects and for more than two considerations where projects are particularly complex. In addition, Cabinet rules allow for projects to be approved without discussion, or under the 'Ten Day Rule', where there are no contentious issues. The move towards more off-the-shelf procurements should reduce overall the number of more complex projects.
- Nevertheless, many defence projects are inherently complex and costly and we anticipate that the two-pass approach will continue to be applied in these cases.

RECOMMENDATION 2.2

To expedite the capability development process and allow the National Security Committee to focus on major issues, a subordinate subcommittee should be created to handle minor and less complex defence acquisition matters.

AGREED IN PART

- We agree with the intent to reduce the heavy work-load of the National Security Committee (NSC) of Cabinet. However, creating a Subcommittee of the NSC may raise the workload of the Committee by requiring three Ministers (Defence, Treasurer, Finance and Deregulation) to attend both a sub-committee and a full NSC meeting to deal with less complex procurement items.
- An alternative approach is for the Secretaries Committee on National Security (SCNS) to advise Ministers where there is departmental agreement on less complex procurement proposals. Where there is departmental agreement these items could proceed to NSC for agreement without discussion unless Ministers specifically raise issues for consideration. Alternatively, less complex procurement matters could be agreed by out-of-session correspondence between Ministers. Either approach will streamline the NSC workload. Options to streamline current processes will need to be discussed with the Department of Prime Minister and Cabinet.
- Following government agreement we will lift the cost thresholds for matters to be brought to Two Ministers and to the NSC. To reduce the Committee's workload, we propose to lift the Minister for Defence's threshold for approving projects from \$8 million to \$20 million and for Two-Minister approval to be accepted for projects costed at between \$20 million to \$100 million (currently the range for two-Minister agreed projects is \$8 million to \$50 million). In the case of these projects either Minister could request that NSC consider a project if necessary. The threshold for projects to come to NSC would be raised from \$50 million to \$100 million. These thresholds will be periodically reviewed to ensure their value is not significantly eroded.
- The review proposed that the Parliamentary Secretary for Defence Procurement might attend a sub-committee of the NSC. This Parliamentary Secretary position was abolished in late February 2009. Attendance of representatives other than the Minister for Defence at NSC is a matter in the first instance for the Minister for Defence to consult with the Prime Minister, following paragraph 3.18 of the Cabinet Handbook (Fifth Edition), which says that "...parliamentary secretaries would generally only be co-opted, with the Prime Minister's approval, for matters of particular relevance to their responsibilities."³

³ The Cabinet Handbook can be downloaded at: <http://www.pmc.gov.au/guidelines/index.cfm>

RECOMMENDATION 2.3

Any decisions to move beyond the requirements of an off-the-shelf solution must be based on a rigorous cost-benefit analysis of the additional capability sought against the cost and risk of doing so. This analysis must be clearly communicated to Government so that it is informed for decision-making purposes.

AGREED

- There is wide agreement that reducing cost and risk for major Defence equipment acquisitions involves procuring equipment that is as “off-the-shelf” as possible from existing production lines. This should be an important first step in any decision to acquire a defence capability. As the Review makes clear, there will be many occasions where modifications are required to military equipment acquired off-the-shelf in order to, for example, meet Australian regulations and to make the equipment interoperable with the rest of the ADF and with our allies. Interoperability modifications, often based on the work of the DSTO provide a critical edge in terms of Australian military capability. However, we need to pursue rigorous steps to ensure that off-the-shelf solutions are explored and only essential modifications are agreed.
- It should be noted that, in many cases, an off-the-shelf defence capability acquisition also entails acquisition from overseas. Pursuing an off-the-shelf approach will certainly produce cost and time efficiencies, though this needs to be balanced against the Government’s intent to support Australian industry, Defence’s need for a strong supply chain, and against a continuing need to ensure that equipment purchased meets Defence’s operational needs.
- CCDG will ensure that off-the-shelf solutions are considered as an essential early step in any capability development proposal and that cost-benefit analysis of OTS options are considered by government.

RECOMMENDATION 2.4

Prior to a project’s entry into the Defence Capability Plan, Capability Development Group should prepare a capability submission that addresses the capability required along with the initial data relating to cost, schedule and risk. The cost, schedule and risk information would be developed by the relevant expert – DMO for military equipment estimates and appropriate Defence Groups for all other inputs to capability.

AGREED

- We understand that the purpose of this submission would be to put more discipline, rigour and an accountability framework around Defence’s internal consideration of capability proposals and the entry of the project to the DCP.

- CCDG, in conjunction with CEO DMO has developed a statement of the capability development process designed to clarify key roles and responsibilities, enhancing opportunities for the Capability Managers and other stakeholders to be involved early in the process and to keep Government better informed about key stages in capability development.

RECOMMENDATION 2.5

At entry into the Defence Capability Plan, a draft Materiel Acquisition Agreement should be developed detailing the responsibilities and expectations of the stakeholders. This agreement should be refined throughout the process as more information is gathered.

AGREED

- Agreed as per recommendation 2.4.

RECOMMENDATION 2.6

Capability Managers should be required to sign the capability submission acknowledging their understanding of the capability being requested and the proposed acquisition strategy.

AGREED

- Agreed as per recommendation 2.4.

RECOMMENDATION 2.7

DMO should be responsible for the equipment acquisition strategy throughout the requirements definition process.

AGREED

- Agreed as per recommendation 2.4.

RECOMMENDATION 2.8

Capability Development Group should be adequately resourced in terms of workforce numbers and skills to develop capability proposals and incorporate specialist advice from DMO and the Defence Science and Technology Organisation.

AGREED

- Appropriate training remains a critical factor in ensuring that the CDG workforce is able to undertake high-quality capability development projects. We acknowledge a continuing need to deepen expertise in cost and schedule estimation and project management. Since the 2003 Defence Procurement Review Defence has invested substantial effort in developing appropriate training programs for CDG and DMO staff. CCDG and CEO DMO will continue to explore how to deepen our capabilities to improve this training.
- The Secretary and the Chief of the Defence Force (CDF), supported by CCDG, the Capability Managers and the Chief Defence Scientist (CDS) will determine an appropriate strategy to manage workforce numbers to ensure that CDG is able to develop capability proposals in a timely fashion and with the necessary levels of expertise. The validation of workforce requirements needs to take account of likely White Paper and Pappas Review outcomes and operate within the context of broader workforce pressures on Defence.

RECOMMENDATION 2.9

Capability Development Group and DMO should further develop their ability, and be adequately resourced to accurately estimate the cost and schedule of major acquisition projects.

AGREED

- Agreed as per recommendation 2.8. We will look to create opportunities to improve and align cost estimation techniques and training in cost estimation between Defence, the DMO and the Department of Finance and Deregulation. This will improve the level of common understanding and reduce conflicts due to the employment of different methodologies.
- An important element to include in this process is the impact of net personnel and operating costs (NPOC) to support new capabilities. The Vice Chief of Defence Force in his capacity as the Joint Capability Coordinator, with the Chief of Joint Operations and the CFO DMO will be engaged in developing and reviewing NPOC related aspects of major acquisitions.

- DMO will be responsible and accountable for developing military equipment cost and schedule estimates and risk analysis and developing and implementing an acquisition strategy. DMO will also be responsible for analysing industry's capacity to deliver the required capability.

RECOMMENDATION 2.10

The Chief Executive Officer of DMO should provide independent advice to Government on the cost, schedule, risk and commercial aspects of all major capital equipment acquisitions, and be a permanently invited adviser to Government committees considering defence procurement.

AGREED

- We agree that CEO DMO must be in a position to provide advice to Government on the cost, schedule, risk and commercial aspects of all major capital equipment acquisitions. As the Review points out, many parts of the Defence organisation bring professional expertise to bear on procurement, including CDG, DSTO, CIO Group, the Defence Support Group (for estate matters), the Capability Managers and the Services as the end-users. These views must be properly reflected in the cabinet submissions which Defence prepares, and which the Minister for Defence brings to the NSC. It would not be appropriate for DMO to make coordination comments on Defence cabinet submissions because, for procurement matters, DMO is intimately involved in preparing these submissions. Coordination comments are made by external agencies after the Minister for Defence has approved the submission.⁴
- Government must be assured that DMO and other relevant parts of Defence have been fully and appropriately involved in producing cabinet submissions. The Deputy Secretary for Strategy, Coordination and Governance will discuss with PM&C a distinctive way to present the advice provided by DMO in the body of cabinet submissions to reinforce the provision of independent advice.
- The Cabinet Handbook makes it clear that officials can be called to attend Cabinet meetings at the request of the Minister (which could be in the form of a request for a blanket approval) and with the approval of the Prime Minister. Agreement will be sought for the attendance of the CEO DMO at all NSC meetings if capability acquisition decisions are being sought.

⁴ Cabinet Handbook (Fifth Edition) Paragraph 5.4.

RECOMMENDATION 3.1

To provide a firm baseline for the delivery of equipment, Capability Managers should sign the Materiel Acquisition Agreements.

AGREED

- This will help to confirm the agreed baseline levels of capability against which the delivery of equipment will be measured.
- CCDG will coordinate this process.

RECOMMENDATION 3.2

As a fundamental principle, oversight and coordination of all elements necessary for the introduction of a capability should be exercised by the relevant Capability Manager.

AGREED

- We agree that Capability Managers should act in a stronger assurance role to ensure there is appropriate oversight and coordination of all elements necessary to introduce a capability. This will require a mechanism involving the DMO and many elements of the wider Defence Organisation to meet at an appropriately senior level to provide such oversight.
- There may be tension from time to time between the DMO's ability to deliver a capability to its approved scope and/or schedule, and a Capability Manager's judgement that this capability can no longer meet his operational requirements (which may have changed since the original approval). Such a judgement would have major implications for the achievement of value for money for the Commonwealth, and would not be taken lightly. However, it is possible, and it is incumbent on the Capability Manager to identify such issues and have them considered by Government as soon as they become apparent. A deliberate decision on whether to proceed, amend, or cancel the procurement would need to be made by the relevant Ministers, taking into account the full range of issues involved. Capability Managers must include whole of life implications and independent advice from the CEO DMO on the cost, risk and schedule implications for projects in their advice to Government.
- Capability Managers with CCDG and CEO DMO will meet to discuss an appropriate governance structure.

RECOMMENDATION 3.3

Defence should implement a framework, through the Capability Managers, to coordinate all the inputs to developing military capability.

AGREED

- See the response to 3.2.

RECOMMENDATION 3.4

Capability Managers should report regularly to Government on the status of the capability development initiatives for which they are accountable.

AGREED

We agree that Capability Managers should report to Government through the Secretary and CDF, who collectively have overall responsibility for capability development and for ensuring that the full range of capabilities under development reflect an appropriate distribution of financial and human resources.

- Defence will explore options for the most effective way for this information to be reported to Government. One option is that this should be a chapter in the classified DCP.

RECOMMENDATION 3.5

For complex and demanding projects, the authority, responsibility and accountability of the Project Manager should be formally set out in a project charter. Project Managers should be held to account for meeting the financial and non-financial performance targets detailed in their charter.

AGREED

- CEO DMO and CCDG are to ensure that such a project charter system is quickly put in place and that specific approvals made by Government can be clearly traced to the charters.

RECOMMENDATION 3.6

An independent Project Performance Office should be established within DMO to review projects and assist project teams to solve problems where necessary.

AGREED

- DMO has a number of mechanisms in place designed to provide such an independent review function and to assist project teams where necessary. For example, the organisation's Assurance Boards form a key element of the DMO's corporate governance framework. The Boards provide independent assurance and advice on the adequacy of governance frameworks (including controls, policy, processes and procedures) for each equipment acquisition and through-life support activity; and on issues and risks involving schedule, cost, capability and sustainability. The Boards are designed to promote best practice project and sustainment management by ensuring that staff prepare for board reviews and are challenged by an independent board with a range of skills and experience. The composition of the Assurance Boards ensures that they are in a position to cast a 'fresh set of eyes' across a project or sustainment activity. DMO Staff are encouraged to use the Assurance Boards as 'sounding boards' and to seek guidance and feedback from the boards on any aspect of concern involving a project or sustainment activity.
- CEO DMO will establish an independent Project Performance Office from within current resources, drawing on the current Assurance Boards and other relevant areas of the organisation.
- Defence and DMO will also investigate with central agencies and the Australian National Audit Office (ANAO) changes to the current project progress reporting arrangements aimed at standardising and simplifying these reports. The US Selected Acquisition Report framework provides a useful model and its adaptation for Australian use will be investigated.

RECOMMENDATION 3.7

DMO should continue to refine its approach to contracting so as to align with commercial practice. Contracts should reflect the risks of the procurement being undertaken.

AGREED

- Defence will continue to work with industry to refine the agreed 'seven principles to improve procurement practice.' As a Commonwealth entity, DMO will continue to be bound by Commonwealth Procurement Guidelines and the broader Government regulatory framework.

RECOMMENDATION 3.8

Public-private partnerships should be applied to defence procurement on appropriate projects. DMO should evaluate all of the relevant issues and provide advice to Government on how best to implement public-private partnerships.

AGREED

- DMO will evaluate what capabilities might be suitable for acquisition under public-private partnership (PPP) arrangements. We note that the Review indicates Defence has previously used a number of PPP arrangements, including on facilities projects and the Special Purpose VIP aircraft operated by the Air Force's 34 Squadron.

RECOMMENDATION 3.9

Projects should be assessed for their potential as a public-private partnership as part of the acquisition strategy developed by the DMO.

AGREED

DMO, in conjunction with key Defence stakeholders will add to project proposals an evaluation of the potential for acquisition under a PPP arrangement.

RECOMMENDATION 3.10

The Government should work with industry and State Governments to address the skills shortage.

AGREED

- This is a high priority for the Government and Defence as reflected in the DMO-run Skilling Australian Defence Industry (SADI) initiative. The SADI program is designed to train new skilled industry personnel, up-skill existing personnel and improve the quality and increase the quantity of training in defence industry overall. In late November 2008, the Government announced spending of \$61 million designed to boost skills in Defence industry.
- A model of this type of cooperative activity with the States is the \$20 million package of initiatives announced by the Premier of South Australia and the Parliamentary Secretary for Defence Procurement on 2 December 2008. This included funding to support industry skills

development through a Schools Pathway Program, a Professional Doctorates program, a Masters of Systems Support Engineering and an expansion of the Masters of Military Systems Integration scheme.

- On 4 December the Government also announced a \$26 million skills package for Defence small and medium sized enterprises which included additional funding Defence Industry Innovation Centers, an Engineering scholarships program and an expansion of the DMO Institute.
- Defence will continue to look for opportunities to further assist in developing essential industry skills.

RECOMMENDATION 3.11

The Government should consider implementation of the recommendations of the Joint Industry Training Task Force.

AGREED

- See response to recommendation 3.10

RECOMMENDATION 3.12

DMO staff development should be expanded to cover contractor management including influence, negotiation and relationship management.

AGREED

- Providing training of this type has been a high priority. The establishment of the DMO Institute supported by the university sector has led to significant advances in the range and depth of training offered to DMO staff and is helping to professionalise the DMO workforce. The DMO Institute is responsible for the design, development and administration of training courses that are aligned to the DMO job families. The DMO Institute provides innovative and contemporary training courses that are aligned with work practices, and is a one stop shop for information regarding professionalism, certification, training and development. Courses offered in procurement and contract management also offer training in advanced negotiation skills.

- On December 4, 2008 the Government announced that it would devote up to \$2.5 million to extend access to DMO Institute training programs to Defence industry.
- DMO staff will further explore opportunities to expand or modify courses addressing contractor management influence, negotiation and relationship management.

RECOMMENDATION 3.13

Changes to the scope of projects should occur through a disciplined process that considers the merit of the change mindful of the impact on cost and schedule.

AGREED

- Material changes to the approved scope, cost or schedule of major projects will require the further consideration of Government. The specific thresholds which should apply, and whether these changes should be considered and approved or rejected by Defence, Two Ministers or NSC, needs to be reviewed in consultation with the Department of the Prime Minister and Cabinet and the Department of Finance and Deregulation. See also Recommendation 3.2.
- Through the Capability Managers, Defence will develop a more formalised process to address scope change. Any such process will need to be sensitive to the requirements for scope change resulting from operational activities.

RECOMMENDATION 3.14

DMO should be held to account for delivering equipment and services as set out in the Materiel Acquisition Agreements.

AGREED

- We agree this reflects a sound approach to emphasising DMO's accountability. To support the proposal the Capability Managers will identify ways in which to report how events or activities outside of DMO's span of control impact on the delivery of capabilities. One option would be to address this in the Defence and DMO Annual Reports. The Defence-DMO charter, the Materiel Acquisition Agreements and the redeveloped and clarified capability development process will provide the transparency needed to ensure reinforced accountability.

RECOMMENDATION 4.1

Net Personnel and Operating Cost (NPOC) estimates should be updated annually as part of the budget process.

AGREED

- We acknowledge that estimating NPOC has been a problem area. Defence has been working hard to factor this element into our capability development process. We believe that we will be substantially better positioned after the new Defence White Paper to account for our NPOC requirements and to make this a robust part of our planning processes. This will be reflected in the annual Defence Management and Financial Plan (DMFP).
- CCDG, CEO-DMO, VCDF and the other Capability Managers will continue to work on the NPOC task with the aim of having a robust system in place for the 2009 budget and thereafter as part of the capability development budget process. Our focus will be to apply annual updates to projects that have an NPOC impact in the Defence Management and Finance Plan (DMFP).
- A key part of this change will be the incorporation of NPOC provisions for major capital equipment projects within the Defence Capability Plan.

RECOMMENDATION 4.2

DMO and Defence need to further develop the key performance indicators in Materiel Sustainment Agreements and the systems needed to record sustainment performance and costs.

AGREED

- We see this as being a vital task and are committed to refining sustainment key performance indicators. It is important to understand that sustainment is a critical factor supporting the ADF's capability to conduct operations. Sustainment supports the readiness levels of the ADF which are in turn defined by the impact of strategic circumstances on Defence's requirement to mount operations. DMO is therefore an integral part of Defence's capacity to undertake military operations. This imperative, as well as the requirement for DMO to be more business-like, will drive sustainment performance and costs.
- Sustainment performance and costs will also be measured in the context of the broader strategic reform program as Defence implements more effective ways to get work done and lowers input costs.

- DMO and Defence will task the Capability Managers to undertake a study to develop a better methodology for arriving at sustainment key performance indicators.

RECOMMENDATION 4.3

An independent Sustainment Efficiency Office should be created in DMO to measure, benchmark and find ways to improve the efficient delivery of sustainment to the Australian Defence Force.

AGREED

- As outlined in the response to Recommendation 3.6, DMO has a number of mechanisms in place for the oversight and review of projects.
- In parallel with the proposal at Recommendation 3.6 on the establishment of an independent Project Performance Office, the CEO DMO will establish an independent Sustainment Efficiency Office from within current resources, drawing on the Assurance Boards and other relevant areas of the organisation. Defence will work closely with DMO to ensure that other critical areas of sustainment support to the ADF (for example that provided by the Defence Support Group, the Chief Information Officer and DSTO) will be closely engaged.

RECOMMENDATION 4.4

Decisions to either purchase new equipment or maintain existing systems should be based on the through-life cost of each option regardless of whether the funding is from the acquisition or sustainment budgets.

AGREED

- This recommendation sets out a suitable planning principle and one that Defence will (and does) seek to apply to capability development. While a useful starting point the reality is that it is difficult to have a precise understanding of the likely through-life cost of an item of equipment. Heavy operational use may fatigue a military capability faster than anticipated. Equally, innovative maintenance strategies or changes in the preparedness requirement may extend a system's life of type. A decision to replace equipment is also dependent on the state of technology and the attractiveness of likely alternate systems. These complexities make it challenging to estimate through-life cost with a high degree of accuracy. In cases where Defence may have a choice between continuing with a current capability and acquiring a new capability we will ensure that business cases are developed that make the government's options clear in terms of cost and capability.

RECOMMENDATION 4.5

Systems Program Office Directors should be empowered through greater delegation to deliver the performance levels set in Materiel Sustainment Agreements and, where necessary, to negotiate changes with Defence.

AGREED

- CEO DMO will give effect to this recommendation, noting that appropriate oversight mechanisms will need to continue to ensure that broader Defence requirements are addressed. Giving the SPO Directors more authority to negotiate changes with Defence will bring with it a requirement to ensure that any changes to the Sustainment Agreements will take full account of ADF preparedness and operational requirements.
- All such changes would be within the approvals set by Government. Any proposed changes that exceed the limitations set by Government in the budget would need to be taken to Government for consideration.

RECOMMENDATION 4.6

The authority, responsibility and accountability of the Systems Program Office Directors should be formally set out in a product charter. They should be held to account for meeting the financial and non-financial performance targets detailed in their charter.

AGREED

- Product charters will be developed as part of the implementation of recommendation 4.5.

RECOMMENDATION 4.7

The current functional split between Defence and DMO for warehousing, distribution and disposal should be retained but responsibility for vehicle maintenance should be returned to DMO.

AGREED IN PART

- We agree that the current functional split between Defence and DMO for warehousing, distribution and disposal should be retained; however the question of vehicle maintenance needs to be studied further before any structural change is made.

- We agree that there may be a strong case to move responsibility for vehicle maintenance to DMO but it will take some time to develop a business case exploring the options. We will task the Vice Chief of Defence Force, who is responsible for the Joint Logistics Command, to review with CEO-DMO the most effective means for Defence to perform vehicle maintenance. This review will need to balance operational and preparedness requirements with the need to ensure a cost effective approach and to ensure that the principles of transparency and accountability are fully applied. The review will also draw on the work of the Defence Budget Audit Team which addresses ways to improve efficiency, including in the vehicle maintenance area.

RECOMMENDATION 4.8

Business improvement should continue in Defence and DMO to increase the visibility of costs due to warehousing, freight and disposal, and to reduce the costs of inventory storage and distribution.

AGREED

- As the Review acknowledges, Defence has invested substantial effort in 2008 to remediate its warehousing, freight and disposal strategies. We are in the process of disposing of large numbers of obsolete items and will implement new strategies which are currently being finalised in a companion review to the White Paper. We expect that our new approach to warehousing will produce savings and, importantly, will increase the visibility of costs to DMO and the wider Defence organisation.

RECOMMENDATION 5.1

DMO should become an Executive Agency under the Public Service Act 1999, and retain its Prescribed Agency status under the Financial Management and Accountability Act 1997.

NOT AGREED

- We do not support this proposal. Our assessment is that making DMO an Executive Agency as well as a Prescribed Agency would weaken Defence's capacity to conduct operations; undermine the CDF's statutory authority for command of the ADF, and the Secretary's statutory authority for administration of Defence; entail potentially significant costs to separate DMO from Defence, and in isolation would not achieve a cultural transformation to make DMO more business-like. Our assessment is that the debate over Executive Agency status has focussed too narrowly on just one of what is a number of options for bringing about change in DMO.

- Impact of making DMO an Executive Agency.** Section 65 of the Public Service Act (1999) allows for the establishment of Executive Agencies. The head of the Executive Agency would become directly responsible to the agency Minister and would be directly accountable to the Government and Parliament in the same way as the Secretary of a Department. The Australian Public Service Commission says that “the purpose of the executive agency structure is to provide a degree of separation from departmental management where that is appropriate to the functions of the agency and something less than a statutory authority is warranted.”⁵ It should be noted that as an Executive Agency DMO would still be bound by the Public Service Act for all matters including recruiting and be accountable through the Minister for Defence to Government and Parliament. There are currently five agencies in the Commonwealth which are both Executive and Prescribed Agencies.⁶ As can be seen from the table below these agencies tend to be small and have largely autonomous functions. Their output does not form an essential and unique contribution to the performance of a Department of State. Given its scale and complexity, the DMO would sit at odds with this group of agencies.

Commonwealth Prescribed and Executive Agencies

Agency	Annual Budget \$ million	Staff (FTE)
National Capital Authority (Old Parliament House)	59,955	51
Insolvency and Trustee Service Australia (ITSA)	71,624	280
National Archives of Australia	147,205	397
CrimTrac	149,359	156
Bureau of Meteorology	334,320	1,295

Source: Portfolio Budget Statements 2008-2009

	Annual Budget \$ million	Staff (FTE)
Defence Materiel Organisation	10,669,838	7,634

- Conduct of Operations.** Because of its central role in sustaining current ADF capability, DMO plays an essential part in Defence’s capacity to conduct operations. The Mortimer review notes that through-life maintenance and support accounts for more than half the DMO annual

5 <http://www.apsc.gov.au/apsinduction/demonstration/content/referencesuite/glossary.htm>

6 <http://www.finance.gov.au/financial-framework/fma-legislation/fma-agencies.html>

budget and about two-thirds of its workforce. Through rapid acquisitions designed to support operations DMO procurement also provides an essential enabling capability to the ADF. Having brought the procurement and sustainment arms of Defence together in the 1990s, with the benefit of significant efficiencies and savings, our assessment is that it would be damaging and economically costly to separate Defence from the procurement and sustainment functions provided by the DMO. We are concerned that making DMO an Executive Agency would lessen its requirement – and its current cultural predisposition – to be responsive to operational needs.

- The Secretary and CDF's statutory authority. The Defence Act (1903) places statutory authority on the CDF for the command of the Defence Force and to the CDF and Secretary jointly for the administration of the Defence Force.⁷ Although this authority can be delegated they are ultimately responsible to Government for all aspects of Defence including those conducted by DMO. At the least the establishment of DMO as an Executive Agency would complicate this matter. DMO is a fundamental enabling element for operational capability and therefore a key component of the CDF's capacity to command operations.
- Costs of separating DMO from Defence. Defence and DMO administrative structures are completely interlinked with Defence providing the substantial ICT, finance, human resource and other forms of administrative support. Equally, DMO provides a number of functions to Defence, for example advice on contract management, so there would also be a requirement for Defence to duplicate some capabilities within a split structure. For an organisation of DMO's size there may be potentially significant additional cost implications that are yet to be quantified of having to build its own ICT, finance, human resource, estate and broader administrative support capabilities.
- Achieving a cultural transformation in DMO. The Mortimer review's ultimate purpose is to give the CEO DMO the authority to bring about a deep cultural change in DMO, to make the organisation more business-like and to do so by making it more separate from the broader Defence organisation. In our assessment the review's finding that the creation of an Executive Agency will achieve this goal does not fully address the challenges associated with achieving cultural change. Even as an Executive Agency DMO will be required to operate under the Public Service Act, which will constrain its degree of independence. Although it is imperative that DMO becomes more business-like, its culture needs also to comprehend the organisation's role as an enabler of military operations and also as an entity that is accountable to Government and Parliament.

7 The Defence Act (1903) http://www.austlii.edu.au/au/legis/cth/consol_act/da190356/index.html#s9a

RECOMMENDATION 5.2

To effect this change a charter should be drawn up between Defence and DMO which would clearly spell out the responsibilities of each agency. The charter should include provision for the Chief Executive Officer of DMO's continuing membership of the Defence Committee.

AGREED

- Noting our position with regard to recommendation 5.1, we agree that a charter between DMO and Defence would be an essential instrument to clarify roles, authorities and responsibilities; to codify the instruments that will enable cultural change in DMO; to set appropriate benchmarks and measures of performance and to institutionalise the more demanding requirements of transparency and accountability. We will, therefore, develop such a charter, with CEO DMO and defence working closely over the next few months to have such a document ready for Government consideration before June 30, 2009.
- CEO DMO will remain a member of the Defence Committee and DMO senior officers will remain members of subordinate committees.

RECOMMENDATION 5.3

It should be mandated that the Chief Executive Officer of DMO must have significant private sector and commercial experience.

AGREED

- We consider it highly likely that future CEO of DMO will have significant private sector and commercial experience. Selection processes must, of course, be open to selecting the best possible candidate in keeping with the merit principle of the Australian Public Service. Our preference would be to select on the basis of candidates having demonstrated substantial commercial and business acumen.

RECOMMENDATION 5.4

Acquisition funding should be directly appropriated to DMO on the basis of a budget submission from DMO outlining anticipated major capital equipment project expenditure.

AGREED IN PART

- Direct appropriations for major capital equipment could act as a useful catalyst to generate a stronger business-like focus in DMO. The implications of this recommendation are, however, far reaching and complicated. They need to be studied carefully to ensure that financial handling issues are worked through, a suitable transition strategy developed and mechanisms put in place to ensure that our accounting treatment of capital and related expenditure is fully transparent.
- By mid-2009 Defence and DMO propose to present a strategy on how this recommendation could be implemented, should Government choose to do so. This will involve working very closely with key central agencies such as the Department of Finance and Deregulation, Treasury and the Department of Prime Minister and Cabinet. Should Government agree it, the strategy would allow for a transition to this funding model from the 2010-11 Financial Year.
- Key elements of this strategy must include:
 - + A mechanism to determine how to split project funding in projects so that DMO is appropriated for its elements (mainly equipment) and Defence for its components (mostly facilities, research and development, and sustainment).
 - + A plan to apply this splitting of funding to the remaining spends of existing approved projects and for all future projects as they come forward for approval.
 - This would require action to separate past and future projects into anticipated Defence and DMO cash streams, including a share of contingency.
 - + A methodology to share contingency costs between Defence and DMO and agreed business rules on how and when to access contingency costs.
 - + An agreed set of business rules allowing the splitting of DMO and Defence balance sheets for major capital acquisition.
 - + DMO would not only receive the cash in-year for acquisition, but would hold the future anticipated appropriation stream across the forward estimates and DMFP for both approved and DCP projects.
 - The option of Defence reflecting future-year anticipated appropriations for DCP projects will be explored with central agencies.
 - An issue to be resolved is the handling of in-year cash for DCP projects that are expected to be approved after the budget. The logical approach would be for this funding to be included in the DMO appropriation.

- + A mechanism to seek Government approval to reprogram funding across years if Defence/ DMO considered that the projected cash flow did not match requirements.
- + A mechanism to seek Government approval to move future funding streams into the Defence Strategic Investment Reserve (DSIR). What is at present a process involving Ministerial approval for transfers within the Defence budget would become a Cabinet decision across agencies at a Budget milestone.
- + With direct appropriation the transfer of cash in the current year (if, for example, DCP projects expected to be approved in-year after the budget did not proceed), will require an adjustment to appropriations agreed by Government at a budget milestone.
- + Direct appropriation will often elevate decisions to Cabinet or Ministerial level to make decisions about the split of allocations between two separate organisations. In some respects this may add to Ministerial workloads, although it will be possible to develop a set of general principles through which the Government provides guidance on handling financial interactions between Defence and DMO.
- + A plan will need to be developed to define the treatment of inventory and the transfer of assets (for example spare parts) between Defence and DMO. An important objective will be to ensure that such transfers can be easily tracked for audit purposes.
- + Agreements with the ANAO and the Department of Finance and Deregulation that the budget arrangements are appropriate and provide the transparency and accountability mechanism that Government requires.

RECOMMENDATION 5.5

Sustainment funding should continue to be provided through Defence to DMO, but Service Fee funding should be appropriated directly to DMO. The Service Fee should be based on anticipated workloads.

AGREED

- We agree that Service fee funding can be directly appropriated to DMO. This will require careful elaboration of appropriate business and accounting rules to ensure that risks and benefits are shared between Defence and DMO. There will be a need to balance mutual requirements with regard to fluctuations in demand for civilian and military personnel numbers.
- Direct appropriation will shift the balance of 'control' in future-year planning from Defence to DMO – as DMO would 'own' the money in the forward estimates when negotiations occur on the provision of ADF staff placements.

- Defence will review its staffing levels in DMO and its posting arrangements to ensure that the level of military staffing to which it commits can be delivered (other than in exceptional circumstances). Mechanisms will be established to provide incentives on the Services to deliver agreed workforce levels. Mechanisms are needed to ensure that where DMO is provided with the agreed workforce it will deliver the level of output agreed, as slippage in outcomes will result in a net increase in staff costs in future years.

RECOMMENDATION 5.6

Government should set a target for no additional funds for real cost increases on major capital acquisition projects beyond approved changes to scope (or other legitimate reasons for a cost increase). This will be contingent on the Chief Executive Officer of DMO achieving the necessary independence and flexibility as provided by an Executive Agency to run the business.

AGREED

- Our assessment is that this recommendation reflects a necessary objective and indeed does reflect current practice with regard to how cost increases are evaluated. We do not agree that it would be necessary to make DMO an Executive Agency in order to implement this approach to cost increases. In order to facilitate the Government's handling of this issue we will improve Defence and DMO's reporting to allow greater transparency to the sources of real cost increases.

RECOMMENDATION 5.7

The Defence Procurement Advisory Board (DPAB) should continue, with the current public sector membership, with an increased focus on providing advice to the Chief Executive Officer of DMO.

AGREED

- We agree with the intent of this recommendation. The DPAB has been a valuable source of advice to Defence and DMO since its inception in 2003.
- In 2009, Defence will embark on a broad program of strategic reform, which will be accompanied by the development of a robust governance and assurance framework, including the proposed establishment of a Strategic Reform Advisory Board, which would draw its membership from both the public and private sector.

- This would be chaired by a person from the private sector with the appropriate skills and experience to advise on a significant reform program in a large and complex organisation. If agreed by Government, the Board would comprise an appropriate balance of internal and external members, including the Secretaries of the Departments of the Prime Minister and Cabinet, the Treasury, Finance and Deregulation and Defence, the Chief of the Defence Force and the CEO DMO. To ensure that strategic reform is pursued on a whole of portfolio basis, the Board will encompass the functions of the DPAB as described in the Mortimer Review.

RECOMMENDATION 5.8

Defence should manage its relationship with DMO in terms of costs and delivery against performance levels.

AGREED

- We will use the Charter described in recommendation 5.2 to set the basis for a management focus on costs and delivery against performance levels. The Capability Managers will play a key role in ensuring that the focus on cost and delivery is at the heart of the DMO-Defence relationship.

RECOMMENDATION 5.9

The Chief Executive Officer of DMO should have greater flexibility to manage the organisation's workforce including control over appointments, remuneration and performance management.

AGREED

- The Secretary of Defence has devolved a wide range of Human Resource related powers and functions to the CEO DMO under the Public Service Framework, the Defence Collective Agreement 2006-2009 (DeCA 2006-2009) that covers employees at Executive Level 2 (EL2) and below and the Workplace Relations Act, 1996 which cover all employees, including those in the Senior Executive Service (SES).
- This means that CEO DMO may exercise these powers in his own right, and as first delegate may devolve any of those powers to others in DMO. When a delegate who holds the power has made a decision properly, it is final. The broad suite of powers devolved to CEO DMO provides a high degree of autonomy to enable him to govern DMO to achieve identified business outcomes, and to provide him with flexibility on employment matters. The powers also give CEO

DMO autonomy to resolve all performance issues. Specifically, he is able to make decisions on remuneration through subsection 24(1) Public Service Act determinations for SES officer employment and to facilitate specific arrangements for employees with specialist skills.

- The Secretary of Defence has a stewardship responsibility as the Defence Portfolio Head to ensure that APS Values and the Public Service Act are complied with across the portfolio. In this respect, the Secretary will be kept informed of SES employment decisions and receive from CEO DMO an annual stewardship report covering the DMO workforce that will enable the Secretary to confirm that the DMO is upholding APS Values and complying with the *Public Service Act*. This in no way diminishes CEO DMO's authority to exercise decision making within the DMO workforce.
- These arrangements will be codified in a letter from the Secretary of Defence to CEO DMO.

RECOMMENDATION 5.10

A new General Manager – Commercial position should be created in the DMO at the Senior Executive Service Band 3 level, to manage strategic commercial issues and acquisition strategy, to support the Chief Executive Officer of DMO achieve a more business-like focus throughout the organisation, and to improve the performance of DMO business areas, with the broad responsibilities and role identified in this report.

AGREED

- CEO-DMO will be responsible for undertaking a recruitment action for the position of General Manager Commercial.

SECTION 3

IMPLEMENTATION OF PROCUREMENT REFORM

OUR IMPLEMENTATION PLAN FOR DEFENCE PROCUREMENT REFORM WILL FOLLOW THESE SIX STEPS:

1. INTERDEPARTMENTAL WORKING GROUP – DEFENCE CAPABILITY

The Government will establish a standing working group to engage central agencies earlier on Capability Development proposals prior to submission to Secretaries Committee on National Security. The group will operate along the same principles as the Strategic Policy Coordination Group (SPCG) ensuring early and close coordination between agencies and helping to streamline the NSC workload. The working group will monitor our implementation of procurement reform.

2. 3-STAR IMPLEMENTATION STEERING GROUP

Jointly chaired by the Chief Capability Development Group and CEO DMO, a 3-Star Steering Group will be established to provide oversight of the implementation of the Mortimer Review recommendations. The Group will comprise CCDG, CEO DMO, DMO's General Manager Commercial, VCDF and the CFO. The Steering Group will report to the Secretary and CDF on progress of the implementation program against agreed timelines and deliverables to Government.

3. PROGRESS REPORTS

The Defence Organisation will provide regular reports to Government on the progress of the implementation program. These will be linked to reporting on Defence's Strategic Reform Program.

4. AUSTRALIAN NATIONAL AUDIT OFFICE (ANAO) AUDIT OF IMPLEMENTATION

The ANAO will be invited to audit the progress of reform at nine and eighteen months post-commencement and report its findings against the agreed plan to make defence procurement more business-like.

5. AUDIT OF CONTINGENCY FUND AND MANAGEMENT RESERVE

Defence and DMO will request Auditor-General and the Department of Finance and Deregulation to provide advice on accounting for contingency funding, management reserve and project slippage. This will be included in the annual Defence Financial Statements.

6. INVIGORATION OF THE DEFENCE PROCUREMENT ADVISORY BOARD

The DPAB will function as described in the Mortimer Review Report will be incorporated in to the terms of reference for the Defence Strategic Reform Advisory Board to be established to oversee the broader Strategic Reform Program in Defence.

