

ADBR Entrepreneur

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Hard yards now coming in quest for defence acquisition reform

Having chosen to commence his term of office with a series of lectures on industry's failings as a supplier to Australia's armed forces, the new CEO of the Defence Materiel Organisation (DMO) now has to face up to the hard job of addressing deeply rooted cultural issues within Defence as a whole, a number of which are likely to continue to stand in the way of achieving any successful long-term defence procurement reform outcome. Two recent Auditor-General's Reports provide some insights into key problem areas remaining to be addressed as part of responses to the Kinnaird Report.

Following his landmark address to Canberra's 'Defence+ Industry 2004' conference in June, the DMO's Chief Executive Officer, Dr Stephen Gumley, has continued in a number of subsequent forums to emphasise the costs to defence-industry of successive failures to deliver new military capability: within the expenditure (ie: Budget) limits first set by government; according to the schedule set when the subject procurement was first approved; and to the required capability benchmarks, including quality and safety.

The transparency of accumulating Defence improvements in each of the above three areas is an important public policy issue, and this issue of 'ADBR-Entrepreneur' continues our series of reflections upon the quality of Departmental reporting on its major project outcomes (see *Insert Chart*), which saw recent expansion to cover the 30 largest projects. This development has subsequently aided the re-branding of our regular commentary as ADBR-E's 'Top 30 Defence Projects Review'.

Quest for accountability & transparency: In undertaking this important project review task, ADBR-E's analytical approach has sought to track a common path in terms of guidance traditionally given to Defence project managers via the Defence Procurement Policy Manual (DPPM), and how those project managers acquire

their responsibilities to taxpayers (in terms of accountability and transparency), as reflected in approved major capital equipment project reports publicly issued by the Department throughout the course of each year.

Within their text, successive iterations of the DPPM have also referred to the Capital Equipment Procurement Manual (CEPMAN) as providing specific procedural processes for the execution of major capital equipment acquisitions. CEPMAN in turn recommended the use of Earned Value Management (EVM) for all projects exceeding \$20m of more than 12 months duration. EVM uses real time cost, schedule and actual measures of work schedules and work commenced to extrapolate project cost variance, schedule variance, and the value of work at the completion of the subject project.

Best practice project management: For Defence project managers, the concept of 'earned value' is said to provide a set of 'best practice' project management principles that assist in establishing objective measures of the actual work achieved compared to the plan for that work. EVM is constructed around two levels of application: Cost/Schedule Control Systems (CSCS) and Cost/Schedule Status Reporting (CSSR), the underlying principles of which are essentially the same.

In a similar fashion, ADBR-E has sought to establish a consistent base by which it can sample officially-approved MCE project reports, and extract/assess the core EVM elements - Expenditure (E), Schedule (S), and Capability (C) - contained in those reports. This is done in order to provide readers with a window into progress by Defence in achieving not only improvements in overall project management and administration, but also improvements in public accountability now demanded by the Howard Government in the aftermath of its endorsement of Kinnaird Report recommendations.

Accepting Australia's warfighters have repeatedly missed out on the timely delivery of new equipment due to past failures in the defence-industry relationship, Dr Gumley's first reform salvo to went straight to industry 'hip pocket' sensitivities, by pointing

How much money has been lost to industry?

to the large quantum of profits being sacrificed by firms because Defence is yet to regain the confidence of Government it can deliver any more, as measured in terms of a regular and controlled flow of new materiel to the armed forces.

As a 'carrot' for improved performance in the future, the DMO Chief's appeal put clearly up in lights the reality that private shareholders and investors - who by the way are now being asked to invest more in defence industry capability to achieve 2004-2014 Defence Capability Plan objectives - have already foregone many tens of millions of dollars of after tax profit from successive failures in past military capability acquisition projects.

Irrespective of any progress Gumley might wreak within the DMO itself, his message was clear that unless the system is improved substantially, and from both sides, industry will continue to forfeit real operating profits in the order of \$200 million from a continuation of extant Defence project underspend. Such losses were struck irrespective of the half a billion dollars of operating profit annually on offer to industry from the six billion dollars worth of contracts let by Defence each year, along with any consequent additional diminishing of that amount by further contract slippage running into the new financial year. The ADBR-E Series A/6 edition (21 May 2004) charted official calculations of project slippage which roughly amounted to \$2,547m (in outturn/inflation adjusted) prices through to 2014.

After moving quickly in the middle of the year to progress an immediate shake-up of Defence contracting approaches and practices, Dr Gumley's next strategy element has been to launch an all-out campaign on improving 'Schedule' adherence as the main driver for broad ranging reform across Defence procurement (*refer ADBR-E Series A/7 - 30 June 2004*). The new focus on 'Schedule' (with apparently less regard for 'Cost') seeks to cut short the quantum of project problems created for the Government due to Defence project managers failing to run individual projects in accordance with time-lines set when the acquisition was first approved. So will elevating 'Schedule' to the top of the pyramid of defence acquisitions mantra provide Dr Gumley with the silver bullet he is looking for?

'Schedule' not all that's wrong with defence contracting

A recent report (No.59 of 2003/04) from the Australian National Audit Office (ANAO) looking into the acquisition of 'Bushmaster' infantry mobility vehicles (IMVs) under the famed project 'Bushranger' (Land 116), was unabashed in its castigation of Defence for poor management of this acquisition, pointing to a number of clear failures of internal Defence processes that have major implications for the long-term success of defence procurement reform initiatives.

According to the Auditor-General's report, the subject project incorporated 'minimal incentives' for effective contractor performance. A large advance payment made for Budget management reasons, combined with systematic scope creep in the initial stages of the contract, were said to have resulted in a transference of contractual risk to the Commonwealth. As a result, Land 116 became characterised by "unwelcome surprises surrounding cost, time, schedule, performance and the risk of litigation."

The ANAO further found that despite the project having a lengthy demonstration phase, the requirements definition had not been fully developed by the time the production option was exercised. During contract negotiations, a number of rectification and enhancement issues identified during trials were discussed, but Defence did not formally amend the contract to take into account the subject rectifications. This oversight exposed the Commonwealth to further risk, and limited its options when the time came to enforce contractual terms and seek delivery as per the established schedule.

Defence's response to these affairs was to attempt to manage the overall cost increase associated with the need for contract renegotiation within the initially approved budget allocation, with the obvious result warfighters would end up receiving a significantly reduced capability in terms of a smaller number of vehicles, accompanied by reduced vehicle requirements - especially their ability to self-recover via on-board winches. According to the report, and during the course of the project, "the number of battalions to be equipped has been reduced from eight to two. The vehicle ultimately procured by Defence was largely of an unproven design and capability, and was far more developmental than

Concern over implications of 'whatever it takes' approach

originally intended. Defence (also) managed the project as though it was a commercial off-the-shelf (COTS) procurement, rather than recognising the developmental nature of the project."

Defence responded to the Audit report saying that, despite criticisms of their project management, the vehicle to be subsequently delivered "is a world class design, and has integral protection levels unparalleled by any comparable vehicle in operation anywhere in the world today." While this might be true, Defence's response missed entirely the Auditor-General's point - from the accountability perspective - that what is shortly to be delivered to the Army does not necessarily relate to what Defence originally set out to purchase, namely, "a modest lightly armoured vehicle with commercial truck components."

The written dialogue between Defence and the ANAO (running to May 2004), highlights a continuing cultural gap within Defence in terms of desired post-Kinnaird defence materiel acquisition practice. The Department staunchly maintains that the 'Bushmaster'-based IMV capability warfighters are to receive will be superior to that originally contracted, and despite past problems, project 'Bushranger' should now be seen as a model project. The Auditor-General alternatively views the whole project with frustration, and despairs for long-suffering taxpayers. Who is right?

If the DMO is going to be effective in acquitting its new Gumley-endorsed charter - 'to equip and sustain Australia's defence force' - should project managers in future be required to remain true to the terms of the original sign-off given by the Government after they have passed through the revised 'two-pass' process? For those projects that subsequently transition from an 'off-the-shelf' acquisition to an 'evolutionary' acquisition during the course of the procurement - for whatever reasons or circumstances - should they be quickly corralled and put up to the Government for cancellation, as was initially the case for project 'Bushranger'?

Should Defence project managers be allowed to administer acquisitions where it is known the project will result in a less than an optimal outcome, as an alternative to expeditiously returning the project to the two-pass system for re-consideration? Should warfighters (and their representatives in Defence HQ) continue to tolerate internal mismanagement whereby the scope of projects are reduced through the use of administrative 'tricks' to camouflage failing performance, whilst funds and schedules are manipulated to avoid accountability for real losses of military capability that are never properly costed against expectations set down at the initial project approval stage?

What is the use of rules if no one follows them?

A second ANAO report (No.5 of 2004/05) looking into Defence's management of the Standard Defence Supply System Upgrade (SDSS) project focused even more on failures within the Department of Defence to follow its own internal processes. The convoluted evolution of what has now become Joint Project 2077 charts not unfamiliar Defence practices, whereby the failure to secure initial project approval (and funding) does not actually result in the 'killing-off' of the project.

Instead, the subject project is given new life as result of practices not unlike a 'chook pen', with managers scratching around for funds within the existing Departmental budget, or even worse, stripping funds from operational allocations to give life to endeavours that are unable to achieve support through more formal mechanisms. In short, the Auditor-General reported the SDSS found life in July 2000 with an initial \$15.87m from Support Command Group operating budget funds, with the main aim of delivering a Standard Supply Chain System across Defence by June 2002, ostensibly a strategic procurement activity.

The project went ahead, even though the ANAO did not observe that Defence sought, or obtained Ministerial approval before implementing the project. This was despite a July 2000 equipment acquisition strategy (EAS) estimating project costs at \$27m, which would normally have elevated the endeavour to MCE project status. Defence is said to have later applied to the Department of Finance & Administration for further SDSS improvements utilising \$40m allocated within the 2000/01 Defence budget, and tagged against 'corporate management systems' [This later became the

**'Chook pen'
funding culture
delivers the
obvious result**

Defence Management System Improvement Program - Joint Project 2080]. Finance subsequently told Defence they would need to submit a report on SDSS progress to justify the additional funds, and even proffered a view that it would be more cost effective to replace the SDSS than to upgrade it.

Given no evidence was found by the ANAO to confirm that Defence sponsored, or actually provided the requested report to Finance, it was subsequently revealed in the audit report that authorisation to initiate the project was derived from a Defence Executive allocation of operational funds to the Support Commander Australia, who in turn authorised the Defence Joint Logistics Support Agency to utilise the operating budget to initiate the project.

Despite all these claimed authorisations, however, the ANAO said it was "unable to locate the subject approval from Defence Executive minutes made available from the Department." As of November 2003, the SDSS project is said to have incurred costs of \$49.9m (\$15.9+\$34m), excluding a further \$5.1m in contract residuals contributed by e-Procurement and SDSS Version 3 legacy training projects. In the interim, work has continued on a fourth version of the SDSS in anticipation this will eventually deliver the required financial reporting functionality.

As at completion of the audit report in August this year, the Auditor-General concluded the delivered SDSS system to be "ineffective in its ability to manage Defence stock holdings to the extent originally envisaged, and restricts Defence's ability to fully account for them. The system does not adequately alert appropriate Defence logistic management staff that strategically important stock holdings have fallen below levels able to support Defence operational requirements."

Project elements defined as critical success measures, yet remaining to be delivered include purchasing, warehousing and financial management. Defence has subsequently advised that an SDSS Version 4 'get well' program is currently underway, at additional cost to taxpayers, with a completion date of December 2005. The whole program is also likely to be caught-up in reforms to the Defence Information Environment/new Chief Information Officer's group (set to commence from 3 December 2004), meaning a wholesale review of SDSS performance is unlikely to emerge until July 2006.

In its catalogue of SDSS culture, the ANAO highlighted Defence errors in attempting to manage a run-away project by imposing extensive scope reduction, again with the result (similar to project 'Bushranger') that it would fail to deliver many of the outcomes for which it was originally funded. Again, and despite the involvement of a Project Management Board, the acquisition was allowed to continue to operate on an extended schedule in excess of 200% of the planned schedule.

The Auditor-General further observed the SDSS project was raised as a 'Minor' capital acquisition project from operating funds to satisfy a quest for major systemic changes to the entire Defence logistics management environment, despite an EAS estimating a cost in excess of \$20m. This alone, at the time, would have invoked higher Defence overview by requiring the subject project to have been approved by Cabinet, and managed as an MCE procurement activity.

**Cracking the
whip within
Defence itself**

Similar to its 'Bushmaster' investigations, the ANAO's report on the SDSS - given it tracks activities spanning the current financial year - raises major questions as to the robustness of the Department of Defence's internal governance, despite major reforms claimed to have been already achieved through to the middle of the year. Along with the usual raft of examples of project management failures, a thorough reading of these two reports prompts the obvious question as to whether a single focus on achieving 'Schedule' compliance in future military acquisitions will be sufficient to satisfy the change of hearts and minds executive government is expecting from current defence procurement reforms, as outlined in decisions made on the basis of Kinnaird Report recommendations. 