

DEFENCE

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STRATEGIC OBJECTIVES AND ENVIRONMENT

Defence Update

Defence Update 2005, released in December 2005, examined Australia's strategic outlook and presented a plan to provide for both the needs of the present and the possibilities of the future. It outlined the way the Government continues to shape the Australian Defence Force (ADF) as a highly capable and flexible military force able to meet a wide range of strategic and responsive tasks. The Update noted that the Government will continue to give priority to the development of the ADF as a network-enabled force that can contribute with increasing effectiveness to global, regional and domestic security. Such a force will be versatile, robust, joint and integrated. The Update informs Defence planning guidance for capability definition and development, corporate management and military strategy development.

Hardened and Networked Army

The Hardened and Networked Army is a response to the Government's requirements from the 2000 Defence White Paper '*Defence 2000: Our Future Defence Force*', which are reiterated in the *Defence Update 2005*, for a bigger land force, which has sufficient firepower, protection and mobility to provide clear advantage in any likely operations in defence of Australia or in our immediate region. This initiative has been taken in a context of increasingly complex and lethal nature of battlefields, as demonstrated in Iraq and Afghanistan.

The Hardened and Networked Army initiative is aimed principally at providing depth and sustainability to the requirements of the Defence White Paper and the *Defence Update 2005*. The Hardened and Networked Army is based on the combined arms approach to combat, whereby infantry, armour, artillery, aviation and engineers work together to support and protect each other.

The Hardened and Networked Army will be achieved through:

- increasing the Army by 1,485 personnel;
- the development of new force structures of combined arms battlegroups;
- re-rolling the 3rd Battalion, the Royal Australian Regiment (3 RAR) from a light parachute battalion to generate a second mechanised battlegroup in 2011;
- redistributing personnel and equipment to enhance the Army's readiness;
- improving communication networks by acquiring radios for individual soldiers through to battle management systems for commanders;
- re-focusing the Army Reserve and providing approximately 2,800 high readiness Reservists to support the Army's front line deployable units; and
- relocating 3 RAR from Sydney to Adelaide.

FORCE STRUCTURE

Defence's force structure remains as reported in the *Portfolio Budget Statements 2005-06* except for the following changes:

- a surface combatant force of five Adelaide-class guided missile frigates (to be reduced to four by the end of 2007) and seven Anzac-class frigates (increasing to a total of eight by September 2006);
- 16 Seahawk naval combatant helicopters, six Sea King maritime support helicopters, 13 Squirrel naval training helicopters, and ten (increasing to a final of 11 in early 2006) Super Seasprite naval combatant helicopters which have achieved interim acceptance for training prior to estimated operational acceptance of full capability not before mid-2006;
- 12 Fremantle-class patrol boats (reducing to ten by mid-2006 with the remainder to be decommissioned by mid-2007) and an Armidale-class patrol boat (increasing to three by mid-2006 and 14 by the end of 2007);
- an afloat support force comprising one auxiliary oil tanker (to be replaced in mid-2006 with a more environmentally-compliant double-hulled tanker) and one fleet replenishment ship; and
- an air transport and air-to-air refueling force that operates two C-130 Hercules airlift squadrons, one squadron each of DHC-4, B-707 and B-737, and Special Purpose Aircraft (B300 Beechcraft and Challenger). Airborne early warning and control aircraft will be deployed from 2007.

OVERVIEW OF THE 2005-06 BUDGET

Significant changes for the 2005-06 budget

Major variations in Defence's 2005-06 budget are:

- an additional \$111.8m in 2005-06 for Operation Slipper which involves the deployment of the Special Forces Task Group for up to one year, as well as two Chinook helicopters and about 110 additional personnel;
- a reduction of \$120m in capital facilities program due to slippages in project schedules and delays in preparing business cases for project approvals;
- a redirection of \$120m in capital facilities funds to the Defence Capability Plan to facilitate the early purchase of the AEGIS system for the Air Warfare Destroyer at a cost saving;
- a carry forward of \$159m to 2006-07 due to timing issues with the early purchase of the AEGIS system for the Air Warfare Destroyer;
- a reduction of approximately 1,000 military personnel numbers due to recruiting and retention difficulties which are now being addressed through a range of initiatives. As a result, \$70m is quarantined in Defence's appropriation receivable pending Government decision on the use of these funds;

- adjustments to the estimates to reflect higher fuel prices (an amount of \$30m was included in the budget in anticipation of the impact but a further \$25m has been allocated to the Defence Materiel Organisation);
- an allocation of funding to a number of initiatives including for living-in-accommodation, estate upkeep, asbestos removal and clearing administrative asset backlogs;
- a price and exchange update reflecting movement in the non-farm GDP deflator estimates since the Budget and changes in the value of the Australian dollar relevant to other currencies (+\$69.0m);
- changes to the estimates to reflect Defence's transition in adopting Australian Equivalents to International Financial Reporting Standards (further details are provided in Table 1.1 below); and
- changes in the split of Defence's and the Defence Materiel Organisation's accounts as the Defence Materiel Organisation is bedded-in as a separate prescribed agency (further details are provided in Table 1.2 below and in Chapter 2 – Resourcing).

Adoption of Australian Equivalents to International Financial Reporting Standards

During 2004-05, the Government decided that it would adopt the Australian Equivalents to International Financial Reporting Standards as the basis of its budget estimates and the transition would be effected through the 2005-06 Additional Estimates process. As part of this decision, the Government decided that it would not apply the requirements of AASB 119 – *Employee Benefits* for its budget estimates, due primarily to the volatility created by the measurement method required by AASB 119.

Defence has therefore prepared its Additional Estimates on an Australian Equivalents to International Financial Reporting Standards basis with the exception of the requirements of AASB 119. All the estimates were based on the assumption that Defence would be able to access the transitional provisions of AASB 1.

The major adjustment made to Defence's estimates relates to restoration obligations. When an obligation to restore an item of property, plant and equipment exists, the estimated cost of such an obligation must be added to the underlying value of the asset and depreciated over the assets useful life. A corresponding provision is then recognised for these restoration obligation costs.

The major financial impacts on Defence's estimates are summarised in Table 1.1.

Table 1.1: Major Adjustments to Defence's Estimates Due to Adoption of Australian Equivalents to International Financial Reporting Standards

Budget Category	Impact (\$m)	Reason for adjustment
Buildings	34.3	To recognise the restoration/make good obligations for leased estate.
Other Provisions	37.1	Recognition of liability associated with restoration obligations
Depreciation Expense	5.3	Flow-on depreciation impact of increased underlying value of assets with restoration obligations
Write-down expense	-4.6	Reverses write-downs undertaken last financial year on intangibles subsequently de-recognised.
Finance Expense	-2.2	Reflects the discounting of the non-current employee provision.
Intangibles	-5.1	Reflects the de-recognition of intangibles.
Total	64.8	

There are also a number of areas within the Defence budget where considerable difficulties have been encountered in adopting Australian Equivalents to International Financial Reporting Standards, particularly in relation to specialist military equipment and inventory.

Bedding-in of the Defence Materiel Organisation as a prescribed agency

Since the Defence Materiel Organisation (DMO) became a prescribed agency on 1 July 2005, the DMO and Defence accounts have been separated as reported in the *Portfolio Budget Statements 2005-06* (p.6). Since then, as part of the bedding-in of the new DMO arrangements, the initial separation of the accounts have been revisited and refined. The most notable changes since the Budget are:

- the decision to transfer Assets Under Construction from Defence to the DMO Balance Sheet;
- the return of Inventory holdings to Defence's Balance Sheet;
- the transfer of Joint Logistics Command from DMO to Defence, and the accounting arrangement that this entailed, and
- a range of other refinements having regard for actual rather than forecast opening balances at 1 July 2005, Australian Equivalents to International Financial Reporting Standards requirements and revisions to the estimated costs and activities undertaken by the DMO.

An overview of the changes to the original Balance Sheet transfers to DMO is shown in Table 1.2 below, noting that further variations have occurred to these figures since then. The revised Balance Sheet estimates for the DMO are shown in Section 2 – Defence Materiel Organisation.

Table 1.2: Changes to Defence's Balance Sheet in relation to Defence Materiel Organisation items

	Budget 2005-06	Additional Estimates 2005-06	Variation	Reason for variation
	\$m	\$m	\$m	
Cash	10.0	0.2	-9.8	Changed to reflect outstanding payments to be made by DMO, including unrepresented cheques
Appropriation Receivable	40.3	40.3	-	No change
Other receivables	44.6	102.6	58.1	Represents the actual opening balance of other receivables on DMO's balance sheet rather than the forecast made at the time of the Budget
Specialist Military Equipment	-	8,314.2	8,314.2	Reflects the decision to move Assets Under Construction to DMO's balance sheet
Infrastructure, Plant and Equipment	317.8	201.7	-116.1	Represents the actual opening balance of Infrastructure, Plant and Equipment on DMO's balance sheet rather than the forecast made at the time of the Budget
Inventories	4,519.9	0.0	-4,519.9	Reflects the decision to return Inventory holdings to Defence's balance sheet
Intangibles	120.6	100.9	-19.7	Represents the actual opening balance of intangible assets on DMO's balance sheet rather than the forecast made at the time of the Budget.
Other non-financial Assets	613.3	602.7	-10.6	Represents the actual opening balance of Other non-financial assets on DMO's balance sheet rather than the forecast made at the time of the Budget
Total Assets	5,666.3	9,362.6	3,696.3	
Employee Provisions	119.7	115.6	-4.1	Represents the actual opening balance of Employee Provisions for DMO's civilian staff rather than the forecast made at the time of the Budget
Suppliers Payables	592.2	623.4	31.2	Represents the actual opening balance of Suppliers payable on DMO's balance sheet rather than the forecast made at the time of the Budget
Other Liabilities	-	1.3	1.3	Represents the actual opening balance of Other liabilities on DMO's balance sheet rather than the forecast made at the time of the Budget
Total Liabilities	711.9	740.3	28.4	
Net Assets	4,954.4	8,622.3	3,667.9	

Further details on the Defence Materiel Organisation are provided in Section Two.

IMPLEMENTING THE DEFENCE WHITE PAPER

Defence Update 2005, released in December 2005, delivers on the Government's commitment in the 2000 Defence White Paper to review periodically Australia's strategic outlook to ensure that Defence maintains the appropriate mix of concepts, capabilities and forces to meet new security challenges as they arise. The Update builds on, and reconfirms, the strategic principles articulated in the Defence White Paper and the *Defence Update 2003*.

Initiatives to Improve Capability

Initiatives remain as reported in the *Portfolio Budget Statements 2005-06* except for the following information.

Land Forces Goal

In addition to the enhancements planned for 2005-06 to improve current and future ability to undertake the tasks necessary to achieve the land forces goal, Defence will also provide soldier combat systems for enhanced lethality and survivability. To further enhance the ADF's land capabilities, Defence is developing the Joint Combined Training Centre Project to facilitate state-of-the-art joint training between Australian and United States forces with priority given to supporting Exercise Talisman Sabre 07.

Air Combat Goal

The first-pass proposal for a project dealing with pilot training systems will now be presented to the Government in 2006-07.

Maritime Forces Goal

Defence's capacity to meet the Government's Maritime Forces Goal will also be enhanced in 2005-06 by:

- continued platform and sensor enhancements to Collins-Class submarines and testing of the advanced capability replacement heavyweight torpedo under development jointly by the United States and Australia;
- progression of the guided missile frigate upgrade to HMAS *Melbourne*;
- delivery of the final Super Seasprite helicopter and progress of the helicopters to full capability, including integration of the Penguin anti-ship missile; and
- modification of the frigate force to enable integration of the MU90 lightweight torpedo entering inventory in 2006.

Defence's ability to meet the Government's aim beyond the next financial year will be enhanced through a range of activities in 2005-06 including:

- further developing detailed capability requirements and performance specifications to acquire three air warfare destroyers. (The Government recently announced the selection of the combat system engineer, ship builder, and platform systems designer); and
- tender for improvements to maritime communications and networking capabilities.

First-pass proposal for improvements to maritime communications and networking capabilities will now be presented to the Government in 2006-07.

Information Goal

To further enhance the ADF's information capabilities, Defence will present the following first-pass proposals to the Government in 2005-06 in addition to those forecast in the *Portfolio Budget Statements 2005-06*:

- high-altitude, long-range multi-mission unmanned aerial vehicles;
- ADF Joint Command Support Environment;
- enhancing military satellite communications; and
- enhancing Defence's finance and personnel information systems.

Defence will seek second-pass approval in 2005-06 for:

- ADF global positioning system enhancements; and
- further enhancements to Defence's logistic information systems.

Initiatives to Improve the Provision of Advice and Decision Making

Information remains as reported in the *Portfolio Budget Statements 2005-06*, except for the following:

Financial Statements Remediation Plans

The implementation of Financial Statements remediation plans continues to improve financial management and business systems and processes. The Chief Finance Officer is responsible for driving Defence's remediation and financial controls framework. Further information on financial remediation is reported in Chapter Six – Management Reforms and Efficiencies.

Initiatives to Enhance Strategic Relationships

Initiatives to enhance strategic relationships remain as reported in the *Portfolio Budget Statements 2005-06*. The *Defence Update 2005* acknowledges Defence's role in supporting regional and global efforts to combat the threats of terrorism and the proliferation of weapons of mass destruction, in assisting regional nations in building their capacity, and in working with the Pacific Island countries to develop practical measures to deal with the unique governance and security challenges they face. Defence is also working through international export control regimes and activities such as the Proliferation Security Initiative to enhance multinational approaches to security.

Status of Defence White Paper Funding

Defence's departmental funding in 2005-06 and beyond continues to be based primarily on the allocations approved by the Government in the context of the 2000 Defence White Paper. The additional funding commitment now totals \$28.5 billion (MYEFO 2005-06 out-turned prices) over 13 years commencing in 2001-02 and represents the most specific long-term funding commitment for Defence for more than 25 years.

The additional Defence White Paper funding is being applied to:

- the Defence Capability Plan, containing a program of capital investment in addition to the investment program already planned at that time (+\$19.8 billion);
- provision for the through-life support costs of the capability enhancements in the Defence Capability Plan (+\$2.9 billion);
- provision for two per cent real per capita growth in personnel costs from 2004-05 onwards, reflecting the cost of maintaining a highly skilled workforce in a sustainable way (+\$4.8 billion); and
- funding of a number of baseline cost pressures, including offsetting some of these through administrative savings (+\$1.0 billion).

After taking account of the reprogramming of the Defence Capability Plan which was agreed by the Government in the 2004-05 and 2005-06 Budgets, additional White Paper funding already provided by the Government totals \$6.3 billion over the period 2001-02 to 2005-06. The remaining funding, totalling \$22.2 billion, is to be provided over the period 2006-7 to 2013-14.

Table 1.3 provides details of the current Defence White Paper funding allocations in 2005-06 prices, including the bringing forward of \$300.0m in Defence Capability Plan funding into 2005-06, as agreed by the Government in the 2005-06 budget.

Table 1.3: Current Defence White Paper Funding Allocations (2005-06 PAES prices, Out-turned)^{(1) (2)}

	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	Total	
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	
A	Original Allocation	510	1,051	1,506	1,552	1,722	2,311	2,402	2,278	2,791	3,422	-	-	-	19,545
	Reprogramming	-	-200	-542	-276	-159	-480	-136	382	553	368	249	302	215	276
	Defence Capability Plan (DCP)	510	851	964	1,276	1,563	1,831	2,266	2,660	3,344	3,790	249	302	215	19,821
B	Original Allocation	-	-	-	195	242	294	428	508	600	639	-	-	-	2,906
	Reprogramming	-	8	21	-134	-64	-5	-	13	84	76	-	-	-	-1
	Through-life Support for DCP Projects	-	8	21	61	178	289	428	522	685	715	-	-	-	2,905
	Allocated	-	8	21	61	157	150	108	110	103	71	-	-	-	788
	To be allocated	-	-	-	-	22	139	320	412	582	644	-	-	-	2,118
C	Allocated	-	-	-	238	380	400	418	437	456	524	-	-	-	2,853
	To be allocated	-	-	-	-	-	123	248	380	523	673	-	-	-	1,947
	Two Per Cent Real Growth in Personnel Costs	-	-	-	238	380	522	666	817	980	1,197	-	-	-	4,800
D	Operating Baseline Adjustment	-	-	-	117	135	142	146	151	157	158	-	-	-	1,007
Total (A+B+C+D)		510	859	985	1,692	2,255	2,784	3,506	4,150	5,166	5,860	249	302	215	28,534

Notes

1. Figures may not add due to rounding.
2. The figures are consistent with the details provided in Table 1.2 of the *Portfolio Budget Statements 2005-06* other than for the amounts being updated to 2005-06 PAES out-turned prices

ORGANISATIONAL STRUCTURE

Senior Executive Changes

On 4 July 2005, the then Minister, Senator the Hon Robert Hill, announced the following appointments:

- Air Chief Marshal Angus Houston was appointed Chief of the Defence Force;
- Lieutenant General Ken Gillespie was appointed Vice Chief of the Defence Force;
- Vice Admiral Russ Shalders was appointed Chief of Navy; and
- Air Marshal Geoffrey Shepherd was appointed Chief of Air Force.

Mr Phillip Prior was appointed Chief Financial Officer on 19 January 2006.

Mr Ron Bonighton, Deputy Secretary Intelligence and Security, retired in November 2005. Mr Shane Carmody was appointed Deputy Secretary Intelligence and Security on 12 October 2005, and Mr Mike Pezzullo was appointed Deputy Secretary Strategy on 13 December 2005. Mr Peter Jennings commenced as acting Chief of Staff Australian Defence Headquarters/Head Coordination and Public Affairs on 30 January 2006.

Organisational Chart

The following chart depicts the structure of the organisation at 1 February 2006.

as at 1 February 2006

