

DEFENCE

CHAPTER ONE

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OVERVIEW

Outcomes for the Community

The Government's desired outcome for the community remains:

The defence of Australia and its national interests.

The Defence strategic objectives remain unchanged from the *Portfolio Budget Statements 2002-03*, as do the six Defence outputs:

1. Defence Operations;
2. Navy Capabilities;
3. Army Capabilities;
4. Air Force Capabilities;
5. Strategic Policy; and
6. Intelligence.

Strategic Environment

Australia lives in a new strategic environment than when the White Paper on defence policy was published in December 2000. The Bali bombings have tragically brought this home to Australians. Consistent with the Defence White Paper's theme of needing to adapt to change, annual reviews of Australia's strategic security environment will be conducted to assist the Government in ensuring the Australian Defence Force (ADF) remains responsive to challenges to Australia's national interests. The first of these annual strategic reviews is currently with the Government.

Defence was directly involved in responding to the Bali bombings in October 2002, providing critical emergency assistance and airlift support. Defence has also carried out a substantial enhancement of its counter-terrorism capabilities, as directed by the Government.

The ADF contribution to the international campaign against terrorism has continued, and is changing in response to the evolving circumstances. The Government has announced the withdrawal from Afghanistan of the ADF special forces, which will start in December. RAAF air-to-air refuelling aircraft have already been withdrawn. Naval ships remain in the Gulf to enforce United Nations sanctions against Iraq. RAAF P-3C maritime patrol aircraft will be deployed in 2003 to provide additional support to the campaign.

IMPLEMENTING THE DEFENCE WHITE PAPER

The Defence White Paper contains the Government's policy framework for Defence, setting out a plan for the development of the ADF over the next decade. The accompanying *Defence Capability Plan* sets out the planned new major investment proposals required over the decade to improve Defence capabilities.

A number of White Paper commitments have been achieved which will enable the ADF to be more efficient, better trained, more flexible and better managed. Recent events, including the war against terrorism and the Government's responses to this increased threat, have led to a revision in the timing and implementation of some initiatives. An update on the most significant Defence White Paper and Defence Capability Plan initiatives are shown below. Additional detail on these initiatives can be found in other chapters of this document.

Initiatives to Improve Capability

Land Forces Goal

The goal is to provide land forces that can respond swiftly and effectively to any credible armed lodgment on Australian territory and provide forces for more likely types of operations in our immediate neighbourhood. In 2002-03, Defence has gained approval for:

- acquiring shoulder-launched anti-armour and 'bunker-busting' weapons for the Army;
- upgrading of general service field vehicles;
- upgrading of M113 armoured vehicles;
- purchasing additional stocks of explosive ordnance; and
- enhanced bridging capabilities.

A proposal, foreshadowed in the *Portfolio Budget Statements 2002-03*, that is still to be considered is additional trooplift helicopters.

The establishment of a second counter-terrorist Tactical Assault Group and an Incident Response Regiment, both of which were 2002-03 budget measures, has been implemented.

Air Combat Goal

The goal is to ensure that Australia retains air-combat force superiority in the region and the flexibility to respond swiftly and effectively to contingencies further afield. In support of the planned acquisition of a new aerospace combat capability, Defence has entered into a memorandum of understanding with the United States covering Australian participation in the system development and demonstration phase of the Joint Strike Fighter project. To improve capability, Defence has, during 2002-03, gained approval for:

- a Joint Strike Fighter design phase; and

- explosive ordnance – warstock.

Options for air-to-air refuelling are still awaiting consideration.

Maritime Forces Goal

The goal is to maintain and enhance a naval fleet capable of surface combat, air warfare, anti-submarine warfare, surveillance, afloat support and amphibious operations. In 2002-03, Defence has gained approval for:

- enhancing the Collins submarine combat system;
- purchasing additional heavyweight torpedoes;
- acquiring the Nulka active missile decoy;
- replacing the Fremantle-class patrol boats; and
- explosive ordnance.

Proposals foreshadowed in the *Portfolio Budget Statements 2002-03* that are still to be considered in 2002-03 are:

- upgrade of the Anzac-class frigate anti-ship missile defence;
- Anzac-class frigate undersea and surface warfighting upgrade program – mine and obstacle avoidance sonar;
- an air warfare destroyers' study; and
- the FFG frigate Standard-01 missile replacement.

Strike Goal

The goal is to enhance strike capability so that, in the event of an attack against Australia, Defence can strike significant military targets or infrastructure within a wide radius of Australia. In 2002-03, Defence has gained approval for:

- finalising the acquisition of an air-to-surface stand-off weapons system.

Information Goal

The goal is to enhance intelligence, surveillance systems, communications, command, logistics and business systems over the coming decade. In 2002-03, Defence has gained approval for:

- extending the central battlefield command support system (computerised communications and command system);
- extending land battlefield communications systems (mobile computerised communications and command system);
- enhancing geospatial information infrastructure and services;
- acquiring a single high-frequency surface wave radar for operational trials; and
- acquisition of accredited secure intelligence facilities.

In addition, a item not foreshadowed in the *Portfolio Budget Statements 2002-03* has been approved:

- increased expenditure for an improved logistic information system.

Proposals foreshadowed in the *Portfolio Budget Statements 2002-03* that are still to be considered in 2002-03 are:

- the development of Headquarters Australian Theatre facilities in Bungendore, New South Wales;
- phase 2 of the Defence management systems improvement program (a continuing program to improve selected Defence management systems); and
- acquisition of electronic warfare self-protection for tactical aircraft.

People Goal

The goal is to ensure the ADF has the right people, with the right skills, as well as the appropriate training, leadership and experience to ensure the capability initiatives outlined in the Defence White Paper can proceed. Defence has adopted a 'results through people' approach which recognises that the strength of Defence is its people. Attracting, retaining and maximising the skills of its people are fundamental to Defence capability. In 2002-03, Defence will:

- review strategic workforce planning requirements to provide vision and strategic guidance for Defence personnel policies and specifically target recruitment and retention issues;
- enhance the role of the Reserves to better complement the role of the permanent forces. Following changes to Reserve legislation, Defence regulations have been introduced to create new categories of Reserve employment across the Services;
- begin implementation of the agreed recommendations from the *Review of Australian Defence Force Remuneration 2001*;
- implement the new agreement between the Commonwealth and the University of NSW at the Australian Defence Force Academy; and
- further enhance the Australian Defence Force Cadets through programs aimed at improving access to uniforms and equipment, administrative support including computerisation, the management and operation of cadet activities, and the quality of experience for cadets in a military-like environment.

Initiatives to Improve Provision of Advice and Decision Making

The Government has recognised that our strategic and business environment can change rapidly and, to position Defence to respond in a timely fashion, has adopted a new approach to capability planning and Defence funding. In 2002-03, Defence will:

- demonstrate transparency and accountability through quality, timely and accurate advice to the Government on how it allocates and spends its funds annually through the Defence Management and Finance Plan; and

- improve decision making processes by investigating and investing in information systems to support performance management and measurement tools such as the *Defence Matters* scorecard and internal customer-supplier agreements.

Initiatives to Get the Best Value for the Defence Dollar

The Defence White Paper provides the long-term guidance needed to ensure that today's decisions are made with an appreciation of tomorrow's requirements. In 2002-03, Defence will continue to:

- implement acquisition reforms, in particular decentralising capital equipment project staff to bases;
- align the whole-of-Defence budget with the Government's strategic direction and ensure resourcing decisions are reflected in the Defence Management and Finance Plan; and
- deliver efficiency savings of at least \$100m for 2002-03 as well as a further \$97m through increased efficiencies in administrative expenses, as identified in the *Portfolio Budget Statements 2002-03*.

Initiatives to Enhance Strategic Relationships

Defence supports an extensive range of strategic relationships through continued involvement in multilateral security forums in the Asia-Pacific region, as well as bilateral defence and security relationships, including the Anzus alliance. Defence continues to:

- maintain and build upon security relationships, especially in the Asia-Pacific region;
- support United Nations operations, particularly in East Timor;
- maintain Australia's contribution to coalition operations; and
- conduct defence cooperation activities in our region, including the management of Australia's Pacific patrol boat program.

Initiatives for Science and Technology and Australian Industry

The Government seeks to make the best use of technology and have the skills required to exploit it to our advantage. A competitive industry base should support a technologically-advanced ADF. Defence continues to:

- undertake a science and technology program to provide better support and advice to the ADF;
- undertake research, particularly in Revolution in Military Affairs technologies, information networks and support to current ADF platforms;
- enhance its research program for defence against terrorism, particularly chemical, biological, nuclear and radiological research;

Overview

- broaden its technology base (including improved technology transfer and improving access to innovative technologies) by better links with industry, universities and other government research agencies;
- advance the Capability and Technology Demonstrator program;
- manage the implementation of the Defence and Industry Strategic Policy Statement; and
- strengthen links with industry to improve access to best-practice skills and innovative technologies.

Monitoring and Reporting

Defence is revising its internal White Paper reporting process to focus more on the contribution of individual projects in achieving broad capability outcomes, in addition to monitoring the progress, cost and schedule of all White Paper initiatives. Defence will report its progress in meeting Defence White Paper initiatives in the Defence annual report.

ORGANISATIONAL STRUCTURE

ORGANISATIONAL CHANGES

Senior Executive Changes

Dr Allan Hawke left Defence on 20 October 2002. Mr Michael Roche and, subsequently, Mr Alan Henderson acted as Secretary until the arrival of Mr Ric Smith as the new Secretary on 18 November 2002.

Admiral Chris Barrie, Chief of the Defence Force, retired in July 2002 and was replaced by General Peter Cosgrove, formerly Chief of Army. Major General Peter Leahy was promoted to Lieutenant General and took over as Chief of Army in late June 2002.

Lieutenant General Des Mueller, Vice Chief of the Defence Force, retired in July 2002 and was replaced by Vice Admiral Russ Shalders, formerly Head Defence Personnel Executive. Rear Admiral Brian Adams, formerly Deputy Chief of Navy, took up the position of Head Defence Personnel Executive in August 2002.

Vice Admiral David Shackleton, Chief of Navy, retired in July 2002 and was replaced by Vice Admiral Chris Ritchie who vacated the position of Commander Australian Theatre. Rear Admiral Mark Bonser became the new Commander Australian Theatre in late June 2002.

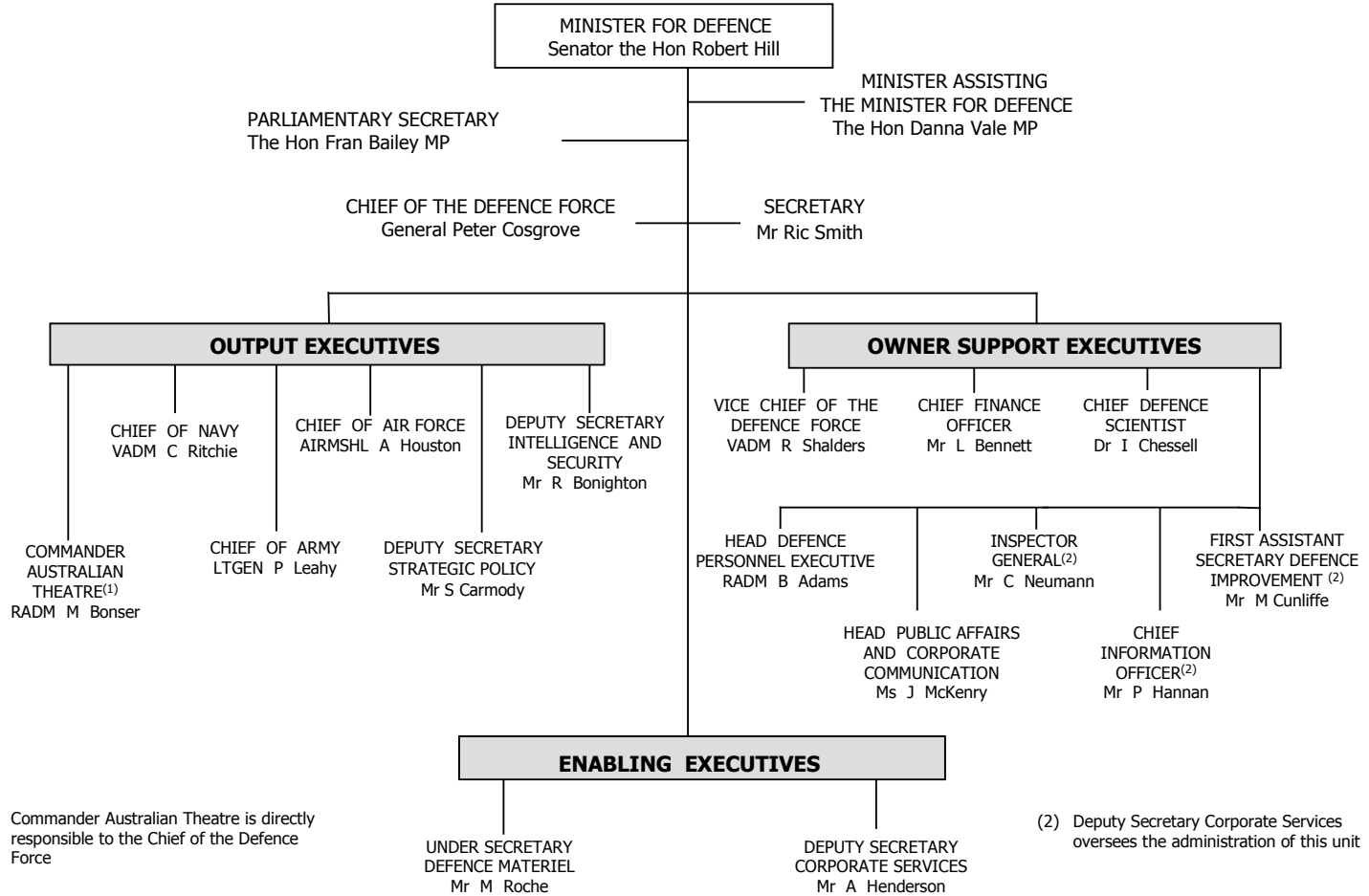
In July 2002, Dr Richard Brabin-Smith vacated the position of Deputy Secretary Strategic Policy to head the Annual Strategic Review team. The position of Deputy Secretary Strategic Policy was filled by Mr Shane Carmody, who transferred from Deputy Secretary Corporate Services. Mr Alan Henderson transferred from the Department of the Prime Minister and Cabinet in July 2002 into the position of Deputy Secretary Corporate Services.

Mr Greg Harper, Chief Finance Officer, left Defence in March 2002 and was replaced by Mr Lloyd Bennett. Mr Patrick Hannan filled the new position of Chief Information Officer in July 2001 and was made a member of the Defence Committee in July 2002. Mr Ron Bonighton was permanently appointed as Deputy Secretary Intelligence and Security in August 2002.

Organisational Chart

The following Chart 1.1 depicts the structure of the organisation in December 2002.

As at 5 December 2002



(1) Commander Australian Theatre is directly responsible to the Chief of the Defence Force

(2) Deputy Secretary Corporate Services oversees the administration of this unit

RESOURCING

SUMMARY OF 2002-03 ADDITIONAL ESTIMATES

Overview

Defence's revised estimate for total resourcing in 2002-03 is \$22,818m. This comprises the following elements in departmental funding, with the budget estimates shown for comparative purposes:

- funding from the Government for price of outputs of \$18,338m (budget estimate was \$18,235m),
- own-source revenue of \$306m (budget estimate was \$287m),
- equity injection from the Government of \$1,215m (budget estimate was \$1,090m), and
- capital receipts of \$723m (budget estimate was \$700m).

It also includes \$2,236m to be administered by Defence on behalf of the Government. The budget estimate for administered items was \$2,206m.

Overall *departmental* funding for Defence from the Government for 2002-03 has increased from \$19,326m at the Budget estimates to \$19,553m, representing an increase of \$227m.¹

This increase consists of the impact of price indexation since the development of the budget estimates (\$100m); additional funding to meet the increased cost of inventory and specialist equipment purchases (\$124m); and other movements resulting from interdepartmental transfers and technical adjustments (\$3m).

Defence's departmental funding is used to pay salaries to its employees and pay its suppliers, and for capital purchases.

The increase in *administered* appropriations from \$2,206m to \$2,236m, an increase of \$30m, is due to the outcome of the revaluation undertaken by the Government's Actuary of the provisions for military superannuation. Administered funding is applied largely to the two military superannuation schemes, the Military Superannuation and Benefits Scheme and the Defence Force Retirement and Death Benefits Scheme.

¹ Total adjustments of \$227m do not include an amount of \$5.8m for Emergency Management Australia. As this function has been transferred to the Attorney General under Administrative Arrangements Orders of 26 November 2001 (Section 32 Determination), this amount has not been included in Defence's own estimates of appropriation revenue for 2002-03 and the forward years. It is, however, included in Appropriations for Outputs (Bills Nos. 1 and 3) which reflect an increase in total appropriations of \$232.8m.

Total resourcing (Departmental and Administered) has increased from \$22,519m at budget estimates to \$22,818m at these revised estimates. This \$299m increase consists of the following elements:

- funding from Government for outputs and the equity injection (\$227m);
- increase in own-source revenue (\$19m);
- increase in capital receipts (\$23m); and
- increase in administered appropriations (\$30m).

The increase in total funding comes on top of the \$712m increase Defence received at budget time over the 2001-02 funding levels provided by the Government at 2001-02 Additional Estimates.

Summary of Planned Financial Performance

Table 1.1 summarises Defence's revised overall resourcing in 2002-03 and over the 2003-06 forward estimates period and provides a comparison between the previous and current budget estimates. The table depicts total resourcing available to Defence through appropriations, own-source revenue and capital receipts.

Table 1.1: Total Estimated Defence Resourcing for 2002-03 and the Forward Estimates⁽¹⁾

2001-02 Actual	2002-03 Budget Estimate	2002-03 Revised Estimate	Variat ion %	2003-04 Forward Estimate	2004-05 Forward Estimate	2005-06 Forward Estimate
\$'000	\$'000	\$'000	%	\$'000	\$'000	\$'000
Departmental						
Revenue from Government for Outputs						
17,843,477	18,235,351	18,337,625	0.6	18,535,684	19,348,351	19,290,181
435,174	287,105	305,774	6.5	298,448	308,306	313,875
Total Revenue for Outputs						
18,278,651	18,522,456	18,643,399	0.7	18,834,132	19,656,657	19,604,056
Capital Funding						
754,175	1,090,415	1,215,201	11.4	1,230,061	1,125,067	1,606,844
217,977	699,766	722,662	3.3	195,384	214,312	40,000
19,250,803	20,312,637	20,581,262	1.3	20,259,577	20,996,036	21,250,900
Administered						
2,289,635	2,205,881	2,236,481	1.4	2,236,481	2,236,481	2,236,481
21,540,438	22,518,518	22,817,743	1.3	22,496,058	23,232,517	23,487,381

Note

1. To provide a better reflection of Defence's activities in 2002-03, calculation of own-source revenue includes resources received free of charge and excludes revenues recognising adjustments to the value of existing non-financial assets (ie 'assets now recognised').

Of overall funding for Defence in 2002-03, \$5,716m is expected to be returned to the Government as capital use charge (\$5,056m) and repayment of equity (\$660m). Defence expects to meet the return of equity from the proceeds of asset sales during 2002-03.

More detailed information on Defence's budgeted financial performance is contained in the budgeted financial statements provided in chapter three. The statements provide details of the budget and forward estimates period, together with comparative

details of the 2001-02 result and the 2002-03 budget estimates published in the *Portfolio Budget Statements 2002-03*.

Whereas table 1.1 above shows the sources of total available resourcing for Defence, table 1.2 describes how funds will be applied in terms of the major categories of (cash) expenditure. The table includes actual results for 2001-02 for comparative purposes.

Table 1.2: Total Departmental Cash Expenditure by Major Category⁽¹⁾

2001-02 Actual		2002-03 Budget Estimate	2002-03 Revised Estimate	Variation
\$'000	Expenditure category	\$'000	\$'000	\$'000
5,535,080	Employees	5,760,874	5,808,252	47,378
4,972,917	Other Operating ⁽²⁾	4,640,385	4,713,390	73,005
2,992,544	Capital	4,072,382	4,197,168	124,786
13,500,541	Sub-total	14,473,641	14,718,810	245,169
4,750,290	Capital Use Charge	5,056,094	5,056,094	-
97,884	Capital Receipts returned to Government	659,500	659,500	-
31,414	Repayment of debts	11,595	11,595	-
18,380,129	Total Expenditure	20,200,830	20,445,999	245,169

Notes

- Total cash expenditure in Table 1.2 will not exactly equate to the total departmental resourcing in Table 1.1 (\$20,581m) because Table 1.1 also includes funding for accrual items, whereas Table 1.2 reflects only planned cash disbursements.
- Other operating expenditure excludes goods and services tax payments.

The total increase of \$245m in planned expenditure over the budget estimates is in part funded through an increase in Defence's appropriations (\$227m) and increased own source revenue (\$18m).

Defence's net asset position is expected to increase over the forward estimates period by about \$4,376m from the budget estimate position. Increases in assets will occur due to the acquisition of assets in the capital investment program, including the implementation of the second stage of projects associated with the White Paper. These increases will be partially offset by reductions resulting from the gradual end of life of existing assets and the enhanced property disposals program. Chart 1.2 shows the planned non-financial asset closing balance by asset at 30 June 2003.

Chart 1.2: Non-Financial Assets – Departmental Budgeted Financial Position for 30 June 2003

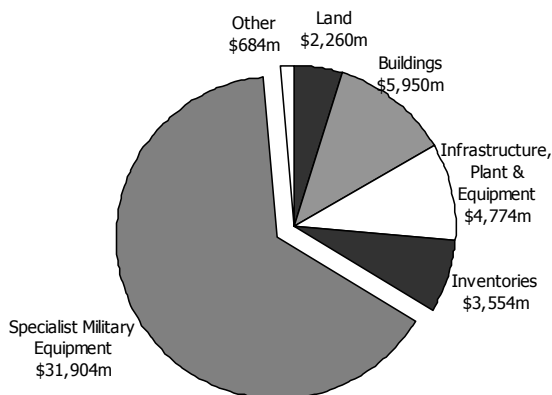


Table 1.3 below shows the movement in these balance sheet items from the budget estimates position to the revised estimates including for comparative purposes, the actual results for 2001-02.

Table 1.3: Non-Financial Assets

2001-02 Actual		2002-03 Budget Estimate	2002-03 Revised Estimate
\$'000		\$'000	\$'000
2,315,576	Land	2,064,897	2,260,344
6,409,524	Buildings	5,393,940	5,949,822
4,866,110	Infrastructure Plant & Equipment	4,196,372	4,774,453
3,620,788	Inventories	3,127,706	3,554,269
30,656,890	Specialist Military Equipment	32,814,178	31,904,356
728,784	Other	583,323	684,155
48,597,671	Total Non-Financial Assets	48,180,416	49,127,399

The planned total net asset position at the end of 2003 was revised to reflect the actual opening balance as at 1 July 2002 (from \$47,645m projected result for 2001-02 to \$48,598m actual outcome for 2001-02).

The revised estimates for the total non-financial assets reflect the impact of the changes in the opening balance (\$953m) and a net \$5m decrease due to technical adjustments resulting from the re-classification of specialist military equipment (SME) to property, plant and equipment and the sale of surplus SME.

Cash Reserves

Cash reserves are estimated to increase by \$133m compared with the opening balance of \$835m, although this is before measures are taken to reduce these reserves to more appropriate levels.

Defence is required to manage its cash liquidity levels to ensure that it is able to pay all of its suppliers and other liabilities when those payments are due and provide for the future replacement of existing assets as they depreciate.

Payables at 30 June 2002 totalled \$1,033m and Defence's employee liabilities are forecast to grow by an average of 3.6 per cent per annum across the forward estimates from \$2,956m at 30 June 2002 to \$3,406m at 30 June 2006.

Defence has reviewed its requirements for cash reserves and has assessed that a cash balance in the order of \$600m is sufficient to meet its working capital requirements. This includes sufficient cash reserves to meet future short term liabilities. Accordingly, Defence is implementing strategies to reduce the current reported estimate of year-ends cash reserves of \$968m to around \$600m.

Price of Defence's Outputs

The prices of Defence's six outputs are summarised in Table 1.4. Further details relating to the outputs can be found in Chapter Two of this document.

Table 1.4: Price to Government of Defence's Outputs

2001-02 Actual	Output	Published Budget Estimate 2002-03	Adjusted Budget Estimate 2002-03	Revised Estimate 2002-03	Variation (Adjusted Budget Estimate to Revised Estimate)
\$'000		\$'000	\$'000	\$'000	\$'000
806,590	1. Defence Operations	1,151,398	839,597	795,164	(44,433)
5,795,789	2. Navy Capabilities	5,797,040	5,730,784	5,740,228	9,444
5,392,148	3. Army Capabilities	5,192,113	5,611,839	5,567,975	(43,864)
5,526,452	4. Air Force Capabilities	5,477,102	5,474,562	5,663,933	189,371
209,103	5. Strategic Policy	175,900	229,309	212,793	(16,516)
339,286	6. Intelligence	441,798	349,260	357,532	8,272
18,069,368	Total Price to Government	18,235,351	18,235,351	18,337,625	102,274

In 2001-02, Defence implemented a new costing model to assist the new statutory disclosure requirement to provide audited output costs from the end of 2001-02. As a consequence of using the new, more robust methodology, some variations arose between the 2001-02 estimated result and the actual outcome for individual outputs. Because of these variations, Defence updated its 2002-03 output prices by using the audited costing methodology during the Additional Estimates process.

Overall, the price to Government of Defence outputs in 2002-03 has increased by \$102m or 0.6 percent as shown in Table 1.4. In addition to the methodology changes, the revised estimates reflect the impact of price and foreign exchange movements and other technical adjustments proportionally affecting all Defence's outputs.

Appropriations

The appropriations from the Government for Defence in 2002-03 total \$21,795m. This funding is summarised in Table 1.5. Table 1.5 differs from Table 1.1 in that it only shows funds appropriated by Government and excludes own-source revenue and capital receipts.

Table 1.5: Total Appropriations for Defence in 2002-03

	Total \$'000
Departmental	
Appropriation Bill Nos.1 and 3 ⁽¹⁾	18,343,416
Appropriation Acts Nos.2 and 4	1,215,201
Total Departmental	19,558,617
Administered	
Appropriation Bill Nos.1 and 3	181
Special Appropriations	2,236,300
Total Administered	2,236,481
Total Appropriations	21,795,098

Note

1. Appropriation for Outputs (Bill Nos. 1 and 3) includes an amount of \$5.8m for Emergency Management Australia. As this function has been transferred to the Attorney General (with the effective appropriation to Defence to be reduced to give effect to the changes in Administrative Arrangements), the amount has not been included in Defence's own estimates of appropriation revenue for 2002-03.

PURCHASER-PROVIDER ARRANGEMENTS WITH THE DEFENCE HOUSING AUTHORITY

Control Arrangements

The Defence Housing Authority board remains unchanged from the *Portfolio Budget Statements 2002-03*.

Resourcing

The 2002-03 revised estimate is \$339.4m, a reduction of \$4.4m from the budget estimate of \$343.8m, for the purchase of services from the Defence Housing Authority. This covers housing and relocation services for ADF members.

The provision of housing services is set out in a services agreement between Defence and the Authority that was signed in August 2000 for a ten-year period. The responsibility for relocation services was transferred from Defence to the Authority on 1 July 2001 and a formal agreement, which is yet to be finalised, provides for an initial review at the end of January 2003. The results of that review will dictate whether Defence and the Authority enter into a further three-year agreement, with options for two additional two-year extensions. There is a requirement for reviews to be conducted at each extension.