



Australian Government
Department of Defence

Response to the Defence Budget Audit

On 30 July 2008, the Government announced the appointment of Mr George Pappas to lead an independent Audit of the Defence Budget. The final report was delivered to the Government in April 2009. The Defence Budget Audit (DBA) was undertaken in parallel with the preparation of the 2009 Defence White Paper and associated companion reviews and the Mortimer Review of Defence procurement and sustainment. The Audit examined the state of the Defence Budget and its major cost drivers, with a view to finding potential for efficiency gains and reinvestment opportunities.

Mr Pappas' report was a frank assessment of the challenges faced by Defence. The Audit identified fundamental reforms that Defence should undertake to become a more accountable, transparent and efficient organisation.

Defence acknowledges the findings of the report which, in large part, formed the basis of the Strategic Reform Program (SRP), the most comprehensive reform program undertaken by Defence. The SRP will mend Defence's broken backbone and deliver around \$20 billion in gross savings required to remediate areas where there has been insufficient funding in the past and assist in delivering *Force 2030*.

There were more than 120 recommendations contained within the DBA, the majority of which will be delivered through the SRP.

Defence's senior leadership group is personally committed to achieving these reforms and fostering a cost-conscious culture that allows Defence to deliver and sustain the capability that Australia requires, within the funding envelope agreed to by Government.

As outlined by Mr Pappas, "It would be far too simplistic to take the numerical targets for efficiency gains from this work, lock them into future budget forecasts and assume they will somehow be realised". Further work is being done to refine the estimates outlined within the DBA. The high level of complexity and the interdependencies contained within the SRP have necessitated that we embark on a highly detailed diagnostic and planning phase. Defence excels in careful planning for military operations and similar care, rigour and discipline is being applied to planning and executing the decade-long campaign of reform that the SRP represents.

The funding model recommended by the DBA has several components. The only component not to be accepted by Government was that updates to Defence funding for movements in inflation be done using a tailored basket of indices. Instead, the Government chose to provide Defence with funding indexed by the long-run average of the Non-Farm Gross Domestic Product (NFGDP) implicit price deflator of 2.5 per cent.

The 2000 White Paper introduced indexation by the NFGDP implicit price deflator. At the time this was a relatively stable index but, as evidenced with the rapid rise in commodity prices in the late 2000's and the more recent decline with the global economic crisis, this index can be subject to substantial volatility and diverge from other indices. Having fixed 2.5 per cent indexation for the period to 2030 removes the need for Defence to adjust its expenditure parameters to suit short term fluctuations in price levels and the volatility in funding that they can introduce.

Long term funding stability, including these more certain indexation arrangements and real growth of 3 per cent to 2017-18 and 2.2 per cent from 2018-19 to 2030 is essential for developing the type of long-term plans outlined in the Defence White Paper. Using a fixed indexation factor that accords with the long term target for consumer price inflation that is agreed by the Australian Government and the Reserve Bank of Australia will assist Defence planning.

While Defence has already improved its approach to major acquisitions significantly since the 2003 Kinnaird *Defence Procurement Review*, the DBA highlighted several issues in relation to capability development and the management of capital for major acquisitions. There is further room for improvement in the way Defence forecasts, plans and manages major acquisitions and appropriate actions have been embodied in the Capability Development, and Procurement and Sustainment streams of the SRP to make these improvements.

A key component of *Force 2030* is the Defence Capability Plan (DCP), which is a forward plan to provide the capability mix outlined by Government in the White Paper. The DCP will evolve over time to reflect unforeseen influences such as changed strategic circumstances, Government priorities, industry capacity and better information on individual project options, costs and technical risks. In light of these planning uncertainties, the DCP contains more proposals than can be afforded in the indicated timescales. This level of over-planning is referred to as 'financial over-programming' and reflects the reality that not all projects deliver on time every time across the program. The DBA recommended that there should be no 'over-programming' of additional projects in the DCP. The Capability Development, and Procurement and Sustainment streams of the SRP will implement reforms to minimise the need for this into the future, however an appropriate level will still need to be retained. In the current environment, over-programming provides a prudent level of flexibility for the Government to manage Defence expenditure within changing circumstances.

The SRP will implement new governance arrangements, incorporating improved processes across Defence's capability decision-making committees to enable the translation of the Government's strategic requirements into capability decisions. Enhanced costing methodologies, training, procedures and tools will be used to improve the quality of long-term cost forecasts to support capability planning and decision-making.

The SRP will also focus on improving the management of funding for major acquisitions. Reforms to the risk management of projects in the DCP will be implemented with a particular focus on technical risk and maturity as well as financial programming reforms. By tightening the linkages between Government's strategic guidance and capability requirements, better value for money judgements will be possible for the capability options presented to Government. To reduce procurement costs, there will be a greater focus on off-the-shelf equipment that will help ensure that capability both matches strategic need and calculated resources.

The DBA also highlighted some deficiencies in the way we sustain military capabilities. Under the SRP, Defence will pursue opportunities for significantly increasing efficiency in the maintenance of military equipment, inventory and supply chain management. Using proven methods, reform will focus on becoming more productive and eliminating waste in the maintenance and supply-chain processes, and reducing inventory costs through smarter procurement processes and reducing the size of inventory holdings. Defence will develop appropriate incentive arrangements in its future maintenance contracts to encourage Defence industry to implement ongoing productivity improvements.

A number of recommendations relating to how Defence should manage its workforce are contained within the DBA. In accordance with these recommendations, Defence will undertake significant reforms to deliver a more flexible, adaptive and cost effective workforce.

The civilianisation of some military support positions will ensure that, wherever possible, permanent Australian Defence Force (ADF) members should be employed where they are critical to delivering and sustaining combat capability and/or delivering military specialist competencies. Workforce reform will not adversely affect capability as the current percentage of ADF members posted to combat or combat related roles will not be reduced.

Under the SRP, Defence will convert approximately 1,100 contractors to Australian Public Service positions. Core business processes will also be examined as part of these workforce reforms to eliminate waste and duplication wherever it exists. This will include a move to a greater use of shared services in areas such as payroll, human resources, procurement and financial services.

Workforce reforms will be both achievable and sustainable through careful planning and a phased roll out of the reforms. An initial detailed planning and evaluation phase is currently underway. The reduction in Defence workforce resulting from these reforms will be balanced by increases due to in-sourcing of work that is currently done by contractors, and the growth required to implement the personnel aspects of the White Paper. Overall, the total workforce will grow by around an additional 3,000 military and 300 civilian jobs over the decade to accommodate the requirements of *Force 2030*.

While there will be reductions in some areas, many of these will be managed through staff turnover and internal transfers. Wherever possible, we will redeploy and retrain people whose roles will be restructured as a result of reform. In all cases we will follow the principles laid out in the Defence Enterprise Collective Agreement.

Part-time members of the ADF are a key contributor to cost effective capability and are critical to current operations, both domestically and off-shore. The DBA made a number of recommendations applicable to Reserves. These include the opportunity to use reserves for surge capacity, a range of requirements to enable an enhanced reservist model, and increasing the use of deployable contractors. As part of the SRP detailed diagnostic and planning phase, Defence is examining a range of options to ensure we make more effective use of the part-time component of the ADF.

On the matter of estate consolidation, the DBA recommended Defence move to the smallest number of super bases that is consistent with strategic requirements and the 'raise, train, sustain' mission of the three Services, over the next 20 to 30 years. It also recommended the establishment of a Defence Estate Review Committee (DERC), to among other things prepare a 'super base' master plan, which would finalise a recommended base footprint and develop a fully costed strategic business case.

The Government does not accept these recommendations. While acknowledging that any move to a 'super-base' model would have strategic, economic and social impacts, the Defence Budget Audit was focussed on financial benefits and therefore did not fully examine these broader issues. Therefore, Defence will carry out a comprehensive review of the Defence estate, including a strategic assessment of Defence's basing requirements and a detailed financial analysis of long-term costs and efficiency gains of different basing mixes, to develop options for the consolidation of the estate over a 25-30 year period. It is envisaged that a detailed study of this type will take 12-18 months to complete. An Independent Commission will then consider Defence's recommendations and report back to the Government.

Careful external scrutiny and regular, detailed performance reporting are essential features of the governance arrangements for the SRP. The Minister for Defence has established an oversight committee, the Defence Strategic Reform Advisory Board, to be a key mechanism to provide this scrutiny. Defence will be able to draw on the combined insights of senior private-sector leaders with experience in large-scale organisational reform as well as the broader whole-of-government perspectives of secretaries of key government departments. The Board will report to the Minister for Defence quarterly.

Mr Pappas delivered a confronting and challenging report that we accepted and have responded to by embarking on a comprehensive suite of improvements to the way Defence conducts its business. Reform on this scale is never easy, but the benefit is that these changes will give Australia a stronger, more agile and harder-hitting Defence Force, with the savings reinvested in capability thus reducing further demands on our national resources.

After support to current military operations there is no higher priority for Defence than the successful delivery of these reforms.