

The Auditor-General  
ANAO Report No.29 2016–17  
Performance Audit

# **Design and Implementation of Defence's Base Services Contracts**

Department of Defence

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Canberra ACT  
14 December 2016

Dear Mr President  
Dear Mr Speaker

The Australian National Audit Office has undertaken an independent performance audit in the Department of Defence titled *Design and Implementation of Defence's Base Services Contracts*. The audit was conducted in accordance with the authority contained in the *Auditor-General Act 1997*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of this audit to the Parliament.

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's website—<http://www.anao.gov.au>.

Yours sincerely



Grant Hehir  
Auditor-General

The Honourable the President of the Senate  
The Honourable the Speaker of the House of Representatives  
Parliament House  
Canberra ACT

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# Contents

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Summary and recommendations.....	7
Background .....	7
Conclusion .....	8
Supporting findings.....	8
Recommendations.....	11
Summary of entity response.....	11
<b>Audit Findings.....</b>	<b>13</b>
1. Background .....	15
Introduction .....	15
Audit approach .....	19
2. Designing and implementing the Base Services contracts .....	20
Did Defence design the Base Services contracts model to achieve its intended objectives? .....	20
Did Defence effectively conduct the procurement process for the Base Services contracts? .....	23
Is the new Base Services model achieving its intended value for money objective? .....	25
3. Managing the Base Services contracts .....	33
Was the transition to the new Base Services contracts managed effectively? .....	34
Did Defence effectively support the implementation of the new contract governance and management framework?.....	39
Has Defence effectively implemented the planned Estate Management IT system to support the administration of the Base Services contracts? .....	44
Has Defence implemented arrangements to assure the performance of its Base Services contractors?.....	47
Appendix 1 Entity response to Section 19 proposed report.....	53
Appendix 2 Introducing incentives to promote contract cost efficiency and innovation.....	55
Incentives to promote contract cost efficiency and innovation .....	55
Appendix 3 Potential sources of data to assure contractor service delivery performance .....	57



# Summary and recommendations

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## Background

1. The Department of Defence (Defence) has 119 bases across Australia. Australian Defence Force (ADF) and Australian Public Service personnel, and other persons working, training or living on these bases, require a range of services. The bases also need to be maintained, upgraded and guarded. To meet these requirements, Defence has entered into a range of Base Services contracts including for: cleaning; housekeeping; transport; access control; estate upkeep; land management; hospitality and catering; and waste management services.

2. In 2012, Defence commenced a process to replace 21 regional contracts via a single tender process, which resulted in 10 consolidated Base Services contracts. This process took place in the context of Defence's 2009–10 Strategic Reform Program that included a \$1.1 billion budget reduction over 10 years, for base services. There were two key objectives and seven guiding principles for the Base Services contracts focused on sustaining Defence capability and optimising value for money (Figure 1.2).<sup>1</sup>

3. The design of the Base Services contracts was informed by market research, a comparison of the merits of a number of models and stakeholder consultation. Defence sought to innovate by moving to: a primarily outcome-based service delivery model; standardising product offerings; introducing national product management and leveraging volume. Given its size and scale, and the amount of change involved, the Base Services Retender was a complex process. The expected value of the Base Services contracts was \$9.3 billion over the potential 10-year life of the contracts.<sup>2</sup> Each contract has an initial term of six years with up to four years of extensions.

### Audit objective and criteria

4. The objective of this audit was to assess the effectiveness of the Department of Defence's design and implementation of the Base Services contracts. To form a conclusion against this objective, the ANAO adopted the following high-level criteria:

- Defence designed and procured the new Base Services contracts model with a view to achieving economy, efficiency and effectiveness in the delivery of base services;
- Defence is on track to realise expected savings; and
- Defence managed the Base Services contracts and monitored service delivery effectively.

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1 Value for money is the optimal use of resources to achieve intended outcomes with regard to economy, efficiency and effectiveness.

2 At August 2014.

## Conclusion

5. Defence designed the Base Services contracts model to achieve its intended objectives—to sustain Defence capability and optimise value for money.
6. Defence adopted seven key guiding principles, most of which relate to its objective of optimising value for money, but is unable to demonstrate that the new Base Services model has achieved that objective. Actual expenditures have been higher than estimated, and expenditure forecasts indicate that the new Base Services contracts model is not likely to achieve Defence's original savings goals.
7. Defence's management of the transition to the Base Services contracts was not effective in facilitating a smooth changeover to the new arrangements, and some two years into the contracts, while services are being delivered, key aspects of Defence's contract management and related processes require attention.
  - Key contract governance and management guidance has not been finalised.
  - The deployment of a new Estate Management IT system, intended to support contract administration, is some five years behind schedule and has cost \$39.81 million (32 per cent) more than initially planned.
  - A recent internal audit concluded that Defence's processes do not provide adequate assurance that the self-assessment results provided by contractors are a fair and reasonable reflection of the actual performance standards delivered.

## Supporting findings

### Designing and implementing the contracts

8. Defence designed the Base Services contracts model to achieve its intended objectives—to sustain Defence capability and optimise value for money.
9. Defence adopted seven key guiding principles which resulted in the model incorporating a number of strategies and features aimed at realising its intended objectives. Key features included: primarily outcome-based contracts involving payment for services rather than availability; provisions to improve efficiency through increased competition and leveraging volume from larger, national contracts; provisions to encourage innovation and to better manage supply and demand for certain services; and a focus on reducing a range of costs to Defence and industry.
10. In developing the model Defence sought expert advice and actively considered risk. However, risk management was not as effective as it could have been.



11. Based on the procedures performed and the evidence obtained in the ANAO's performance review<sup>3</sup> nothing came to the ANAO's attention to cause it to believe that the Base Services contracts procurement process was affected by a lack of appropriate approvals or non-compliance with mandatory requirements of the Commonwealth Procurement Rules. However, the procurement process took considerably longer than expected, with contract signatures occurring around a year later than planned.

12. Defence is unable to demonstrate that the new Base Services contracts model has achieved the intended value for money objective.

- Actual expenditures have been higher than estimated. In 2015–16 Defence spent \$1039 million on base services, some \$195.5 million (23 per cent) more than the negotiated amount. Defence was unable to provide the ANAO with an accurate, consolidated summary accounting for the full \$195.5 million difference between the negotiated contract price (\$844 million) and actual expenditure in 2015–16 (\$1039 million).

13. Defence forecasts and ANAO estimates indicate that the new Base Services contracts provide no net savings over the life of the contracts.

- The department's actual 2015–16 expenditure, combined with Defence's forecasts for the period 2016–17 to 2024–25, indicate that the potential 10-year expenditure on the Base Services contracts will be around \$11.06 billion. If realised, the forecast expenditure would be \$989 million (10 per cent) higher than the projected expenditure at the completion of contract negotiation.
- Further, the ANAO has estimated that expenditure under the new contracts would be comparable to expenditure under the previous contracts, had the previous contracts continued until 2021–22.

14. Defence does not capture data that enables it to make informed assessments around the achievement of value for money.

- While expenditure on Base Services contracts is monitored and reported, Defence does not capture data or report on Defence's administration costs. Current reporting does not provide insight into the financial outcomes of initiatives intended to improve the efficiency of base services provision. The ANAO has made a recommendation on this matter.

## Managing the contracts

15. Defence's management of the transition to the Base Services contracts was not effective in facilitating a smooth changeover to the new arrangements. There was a 12-month delay in

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3 The ANAO conducted a performance review of the procurement process for the Base Services contracts. A performance review provides negative assurance. In this type of review, the objective is a reduction in performance engagement risk to a level that is acceptable in the circumstances of the engagement, as the basis for a negative form of expression of the review conclusion. The acceptable performance engagement risk in such an engagement is greater than for a reasonable (positive) assurance engagement. A performance review can assess the adequacy of an internal control structure or specific internal controls, in particular those intended to safeguard assets and to ensure due regard for economy, efficiency or effectiveness; the extent to which resources have been managed economically or efficiently; and the extent to which activities have been effective.

finalising the tender but the completion date for transition was not adjusted accordingly. As a consequence the transition times were reduced from 18 months to three months.

16. Issues identified by Defence in the initial roll out phase recurred in subsequent phases. For example: new contract standards were interpreted locally and inconsistently; communications materials contained incorrect information about the provision of services under the new contracts; and new contractors were not staffed to the required numbers.

17. Defence was aware of the risk that data in its tender data packs might not accurately reflect ongoing changes to the Defence estate, and this risk was realised when inaccurate data caused difficulties for successful tenderers during the transition and subsequently. The full scope of the services expected to be delivered often differed from the basis on which firms had made their bids.

18. Defence was not fully effective in supporting the implementation of the new contract governance and management framework for its Base Services contracts. While a high-level framework was put in place to coincide with the commencement of the new contracts, most of the key supporting documents and agreements have not yet been finalised, some two years after the contracts were signed. There has also been limited guidance provided to key regional personnel, contributing to an inconsistent and slow transition to the new arrangements.

19. There were shortcomings in training arrangements for staff involved with the Base Services contracts, resulting from poor communication and implementation by Defence and failure by responsible staff to proactively access the training resources provided.

20. Defence has not effectively implemented the planned Estate Management IT system. Defence currently expects the new system to be deployed nationally at the end of 2017—some five years late. When additional project costs and other costs are taken into account, upgrading the system has cost the taxpayer \$39.81 million (32 per cent) more than initially planned.<sup>4</sup>

21. Defence's interim Estate Management IT system remains in use, and has limited functionality. The system does not support service providers to effectively communicate the status of work orders to Defence customers, or enable Defence to collect and analyse data relating to its estate and the Base Services contracts.

22. Two years into the Base Services contracts, Defence has not fully implemented a consistent and structured approach to assure itself over contractor performance. For example, Performance Assurance Instructions for contract management personnel remain in draft form.

23. In the absence of finalised Instructions and subsidiary national guidance, the responsible Product and Services Managers have developed local approaches to assuring contractor service performance on Defence bases. A 2016 internal Defence audit concluded that existing processes do not provide adequate assurance that the self-assessment results provided by contractors are a fair and reasonable reflection of the actual performance standards delivered. Defence advised the ANAO that it has initiated a review of its process for performance assessment, reporting and assurance.

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4 Defence advised the ANAO in November 2016 that parts of the system were technically deployed in January 2015, but that no users were provisioned.

## Recommendations

**Recommendation No.1**  
**Paragraph 2.27** That Defence monitors and report on the performance of Base Services contracts in achieving value for money outcomes. In particular, Defence should monitor and report on:

- (a) the costs of contract administration;
- (b) the impact of initiatives to improve the management of supply and demand; and
- (c) the impact of incentives, gain-sharing arrangements and other innovation measures.

**Defence response:** *Agreed.*

**Recommendation No.2**  
**Paragraph 3.55** That Defence:

- (a) finalises its Contract Governance Plans, Service Level Partnering Agreements and Base Support Agreements;
- (b) ensures that personnel performing key roles in the Base Services contracts model are provided with up-to-date guidance on the requirements of their roles; and
- (c) develops a cost-effective approach for obtaining assurance over (validating) self-reported information provided by contractors.

**Defence response:** *Agreed.*

## Summary of entity response

24. The proposed audit report issued under section 19 of the *Auditor-General Act 1997* was provided to the Department of Defence. The summary response is provided below. Defence's full response is provided at Appendix 1.

Defence acknowledges the findings contained in the audit report, and accepts the two recommendations.

The Strategic Reform Program required a budget reduction in enablers, such as base services, to support the delivery of the 2009 Defence White Paper. That program and approach is now obsolete. Defence now operates within a new environment, with government support for enablers established through the 2016 Defence White Paper.

The establishment of the new Base Services Contracts provided opportunities for Defence to improve its value for money outcomes by leveraging volume, increasing standardisation, and better managing supply and demand, whilst introducing innovation and efficiency provisions.

The changing strategic context of the Defence business directly impacts the demand on base services, and consequently, the costs of these services. For example, the program for future capability builds, demands an increased service delivery capability response. This places increasing demand on our services and bottom line expenditure.

The ANAO highlights the complexity of the Base Services Retender process, emphasising the size and scale of the changes involved.

Whilst it is noted that the ANAO states contract rates have not increased, Defence considers that the ANAO's finding, that value for money objectives have not been demonstrated, are based on comparing the negotiated price with the actual expenditure in 2015–16. Similar comparisons have been made in relation to 10 year forecasts.

Defence seeks to monitor and report on value for money objectives by assessing any additional expenditure against the value of additional services received.

Defence is of the view that the Base Services contracts have resulted in a lower cost to Defence for the increased base service demands than if this increased output had occurred under previous arrangements.

## **Audit Findings**

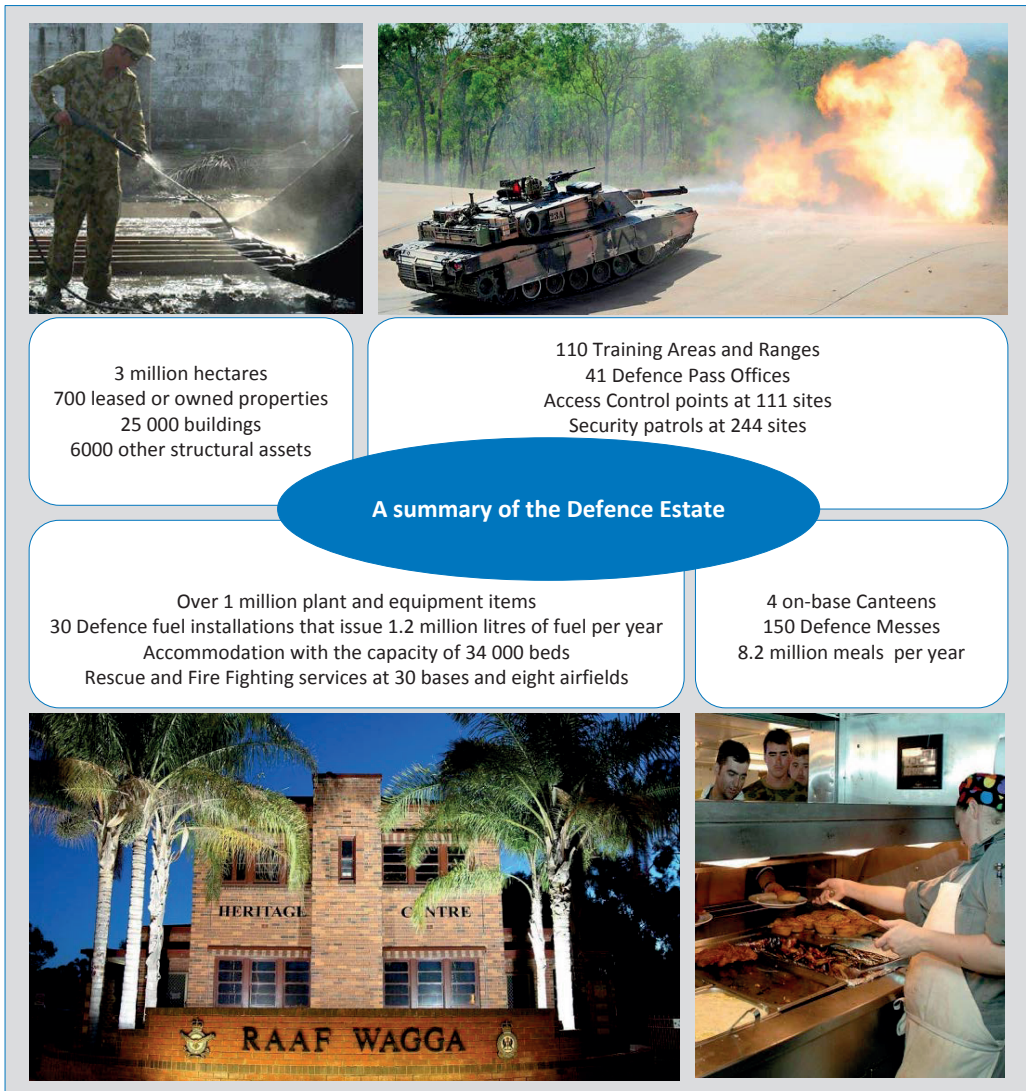


# 1. Background

## Introduction

1.1 The Department of Defence (Defence) has 119 bases across Australia. Australian Defence Force (ADF) and Australian Public Service (APS) personnel, and other persons working, training or living on these bases, require a variety of services, and the bases must also be maintained, upgraded and guarded. These services are provided to Defence under the Base Services contracts (Figure 1.1).

**Figure 1.1: Summary of the Defence Estate**



Source: ANAO. Photos sourced from [www.defence.gov.au/images](http://www.defence.gov.au/images).

1.2 A 2008 *Audit of the Defence Budget* prepared for the Minister for Defence<sup>5</sup> recognised that Defence's annual spending was under intense scrutiny and constant pressure. It also suggested that Defence could achieve savings by reducing non-equipment procurement costs and recommended a deep reform program. The Government subsequently endorsed a Defence Strategic Reform Program in the 2009 Defence White Paper.<sup>6</sup>

1.3 The Strategic Reform Program aimed to deliver gross savings to Defence of around \$20 billion from 2009–19.<sup>7</sup> Reform of Defence Base Services contracts was expected to contribute to achieving the required savings for non-equipment procurement. Defence also regarded its planned Base Services Retender as an opportunity to implement demand-related savings initiatives and other reforms identified as part of the Strategic Reform Program.<sup>8</sup>

1.4 In 2012, Defence commenced a process to replace its existing 21 regional contracts for Garrison Support Services and Comprehensive Maintenance Services with consolidated Base Services contracts via a single procurement process. This process was required to take into account Defence's Strategic Reform Program, which had included a budget reduction of \$1.1 billion over 10 years for base services, commencing in 2009–10.

1.5 The procurement process commenced in March 2012. Between July and August 2014, Defence entered into 10 Base Services contracts, at an expected value of \$9.3 billion over the potential 10-year life of the contracts.<sup>9</sup>

### **Base Services contracts**

1.6 Defence's objectives for the new Base Services contracts were to sustain Defence capability and optimise value for money. The process was informed by seven key guiding principles (Figure 1.2) which largely related to the objective of optimising value for money outcomes in the delivery of base services. A May 2012 Defence brief prepared for Senate Estimates stated that Defence would seek to: 'maximise the opportunity provided by the Re-tender to optimise value for money for Defence' by allowing modernisation of the providers' service delivery models; better leveraging industry innovation by separating out packages of service requirements; better leveraging volume (national tender), standardisation (consistency of activities across Australia); and having an outcome-focused statement of works.

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5 McKinsey and Company, 2008, *Audit of the Defence Budget*, pp. 6–12.

6 Australian Government, 2009, *Defending Australia in the Asia Pacific Century: Force 2030*, p. 107.

7 The Strategic Reform Program commenced on 1 July 2010 and was established to achieve \$20 billion of internal reforms across Defence in order to self-fund capability requirements. There were nine individual streams of reform, with the non-equipment procurement stream covering 23 categories of non-military goods and services from external suppliers.

8 The ANAO had previously found that Defence's expenditure on base services had increased by 58 per cent between 2001–02 and 2008–09. See ANAO Audit Report No.11 2009–10, *Garrison Support Services*, p. 13.

9 Each contract has an initial term of six years and up to four years of extensions.



**Figure 1.2: Contract objectives and guiding principles for the Base Services contracts**

Objectives			
Sustain Defence capability		Optimise value for money	
Guiding Principles			
Leveraging volume	Maintaining competitive tension	Outcome-based contracts	
Standardisation	Sustainability	Innovation	Total asset management

Source: Defence.

1.7 Defence grouped services in the new Base Services contracts according to five service delivery regions, a ‘bundle’ of services—Estate Maintenance and Operations Services<sup>10</sup> (EMOS)—and a number of Miscellaneous Services Packages (Table 1.1).

**Table 1.1: Base Services contracts and expected costs at contract signature**

Service lines	Contractors	Regions	\$million <sup>a</sup>
<b>Estate Maintenance and Operations Services (EMOS)</b>			
<b>Estate Maintenance and Operations Services (EMOS)<sup>b</sup></b>	Transfield (Broadspectrum) <sup>c</sup>	Central and West, and Victoria and Tasmania	3419.2
	Brookfield	Northern NSW	994.7
	Spotless Facility Services	Queensland and Southern NSW	2069.4
<b>Miscellaneous Services Packages (MSPs)</b>			
<b>Access Control</b>	Wilson Security	Central and West, Victoria and Tasmania, and Southern NSW	792.9
	MSS Security	Northern NSW and Queensland	537.9
<b>Hospitality and Catering</b>	Compass Group	Northern NSW, Southern NSW, and Queensland	992.6
	Transfield (Broadspectrum)	Central and West, and Victoria and Tasmania	Included in EMOS figures <sup>d</sup>
<b>National Program Services</b>	Cushman & Wakefield <sup>e</sup>	National	43.6
<b>Project Delivery Services</b>	Augility	National	104.6
	Aurecon Services	National	128.7

10 The services delivered in the Estate Maintenance and Operations Services (EMOS) bundle include: Management, Integration and Coordination (including Estate Appraisal); Airfield Support; the Base Services Support Centre; Cleaning; Commercial Operations (Woomera); Estate Upkeep; Housekeeping; Land Management; Laundry & Dry Cleaning; Pest and Vermin; Reprographics and Printing; Sport and Recreation; Training Areas and Range Management; and Transport.

Service lines	Contractors	Regions	\$million <sup>a</sup>
<b>Waste Management</b>	Veolia Environmental Services	National	187.5
<b>Retail Stores and Petrol, Oil &amp; Lubricants</b>	Transfield (Broadspectrum)	National	Included in EMOS figures <sup>d</sup>
<b>Aircraft Refuelling, Rescue &amp; Fire Fighting</b>	Transfield (Broadspectrum)	National	Included in EMOS figures <sup>d</sup>
<b>Total (over ten years)</b>			9271.5 <sup>f</sup>

Note a: The expected fixed fee and scheduled item amount at contract signature in August 2014. Does not include ad hoc requested works.

Note b: See footnote 10.

Note c: Transfield Services Group was rebranded on 30 October 2015 and Transfield Services (Australia) Pty Ltd's name changed to Broadspectrum (Australia) Pty Ltd on 30 November 2015. For consistency, the ANAO will use the name Broadspectrum throughout this report.

Note d: For these items, the total value is included in the Broadspectrum Contract (\$3419.2 million).

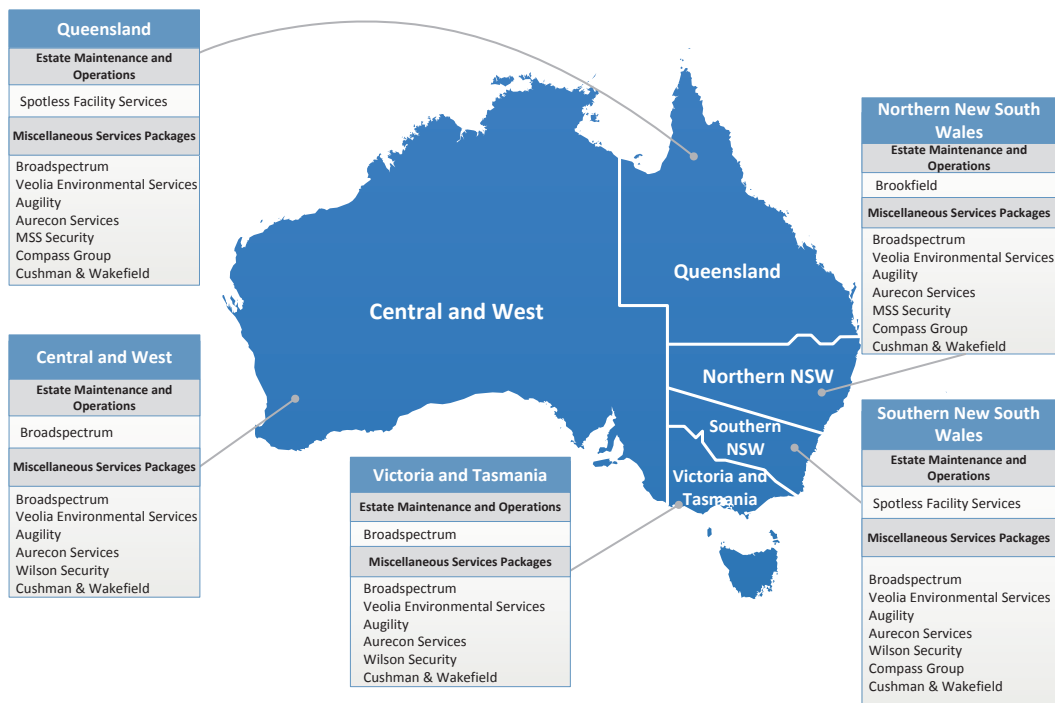
Note e: Formerly UGL Services.

Note f: In this Table, the total does not equal the sub-totals due to rounding.

Source: Defence and ANAO analysis.

1.8 Figure 1.3 illustrates the distribution of service providers across Defence's five regions.

**Figure 1.3: Base Services regions and contractors**



Source: ANAO.

ANAO Report No.29 2016–17  
Design and Implementation of Defence's Base Services Contracts

## Audit approach

1.9 The objective of the audit was to assess the effectiveness of Defence's design and implementation of the Base Services contracts.

1.10 To form a conclusion against the audit objective, the Australian National Audit Office (ANAO) adopted the following high-level audit criteria:

- Defence designed and procured the new Base Services contracts model with a view to achieving economy, efficiency and effectiveness in the delivery of base services;
- Defence is on track to realise expected savings; and
- Defence managed the Base Services contracts and monitored service delivery effectively.

1.11 In undertaking the audit, the ANAO:

- reviewed relevant Defence files and documentation, including instructions, policies, briefs, and performance reports;
- collected and analysed data relating to the Base Services contracts;
- visited a selection of Defence bases across Australia; and
- interviewed key Defence personnel and contracted staff across a range of locations and Defence Service Groups.

1.12 The ANAO also conducted a performance review (negative assurance) of the Base Services procurement process.<sup>11</sup>

1.13 The audit was conducted in accordance with the ANAO's auditing standards at a cost to the ANAO of approximately \$569 000.

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11 In this type of review, the objective is a reduction in performance engagement risk to a level that is acceptable in the circumstances of the engagement, as the basis for a negative form of expression of the review conclusion. The acceptable performance engagement risk in such an engagement is greater than for a reasonable (positive) assurance engagement. A performance review can assess the adequacy of an internal control structure or specific internal controls, in particular those intended to safeguard assets and to ensure due regard for economy, efficiency or effectiveness; the extent to which resources have been managed economically or efficiently; and the extent to which activities have been effective.

## 2. Designing and implementing the Base Services contracts

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### Areas examined

The ANAO examined Defence's design of the Base Services contracts, procurement process for the contracts, and achievement of its value for money objective.

### Conclusion

Defence designed the Base Services contracts model to achieve its intended objectives—to sustain Defence capability and optimise value for money.

Defence adopted seven key guiding principles, most of which relate to its objective of optimising value for money, but is unable to demonstrate that the new Base Services model has achieved that objective. Actual expenditures have been higher than estimated, and expenditure forecasts indicate that the new Base Services model is not likely to achieve Defence's original savings goals.

### Areas for improvement

The ANAO has made a recommendation aimed at improving Defence's monitoring and reporting on the performance of the Base Services contracts in achieving its value for money objective.

### Did Defence design the Base Services contracts model to achieve its intended objectives?

Defence designed the Base Services contracts model to achieve its intended objectives—to sustain Defence capability and optimise value for money.

Defence adopted seven key guiding principles which resulted in the model incorporating a number of strategies and features aimed at realising its intended objectives. Key features included: primarily outcome-based contracts involving payment for services rather than availability; provisions to improve efficiency through increased competition and leveraging volume from larger, national contracts; provisions to encourage innovation and to better manage supply and demand for certain services; and a focus on reducing a range of costs to Defence and industry.

In developing the model Defence sought expert advice and actively considered risk. However, risk management was not as effective as it could have been.

### Management arrangements for the design process

2.1 Work on the design of the Base Services contracts model formally commenced in 2011, with the engagement of Accenture to conduct market research and provide Defence with future acquisition strategy options. The design phase concluded in July 2012 with Defence issuing an Invitation To Register to the market. Defence approached the design task as a business as usual activity—there was no specific project plan prepared or budget allocated. A project team was established, led by Procurement and Contracting Branch officers in collaboration with staff from Defence's Service Delivery Division. Defence advised the ANAO that additional staffing resources

were provided as required from within Defence Estate and Infrastructure Group. Approximately \$11 million was expended on consultancies, legal services and probity advice during the design and tender process.

2.2 A number of governance committees oversaw aspects of the design and tender process, including:

- a Non-Equipment Procurement Governance Committee and a Non-Equipment Procurement/Estate Committee. Matters requiring decision and regular progress reports were provided to the committees;
- a Base Services Retender Advisory Group, which operated from May to July 2012;
- a Project Control Group provided oversight over the development of the documentation for the national tender process from 30 November 2012 to 22 February 2013; and
- a Tender Evaluation Steering Group met during the tender evaluation phase, from March 2013 to November 2013, to discuss and progress issues associated with the tender evaluation.

2.3 Defence recognised that risks to the successful design and implementation of the new Base Services contracting model required close management attention. Risk and transition issues were included on the agenda of the Tender Evaluation Steering Group. During the design and implementation process, Defence also prepared several risk assessment and management documents including:

- a Non-Equipment Procurement Risk Management Plan for Base Services Retender (September 2012);
- a Base Services Retender Project Evaluation and Implementation Risk Dashboard (risk register);
- a Strategic Benefit and Risk Assessment of the leading bids (December 2013); and
- a Contract Governance Directive, issued in July 2014, which provided details of the Risk Management Framework for the Base Services contracts.

2.4 The risk assessments examined by the ANAO identified a range of risks<sup>12</sup> to the implementation of the new Base Services contracts including:

- data accuracy (including for estate data)—which could affect the quality of the procurement outcome (price, risk of subsequent variation);
- governance—the Corporate Governance Framework would need to be in place to support the transition of the contracts (for example, IT systems, personnel training and skilling);
- schedule—requiring additional time for the tender evaluation and contract negotiations;
- continuity—transition to the new contracts might adversely impact the continuity of Defence base services; and
- ICT—the project to replace Defence’s Estate Management IT system would need to align with the Base Services Retender requirements and timeframes.

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12 These risks are discussed further in Chapter 3.

2.5 The risk assessments were prepared in accordance with the Non-Equipment Procurement Risk Management Plan for Base Services Retender and identified mitigation strategies, risk levels after applying those strategies, and responsibilities.

### **Key inputs into the design**

2.6 Defence conducted market research and sought feedback from key stakeholders on a range of issues related to the design of a new Base Services contracts model.

2.7 In 2011, Defence engaged Accenture to recommend a future acquisition strategy for base services. Accenture considered that Defence could improve value for money outcomes and reduce management fees, and that Australia's supply market capability could manage the provision of bundled services.

2.8 In December 2011, Defence presented a detailed review of Garrison Support Services to the Two Star Non-Equipment Procurement/Estate Committee as part of the development of savings options to address the Strategic Reform Program targets for base services. The review recommended:

- establishing a 'principles-based' approach to the definition of Base Services requirements; and
- proposed Guiding Principles for development of Base Services contracts supported by Operational Requirements principles to redefine the service requirement.

2.9 The Guiding Principles were: leveraging volume, maintaining competitive tension, outcome-based contracts, standardisation, sustainability, innovation and total asset management. The Guiding Principles largely related to the objective of optimising value for money (Figure 1.2).

2.10 In May 2012<sup>13</sup>, Defence established a Requirements Definition Working Group. The Terms of Reference for the Group included developing outcome-based base service requirements and referring contentious requirements to the Base Services Retender Advisory Group.<sup>14</sup> A key aim was to ensure that requirements and standards would support capability, meet legislative and corporate responsibilities, and were affordable. Requirements were summarised into 'product profiles' which were provided to the Non-Equipment Procurement Governance Committee for endorsement.

2.11 The Requirements Definition Working Group operated between May 2012 and October 2014. Defence documents indicate that incorporation of customer requirements into the Statement of Works<sup>15</sup> was more complex than anticipated.<sup>16</sup>

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13 Defence continued to progress the Base Services Retender between December 2011 and May 2012, releasing the Request For Information (RFI) to industry in March 2012, and providing an Industry Brief to 200 attendees on 2 April 2012. The RFI closed on 27 April 2012.

14 The Base Services Retender Advisory Group comprised key Three Star military members and Defence's Associate Secretary. The Group met in May, June and July 2012.

15 The Statement of Works included documentation of previously agreed reforms.

## Design process

2.12 The design process for the new Base Services contracts model concluded in July 2012 with the release of the Invitation To Register. This was in line with expected timeframes. The Invitation To Register was authorised by the Deputy Secretary, Defence Estate and Infrastructure Group. At the conclusion of the design process Defence had developed an acquisition strategy, with defined bundles and packages of services, which was taken to market as part of a two-stage procurement process. The first stage involved an Invitation To Register and the second stage a Request For Tender to prequalified companies.

2.13 The new Base Services contracts model incorporated a number of strategies and features intended to improve value for money outcomes for Defence whilst sustaining Defence capability. Key features included:

- primarily outcome-based contracts, involving payment for services rather than availability;
- provisions to improve efficiency through increased competition and leveraging volume from larger, national contracts;
- provisions to encourage innovation, and to better manage supply and demand for certain services; and
- a focus on reducing a range of costs to Defence and industry.

2.14 The extent to which these features are achieving their value for money objective is discussed later in this chapter. Management of service delivery is discussed in Chapter 3.

## Did Defence effectively conduct the procurement process for the Base Services contracts?

Based on the procedures performed and the evidence obtained in the ANAO's performance review<sup>a</sup>, nothing came to the ANAO's attention to cause it to believe that the Base Services contracts procurement process was affected by a lack of appropriate approvals or non-compliance with mandatory requirements of the Commonwealth Procurement Rules. However, the procurement process took considerably longer than expected, with contract signatures occurring around a year later than planned.

Note a: The ANAO conducted a performance review of the procurement process for the Base Services contracts. A performance review provides negative assurance. In this type of review, the objective is a reduction in performance engagement risk to a level that is acceptable in the circumstances of the engagement, as the basis for a negative form of expression of the review conclusion. The acceptable performance engagement risk in such an engagement is greater than for a reasonable (positive) assurance engagement. A performance review can assess the adequacy of an internal control structure or specific internal controls, in particular those intended to safeguard assets and to ensure due regard for economy, efficiency or effectiveness; the extent to which resources have been managed economically or efficiently; and the extent to which activities have been effective.

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- 16 Defence documents indicate that concerns were held by Defence personnel that insufficient time had been allocated to the development of the Statement of Works and that there was insufficient consultation with nominated Service and Group representatives. In September 2016, Defence advised the ANAO that six months was allocated for consultation on the Statement of Works and for the Services and Groups to finalise their agreed reforms. An ongoing consultation process was also established to enable Services and Groups to conduct quality reviews of the Statement of Works and respond to Tenderers' clarifications during the Request For Tender period.

## Conducting the procurement process (ANAO performance review)

2.15 Between March 2012 and December 2013, Defence conducted the tender process to replace and consolidate the existing 21 Base Services contracts (Figure 2.1).<sup>17</sup> The ANAO conducted a performance review of the procurement process. This review, and its outcomes, are summarised below.

### Box 1 Performance review of the Base Services procurement process

The ANAO's performance review focussed on the oversight, planning and conduct of the procurement for the Bases Services contracts. In conducting the review, the ANAO examined whether the records retained by Defence indicated that:

- appropriate approvals were obtained before procurement was initiated;
- the tender process met mandatory Commonwealth Procurement Rules:
  - the final signed contract included all mandatory contractual requirements;
  - any non-compliance was adequately reported on;
- actions taken by Defence focused on probity and integrity in the procurement process; and
- the evaluation criteria enabled Defence to determine which supplier represented best value for money.

Based on the procedures performed and the evidence obtained, nothing came to the ANAO's attention to cause it to believe that the Base Services contracts procurement process was affected by: a lack of appropriate approvals or non-compliance with mandatory requirements of the Commonwealth Procurement Rules. Evidence provided by Defence indicates that the Department took action to conduct a procurement process that focused on probity and integrity and that the evaluation criteria focused on determining value for money.

The ANAO identified delays in Defence placing the final contracts on AusTender. The delay was administrative and did not affect the outcome of the procurement process.

## Timeframes for the procurement process

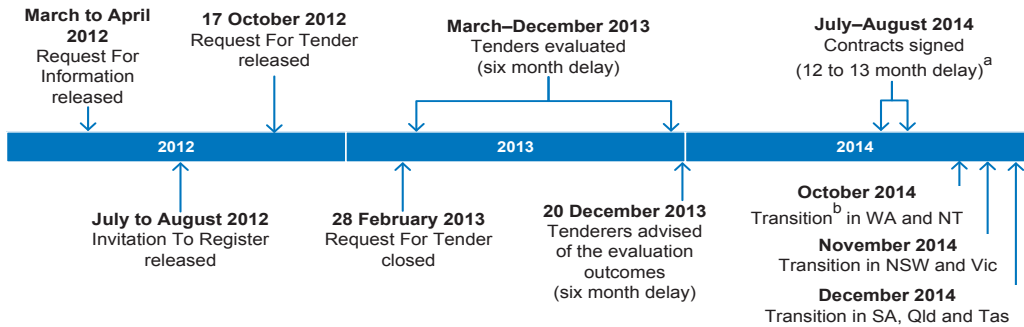
2.16 Defence prepared a Tender Evaluation Plan which included a schedule for the procurement process. A timeline for the procurement process is at Figure 2.1. The original schedule provided four months for tender evaluations<sup>18</sup> (4 March 2013 to 28 June 2013) and less than four weeks for contract negotiations (8 July 2013 to 31 July 2013). These milestones were not achieved and contract signature occurred 12 to 13 months later than planned (from July to August 2014). As a result of this delay, Defence incurred greater costs than originally anticipated for the procurement process, as it was required to continue to support the project team for another year.

17 In July 2012, Defence prepared a Non-Equipment Procurement Plan for Re-Tender of Base Services.

18 The tender evaluation process was more complex than originally envisaged, with Defence evaluating 121 conforming bids.



**Figure 2.1: Procurement timeline**



Note a: Cumulative delay.

Note b: Two Miscellaneous Services Packages (National Program Services and Project Delivery Services) transitioned nationally in August 2014. The other Base Services contracts transitioned by region, between October and December 2014.

Source: ANAO analysis.

## Is the new Base Services model achieving its intended value for money objective?

Defence is unable to demonstrate that the new Base Services contracts model has achieved the intended value for money objective.

- Actual expenditures have been higher than estimated. In 2015–16 Defence spent \$1039 million on base services, some \$195.5 million (23 per cent) more than the negotiated amount. Defence was unable to provide the ANAO with an accurate, consolidated summary accounting for the full \$195.5 million difference between the negotiated contract price (\$844 million) and actual expenditure in 2015–16 (\$1039 million).

Defence forecasts and ANAO estimates indicate that the new Base Services contracts provide no net savings over the life of the contracts.

- The department’s actual 2015–16 expenditure, combined with Defence’s forecasts for the period 2016–17 to 2024–25, indicate that the potential 10-year expenditure on the Base Services contracts will be around \$11.06 billion. If realised, the forecast expenditure would be \$989 million (10 per cent) higher than the projected expenditure at the completion of contract negotiation.
- Further, the ANAO has estimated that expenditure under the new contracts would be comparable to expenditure under the previous contracts, had the previous contracts continued until 2021–22.

Defence does not capture data that enables it to make informed assessments around the achievement of value for money.

- While expenditure on Base Services contracts is monitored and reported, Defence does not capture data or report on Defence’s administration costs. Current reporting does not provide insight into the financial outcomes of initiatives intended to improve the efficiency of base services provision. The ANAO has made a recommendation on this matter.

## Value for money objective

2.17 One of the original drivers for reforming the Base Services contracts was to meet savings goals established as part of the Strategic Reform Program. Tender evaluation documentation stated in December 2013 that the Base Services Retender financial objective was: ‘an opportunity to both achieve supply side savings and implement demand related savings initiatives previously identified as part of the Strategic Reform Program.’

2.18 Under the Strategic Reform Program, Defence budgeted for savings of \$1.1 billion over 10 years from the base services budget.<sup>19</sup> This reduced budget spanned the period of the previous base services arrangements and the new Base Services contracts. At the time, Defence estimated that the new Base Services contracts would contribute approximately \$400 million in savings over the potential 10-year life of the contracts.<sup>20</sup>

2.19 Defence advised the ANAO that the Strategic Reform Program reforms were overtaken by the 2013 Defence White Paper. In September 2013 the Secretary, Chief of the Defence Force and the Minister for Defence approved the Strategic Reform Operating Model to replace the 2009 Strategic Reform Program.

## Assessment of the Base Services model

2.20 Table 2.1 summarises key features of the Base Services model<sup>21</sup> and provides an assessment of their status as at August 2016. When designing the new Base Services contracts, Defence was keen to optimise value for money through: cost savings; a reduction in tendering costs and contract management overheads; economies of scale; and improvements in supply and demand management.<sup>22</sup> Table 2.1 indicates that Defence is not capturing data that would enable it to ascertain whether it is achieving its value for money objective. Defence does not capture or monitor its administration expenses (overheads) or assess the efficiency impacts of introducing larger contracts, Customer-Pays initiatives or innovation incentives.

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19 Comprising savings of \$645 million from Garrison Support Services and \$505 million from Comprehensive Maintenance Services. These services are now provided under the new Base Services contracts.

20 The 2012 tender Financial Evaluation Report provided estimates of the savings that Defence would achieve from the Base Services Retender, to the value of 4 per cent. In September 2016 Defence advised the ANAO that the tender evaluation documentation forecasted approximately \$25 million in clear savings, but that this figure would increase to approximately \$30-40 million when other ‘efficiencies’ which were absorbed in the contracts are included. This amounts to approximately 5 per cent, which equates to \$400 million in savings for the Base Services Retender over 10 years.

21 These features were described in a number of Defence documents, including Senate Estimates Briefs and expert advice provided to Defence.

22 These considerations have appeared in Defence documents, including Senate Estimates Briefs and Question Time Briefs.

**Table 2.1: ANAO assessment of the Base Services model**

Feature	ANAO assessment
Outcome-based contracts	<b>Achieved</b> —Contracts are primarily outcome-based. <sup>a</sup> The previous contracts were descriptive and requirement-based.
Remove Prime Contractors <sup>b</sup>	<b>Achieved</b> —Prime Contractors removed.
Leverage volume and gain efficiencies of scale <sup>c</sup> from larger, national contracts	<b>Insufficient data</b> —The number of contracts was reduced from 21 to 10. These are a mix of national and regional contracts. Defence is not capturing data to ascertain whether the larger contracts have resulted in efficiencies of scale. <sup>d</sup>
Strategic bundling strategy	<b>Achieved</b> —The bundling/packaging of services has been significantly revised.
Attract new entrants	<b>Achieved</b> —Three new contractors for base services were engaged. <sup>e,f</sup>
Focus on incentives and innovation	<b>Insufficient data</b> —Contracts include provisions relating to incentives and innovation. Use of incentives is not yet mature. Provisions for innovation are not often used (see Appendix 2).
Improved management of supply and demand including through ‘Customer-Pays’	<b>Insufficient data</b> —Contracts include Customer-Pays for some services. Defence is not yet capturing data to measure whether there has been any improvement to the management of supply and demand (see Appendix 2).
Reduce contract overheads by introducing self-reporting by contractor	<b>Insufficient data</b> —Contracts introduced contractor self-reporting of compliance using an ISO 9001:2008 compliant Quality Management System. Defence is not capturing data to measure whether contract overheads have been reduced.
Cost savings	<b>Insufficient data</b> —Defence is not capturing data on the costs of contract administration. <sup>g,h</sup> Defence is not capturing adequate data to make a judgement about savings—however, available Defence data indicates that base services expenditure is higher than forecast. <sup>i</sup> Delays in the implementation of the integrated Estate Management IT System resulted in additional costs and prevented Defence from realising expected efficiencies from the new Base Services model. <sup>l</sup>
Reduction in tendering costs for Defence and industry through smaller number of contracts	<b>Insufficient data</b> —Available Defence data indicates a reduction in the number of contracts and this may reduce future costs. However, the procurement process took 12 months longer than planned and has consequently increased tendering costs for Defence.
Reduction in Defence’s contract management overheads by reducing the number of contracts	<b>Insufficient data</b> —Available Defence data indicates a reduction in the number of contracts. Defence is not capturing data on its contract management overheads.

Feature	ANAO assessment
Standardisation—service delivery to be more broadly consistent regardless of location	<b>Achieved</b> —Contracts have increased standardisation in service delivery across bases.

Note a: In outcome-based contracts, payment is for services rather than their availability.

Note b: A Prime Contractor is a single contractor accepting all accountability and liability for service irrespective of whether the service is delivered 'in-house' or through subcontracting.

Note c: Improved purchasing power.

Note d: In November 2016, Defence advised the ANAO that at contract negotiations it anticipated savings of \$3.8 million per annum resulting from a reduction in contract management costs.

Note e: UGL services (now Cushman & Wakefield) was previously contracted to Defence to manage the Property Leasing Portfolio at the national level, but had not been a contractor for base services. Augility and Aurecon were new entrants.

Note f: In the context of base services, of the 10 contracted providers only four had previous direct contractual relationships with Defence. Of the remaining six, three had previously provided services under subcontract or supply arrangements to Prime Contractors. The remaining three were new entrants from the previous generation of Base Services contracts.

Note g: The 2015 First Principles Review found that: 'The current way public service numbers are managed in Defence drives some perverse behaviour and unintended outcomes—the focus on staffing numbers separate from budget allocation is not consistent with how other departments manage their budgets. At the project level, Defence treats staff as a 'free good'.

A 2016 Defence *Total Cost of Ownership* Review recommended that 'labour/personnel costs (including Australian Defence Force, Australian Public Service and contractors)' be included to capture the full cost of an asset or system. The Review also noted that a number of internal Defence reviews have indicated that inadequate attention has been given to managing and costing Defence capabilities on a whole-of-life basis. This has led to funding shortfalls for ongoing operating, maintenance and support costs.

Note h: Defence does not track the staffing, and associated costs, involved in administering and managing the Base Services contracts. In August 2016, in response to an ANAO request, Defence advised the ANAO that there had been an estimated reduction of 196 Full Time Equivalent staff (13.3 per cent) within the Division responsible for administering and supporting the contracts, from 1473 (October 2014) to 1277 (July 2016).

Note i: In August 2016 Defence advised the ANAO that demand has increased, resulting in an increase in contract expenditure. Defence further advised that the underlying basis of the costs (i.e. unit costs) had not changed.

Note j: The integrated Estate Management IT system was intended to be a key enabler for delivering cost savings by significantly improving the integrated management of the Defence estate.

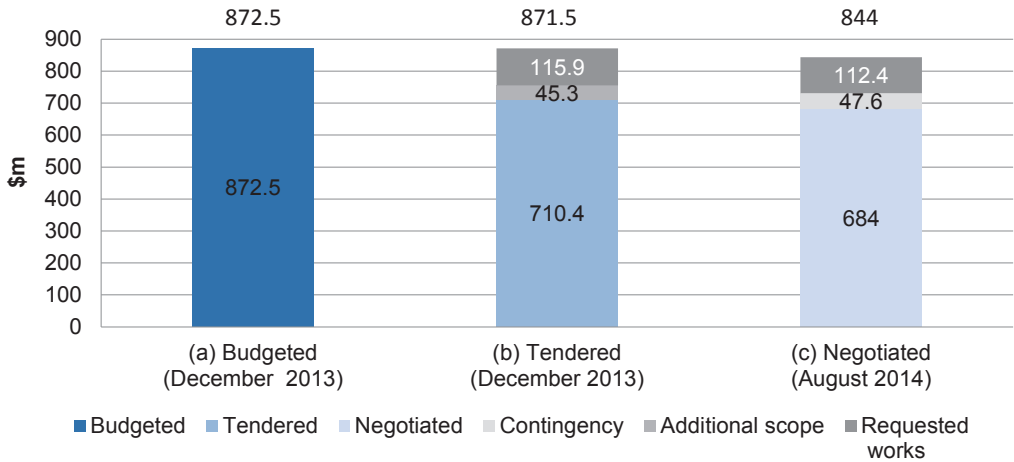
Source: ANAO analysis.

## Actual and estimated contract expenditure on base services

2.21 In December 2013, at the conclusion of the tender evaluation process, Defence estimated that expenditure for the first full year of the new contracts (2015–16) would be some \$871.5 million—a 4.5 per cent reduction on expenditure in the last full year of the previous contracts (2013–14). Following contract negotiations, the final estimate for expenditure in 2015–16 was \$844 million—an eight per cent decrease on expenditure in 2013–14.<sup>23</sup> Figure 2.2 shows the amounts for Defence's original budget goal (a), estimated costs following tender evaluation (b) and estimated costs at the conclusion of negotiations (c). A contingency of \$47.6 million was included after negotiations for due diligence (discussed further at paragraphs 3.11 and 3.12).

23 This amount includes estimates for the requested works, variable components of base services based on the rates in the new Base Services contracts, contingencies, amounts set aside for due diligence and items suspended during negotiation, and additional scope—items added after the tender.

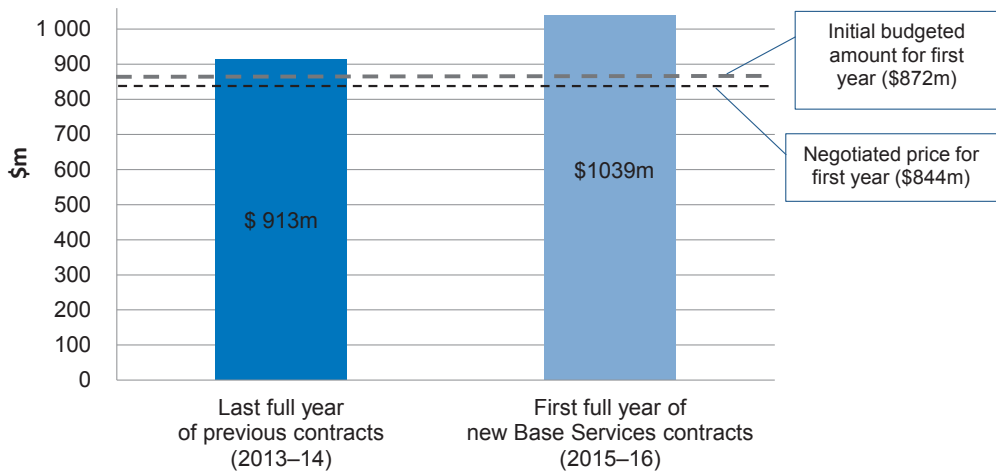
**Figure 2.2: Progression of estimated costs during tender process**



Source: ANAO analysis of Defence data.

2.22 Actual expenditures have been higher than estimated. In 2015–16 Defence spent \$1039 million on base services, some \$195.5 million (23 per cent) more than the negotiated amount. This was also \$125.9 million (13.8 per cent) more than in the last full year of the previous contracts (see Figure 2.3).<sup>24</sup>

**Figure 2.3: Actual expenditure on Base Services contracts in 2013–14 and 2015–16**



Note: The 2014–15 financial year was the transitional year and included expenditure from both the previous contracts and the new Base Services contracts. Expenditure totalled \$924.52 million.

Source: ANAO analysis of Defence data.

24 The 2015–16 figure is the cash spent in 2015–16 and does not include prepayments (\$21 million) from the previous period. It does include back payments for costs incurred in earlier years.

2.23 Defence was unable to provide the ANAO with an accurate, consolidated summary accounting for the full \$195.5 million difference between the negotiated contract price (\$844 million) and actual expenditure in 2015–16 (\$1039 million). The reasons for the variation between negotiated costs and actual expenditure in 2015–16, as advised by Defence, are included in Table 2.2.

**Table 2.2: Variation between negotiated costs and actual expenditure in 2015–16**

Reason	Value (\$m)
Missing/incorrect data—in some instances the data used for the tender did not match the requirements when the contract started. For example, over 400 kilometres of firebreaks were not in tender data (see paragraphs 3.9 and 3.10).	Defence unable to advise
Additional scope of work—Defence advised there were greater than anticipated changes to the scope of work. For example, Defence added recently constructed buildings that require cleaning and maintenance (see paragraphs 3.11 and 3.12)	Defence unable to advise
Back payments for due diligence <sup>a</sup> —claims not invoiced until later years due to processing delays.	76
Policy decisions and changes in Defence’s operating environment—primarily increases in the size of the ADF, US Force Posture (US Marines locating in Darwin), and increased base security (base security level changed to Safe Base Charlie <sup>b</sup> —resulting in a range of measures such as increased number of guards).	10.7
Suspended items for Oakey Aviation Fire Fighting and Access Control at Orchard Hills. <sup>c</sup>	8.3
During the course of the audit Defence advised the ANAO (October 2016) that \$37 million of extra estate upkeep/maintenance was undertaken by Defence on ‘a discretionary basis’.	37
Indexation—the contracts allow for contractors to claim annual adjustments based on movements in the Australian Bureau of Statistics Wage Index. Delays in the tender process meant that within the first few months contractors had claimed \$14 million of indexation increases. An additional \$20 million in indexation was applied in 2015–16.	34
<b>Total of costs advised by Defence</b>	<b>166</b>

Note a: Due diligence allows contractors to claim variances arising from a number of factors. See paragraphs 3.11 and 3.12.

Note b: Safe Base Charlie is the third level of Defence’s five alert levels, Alpha (lowest) to Echo (highest), that are changed in response to the national terrorism threat level.

Note c: These expenditures were previously covered by other areas within Defence.

Source: ANAO analysis of available Defence data.

### *Expenditure forecasts*

2.24 Defence prepares regular forecasts<sup>25</sup>, for its Defence Service Delivery Division<sup>26</sup> Executive, of expenditure for the potential 10-year life of the contracts.<sup>27</sup> The department’s actual 2015–16 expenditure, combined with Defence’s forecasts for the period 2016–17 to 2024–25, indicate that

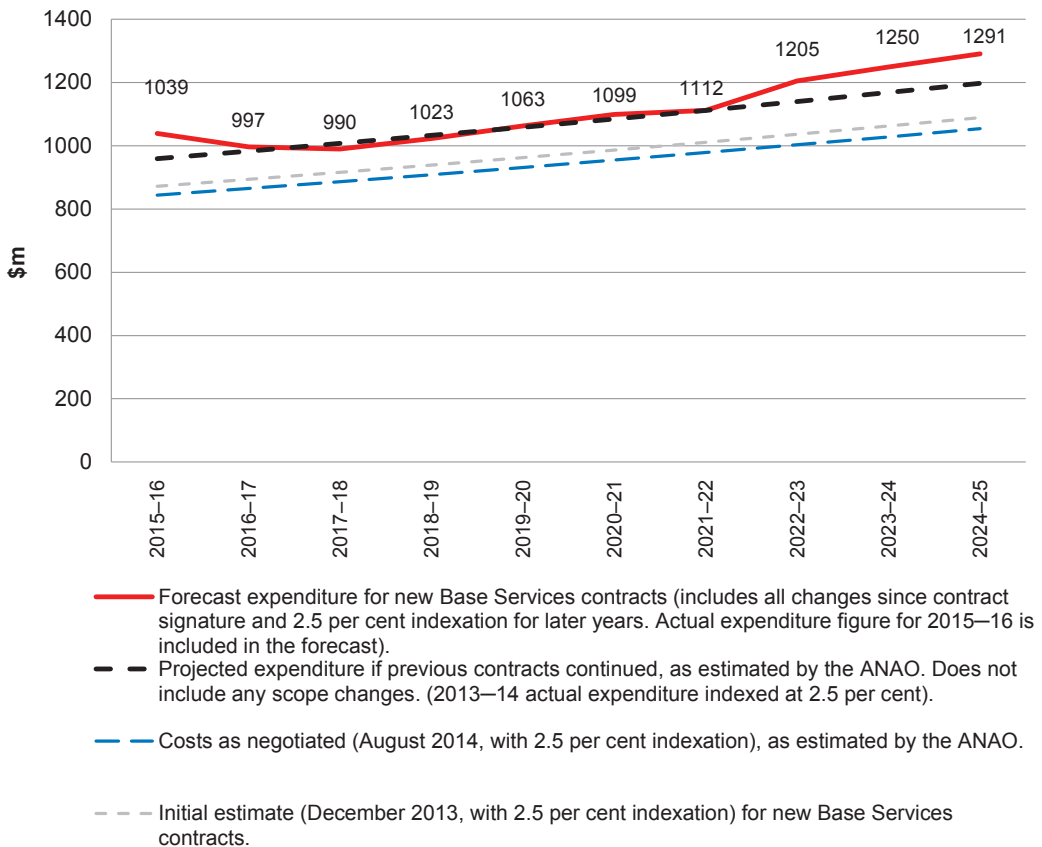
25 The forecasts are known as Affordability Briefs. Three Affordability Briefs have been prepared, which also provide guidance on the future cost of the contracts and include explanations for any increases.

26 The Base Services contracts are managed by the Defence Service Delivery Division.

27 Affordability Briefs include additional program costs of \$158.55 million over the 10-year period, for example, costs associated with Air Services Australia.

the potential 10-year expenditure on the Base Services contracts will be around \$11.06 billion (see the red line in Figure 2.4). If realised, the forecast expenditure would be \$989 million (10 per cent) higher than the projected expenditure at the completion of contract negotiation.<sup>28</sup> Further, the ANAO has estimated that expenditure under the new Base Services contracts would be comparable to expenditure under the previous contracts, had the previous contracts continued until 2021–22 (see the broken black line in Figure 2.4). On the basis of these forecasts and estimates, the new Base Services contracts provide no net savings over the life of the contracts.

**Figure 2.4: Forecast Base Services contracts expenditure 2015–16 to 2024–25 compared to initial forecast, negotiated and current forecasts**



Source: ANAO analysis of Defence data.

28 The May 2016 Affordability Brief estimated a \$344 million higher than forecast contract expenditure over 10 years. However, this figure was based on a lower estimated expenditure figure for 2015–16 than was actually achieved. Defence does not prepare any affordability assessment for Defence-wide base services expenditure, which would require the addition of Customer-Pays components to this. Defence was only able to provide an estimate of \$23 million per annum or \$230 million for the potential 10 years of the contracts for Customer-Pays.

2.25 The funding for higher than anticipated expenditure on Base Services contracts will need to come from elsewhere within Defence. In October 2016, Defence advised the ANAO that: ‘required rebalancing of budget pressures or softness is identified and managed at the whole of Division and Group level’.

### **Areas for improvement**

2.26 Defence reports to the Defence Services Delivery Division Executive provide a 20-year forecast on the cost of the Base Services contracts, including an estimate of indexation increases. These forecasts do not take into account expected changes to bases, staffing levels or future estate management plans. Defence intends that the planned upgrade to its Estate Management IT system will improve the way data is held and managed and provide a better national understanding of the Defence estate, the services required at each base and the Base Services contracts (see Chapter 3). Improved data quality will support Defence’s strategic decision making regarding the future direction of the Base Services contracts, including decisions related to contract performance and contract extensions. Defence is currently two years into a minimum six-year contract, and has advised that it will begin work on its first strategic review of the contracts in late 2016. The review will inform contract extensions.

#### **Recommendation No.1**

2.27 That Defence monitors and report on the performance of Base Services contracts in achieving value for money outcomes. In particular, Defence should monitor and report on:

- (a) the costs of contract administration;
- (b) the impact of initiatives to improve the management of supply and demand; and
- (c) the impact of incentives, gain-sharing arrangements and other innovation measures.

**Defence response:** *Agreed.*



### 3. Managing the Base Services contracts

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#### Areas examined

The ANAO examined Defence's management of the transition to the new Base Services contracts, implementation of the new contract governance and management framework, implementation of the planned Estate Management IT system, and implementation of arrangements to assure the performance of its Base Services contractors.

#### Conclusion

Defence's management of the transition to the Base Services contracts was not effective in facilitating a smooth changeover to the new arrangements, and some two years into the contracts, while services are being delivered, key aspects of Defence's contract management and related processes require attention.

- Key contract governance and management guidance has not been finalised.
- The deployment of a new Estate Management IT system, intended to support contract administration, is some five years behind schedule and has cost \$39.81 million (32 per cent) more than initially planned.
- A recent internal audit concluded that Defence's processes do not provide adequate assurance that the self-assessment results provided by contractors are a fair and reasonable reflection of the actual performance standards delivered.

#### Areas for improvement

The ANAO has made a recommendation aimed at Defence finalising its key contract governance and management documents, providing key personnel with up-to-date guidance on their roles, and determining the most efficient means of obtaining the necessary information to provide reasonable assurance in respect of contractor self-reporting.

3.1 A key guiding principle of the new Base Services contracts model was to standardise the contracts to achieve national consistency in service delivery and governance arrangements. Defence designed a contract governance and management framework aimed at implementing consistent processes and standards across all contracts and regions, while allowing some contract-specific flexibility. The Base Services contracts model was to be supported by a new Estate Management IT system, and was to be accompanied by a change to Defence's contract assurance arrangements.

## Was the transition to the new Base Services contracts managed effectively?

Defence's management of the transition to the Base Services contracts was not effective in facilitating a smooth changeover to the new arrangements. There was a 12-month delay in finalising the tender but the completion date for transition was not adjusted accordingly. As a consequence the transition times were reduced from 18 months to three months.

Issues identified by Defence in the initial roll out phase recurred in subsequent phases. For example: new contract standards were interpreted locally and inconsistently; communications materials contained incorrect information about the provision of services under the new contracts; and new contractors were not staffed to the required numbers.

Defence was aware of the risk that data in its tender data packs might not accurately reflect ongoing changes to the Defence estate, and this risk was realised when inaccurate data caused difficulties for successful tenderers during the transition and subsequently. The full scope of the services expected to be delivered often differed from the basis on which firms had made their bids.

3.2 The transition to the new Base Services contracts occurred progressively from 1 October 2014 to 1 December 2014. The transition was originally expected to commence in June 2013 and to take 18 months (December 2014). As discussed in Chapter 2, there was a 12-month delay in finalising the Base Services tender.<sup>29</sup> As the planned completion date for transition was not adjusted accordingly, transition times were reduced to 12 weeks (three months). Defence advised the ANAO that it did not change transition times because the incoming Base Services contractors had not requested a change at the time of contract signature, indicating that they would be able to complete transition activities within the reduced timeframe. Defence further advised that the timeframe for transition could not be extended past this point because some of the previous contracts for the provision of base services were due to expire.

3.3 Transition involved detailed transition-out/in activities for 10 contractors at 867 Defence properties (119 bases) across Australia. The transition involved significant changes to the way base services were delivered, including a:

- reduction in the number of contracts from 21 to 10;
- new mix of service providers; and
- move to outcome-based contracting.

3.4 Defence managed the transition changes through the Defence Support Operations Transition Program.<sup>30</sup> The Transition Program was supported by a governance and planning framework which included:

- a Transition Steering Group;

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29 The Request For Tender was released according to schedule, and while the Tender Evaluation began on time, insufficient time was allowed to complete Tender Evaluation and Contract Negotiations. Contracts were signed between 12 and 13 months later than originally scheduled.

30 The Defence Support Operations Division led the changes.

- national and regional-level transition planning for the new Base Services contracts;
- a Change Management Strategy for the new Service Delivery Division operating model;
- a Program Management Plan, Integrated Program Schedule, and Integrated Communications Strategy; and
- an Implementation Plan for the interim Estate Management IT system and the planned Estate Management IT system upgrade.

## Transition Issues

3.5 Defence experienced numerous issues when it transitioned to the new Base Services contracts. During interviews for this audit, 37 of 83 regional Defence personnel involved in managing the transition (45 per cent) described the transition as challenging, poor, difficult, or complicated.<sup>31</sup>

### *Management of the transition timeframe*

3.6 Defence intended to implement the transition progressively throughout the regions so that lessons learned could be applied to subsequent phases. However, Defence's poor management of the procurement and transition timeframe caused delays to the delivery of key transition planning documentation to Service Delivery Division staff and ADF Service personnel, which impacted its ability to complete all transition activities within the allocated time and to the expected standard. Additionally, issues identified by Defence in the initial roll out phase recurred in the subsequent phases. For example:

- the new contract standards were interpreted locally and inconsistently;
- communications materials contained incorrect information about the provision of services under the new contracts;
- new contractors were not staffed to the required numbers; and
- there was a lack of management plans to support the level and frequency of services required.

3.7 Defence advised the ANAO that these transition issues recurred 'despite attempts to resolve the issues through Contractor engagement and updated transition guidance'.

3.8 Another consequence of the reduced transition timeframe was that Defence 'suspended' negotiations over 135 service items during negotiation with the successful tenderers so that the contracts could be finalised. The annual cost of these items was estimated to be \$28.29 million at the end of negotiations (August 2014). Defence advised the ANAO in November 2016 that negotiations between the contractors and Defence personnel over resolution of these suspended items occurred during and after the transition period. As at 17 August 2016, 111 of the suspended items were finalised at a cost of \$31.91 million annually, some \$3.62 million above the August 2014 estimate for suspended items.

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31 The ANAO interviewed the following Defence personnel: Senior Australian Defence Force Officers, Base Support Managers, Base Support Operations Managers and Estate Maintenance and Operations Services Managers.

### *Inaccurate estate data and incomplete specification of service requirements*

3.9 Defence was aware of the risk that data in the tender data packs might not accurately reflect ongoing changes to the Defence estate, including changes that were not entered into the previous Estate Management IT system (from which they extracted the data), and any updates to the system after the point of extraction.<sup>32</sup>

3.10 This risk was realised, and the data packs provided to prospective tenderers did not provide an accurate picture of the Defence estate.<sup>33</sup> The inaccurate data caused difficulties for successful tenderers when they became aware that the full scope of the services expected to be delivered differed from the basis on which they had made their bids. Table 3.1 provides some examples of the inaccuracies in the estate data.

**Table 3.1: Examples of inaccurate estate data**

Service	Issues with data
Waste Management	165 waste collection sites were included in the Request For Tender, but the required service delivery footprint was 360 sites. During transition this resulted in the contractor failing to empty a large number of bins.
Land Management	Data not included in tender packs included: <ul style="list-style-type: none"><li>• 422 km of firebreaks;</li><li>• 257 km of drains; and</li><li>• 39 616m<sup>2</sup> of garden beds.</li></ul>
Access Control	Additional guards required.
Cleaning	Inaccurate data for 3740 spaces in buildings, including: <ul style="list-style-type: none"><li>• beds in Defence Housing Australia accommodation;</li><li>• missing buildings; and</li><li>• incorrect building size and levels.</li></ul>
Transport	Mail sorting and delivery was not included at some bases.

Source: ANAO analysis.

3.11 The Base Services contracts included a 'due diligence' period of nine months that allowed contractors to claim variances arising from:

- Defence providing incomplete or inaccurate estate data at the time of the tender; and

32 The Base Services Retender relied on data drawn from Service Delivery Division's previous Estate Management IT system—a 12-year old stand-alone database. This system did not interact with Defence's central fixed asset register or the financial management system. Defence internal audit and previous ANAO audits have identified data integrity issues due to lack of system controls. Defence's Estate and Infrastructure Group is currently upgrading its Estate Management IT system, which is expected to improve the way data is held and managed.

33 Defence advised the ANAO that periodic reconciliations had been conducted between the Defence estate data and Defence's financial asset systems. Additionally the successful contactors were given an updated estate data pack in September 2014.

- Defence's service specifications failing to identify local contracting arrangements in the previous contracts.<sup>34</sup>

3.12 Due diligence claims provide for 'material difference between the actual services encountered and those in the contract'. Defence extended the due diligence period for four of the Base Services contracts from May–August 2015 to June–November 2015, to give the contractors additional time to raise claims.<sup>35</sup> Defence advised the ANAO that the negotiated contracts contained a provision (contingency) of \$47.6 million per year for due diligence claims:

- As at 29 June 2016, completed due diligence claims amounted to an annual cost of \$44.08 million.<sup>36</sup>
- The time taken to process the due diligence claims ranged from 27 to 239 days, with the average time being 160 days. One claim was still in progress after 350 days.

*Communicating changes to roles, responsibilities and service delivery, to a geographically dispersed workforce*

3.13 Defence conducted a range of activities aimed at preparing Defence personnel for the transition to the Base Services contracts and accompanying changes to the Service Delivery Division Operating Model and IT support systems. These activities were guided by an Integrated Communication Strategy and included:

- transition directives, roadshows and workshops;
- information sheets detailing products and services delivered under the contracts;
- Frequently Asked Questions provided on the Defence intranet; and
- a Service Delivery Division reform email address to answer questions and relay feedback.

3.14 Defence's post-transition learning and development activities found that:

- despite attending information or training sessions to help with change, most staff did not feel that the desired outcomes of these sessions were achieved; and
- just one-third of staff reported that they understood how to use the interim Estate Management IT system, which is used to manage the new Base Services contracts (discussed in paragraph 3.43).

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34 Since contract signature, 1253 contract variations and changes have been submitted. These changes are managed through Contract Change Proposals, which include due diligence, new scope (including the introduction of new capabilities, changes to security requirements or legislation) and any other contract changes. As at July 2016, 593 Contract Change Proposals had been completed at an annual cost of \$179.3 million.

35 Defence internal correspondence at the time noted that due to the volume of due diligence claims, some Base Services contractors had been delivering essential services without being paid.

36 The completed claims encompass most of the service lines. Estate Upkeep, Land Management and Cleaning/Housekeeping are the service lines with the highest value changes—ranging from \$5.05 million to \$24.37 million per annum.

### Setting service expectations

3.15 During ANAO fieldwork, 25 of 83 regional Defence personnel (30 per cent) interviewed by the ANAO stated that the extent of the changes to base services under the new model was not accurately communicated to them, leading to a misalignment between their service expectations and the services actually delivered.

3.16 Table 3.2 details transition issues arising from shortcomings in the handover between incumbent contractors and new contractors who were unfamiliar with the local requirements, leading to gaps and delays in service delivery; and failure to include some services previously provided under 'local arrangements' in the new Base Services contracts, leading to a perception of a reduction in service delivery.

**Table 3.2: Issues with service delivery experienced during transition**

Service Line	Location	Transition Issues
Hospitality and Catering	Northern Territory	The contractor was not provided with adequate information to enable all aspects of catering support to be delivered. In some instances duty meals, rations and catering support to hospital patients were not provided.
Waste Management	National	Defence did not always provide accurate site maps to the contractor, and in some instances the contractor did not adequately orientate waste collection drivers to the sites, which resulted in some bins not being emptied.  The contractor did not have appropriate clearances to dispose of classified waste. Defence personnel were advised that they would need to use paper shredders to dispose of classified waste. This solution was not appropriate because some personnel did not have access to paper shredders and not all classified waste is paper, for example, explosive material used during training exercises.
Accommodation	National	Confusion regarding the allocation of accommodation keys after normal business hours.
Transport	Victoria and Tasmania	The previous contracts provided an ad hoc airport shuttle service. Under the new contracts this changed to a scheduled service. These changes to service delivery were not well communicated and caused issues because the high volume of trainees from regional locations prevented an effective scheduling solution from being achieved.  The contracts only provided for a single delivery of explosive materials at a scheduled time. A more frequent, flexible arrangement was considered necessary to meet training requirements. This arrangement was provided as a 'local arrangement' under the previous contracts, but was not captured in the Base Services contracts.

Source: ANAO analysis.

3.17 ADF Service personnel also told the ANAO that many of the issues identified during transition have since been addressed and rectified and that the Base Services contracts are now supporting the delivery of base services across the Defence estate. Appendix 3 of this audit report outlines how Defence collects information on contractor service delivery performance, including customer satisfaction surveys. Survey results indicated that satisfaction with base services was low (fewer than 50 per cent of respondents were satisfied or very satisfied).

## Did Defence effectively support the implementation of the new contract governance and management framework?

Defence was not fully effective in supporting the implementation of the new contract governance and management framework for its Base Services contracts. While a high-level framework was put in place to coincide with the commencement of the new contracts, most of the key supporting documents and agreements have not yet been finalised, some two years after the contracts were signed. There has also been limited guidance provided to key regional personnel, contributing to an inconsistent and slow transition to the new arrangements.

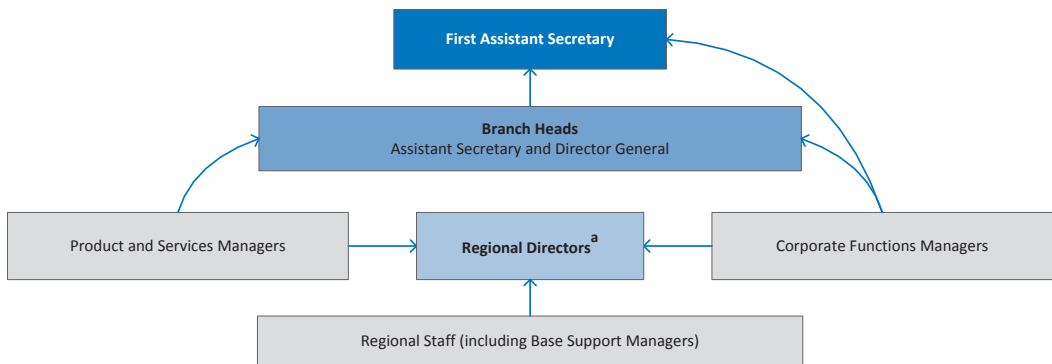
There were shortcomings in training arrangements for staff involved with the Base Services contracts, resulting from poor communication and implementation by Defence and failure by responsible staff to proactively access the training resources provided.

### Managing the contracts

#### National roles

3.18 Defence’s Service Delivery Division supports and manages the Base Services contracts, and provides regional staff to locally support service delivery at 119 Defence sites across Australia. The new Estate and Infrastructure Group Operating Model created 14 national-level Product and Services Managers, with national accountability for the budget, planning, support, delivery, and performance assessment of assigned service lines (for example, Access Control or Waste Management) across Australia.<sup>37</sup>

**Figure 3.1: Service Delivery Division organisational structure and reporting lines**



Note a: Regional Directors (EL 2.1) report to First Assistant Secretary.  
 Source: ANAO analysis of Defence documentation.

37 See paragraph 3.50 for details on the role Product and Services Managers play in performance assessment.

3.19 Defence has adopted a matrix-style arrangement for the day-to-day administration of the contracts:

- the reporting lines and accountabilities of the 14 Product and Services Managers are split among the five Regional Directors and two Branch Heads in Defence’s Service Delivery Division; and
- Regional Directors have both regional and national management responsibilities.

3.20 The 2015 First Principles Review found that:

Defence lacks a service delivery culture. This manifests itself in providers and customers not appropriately negotiating with each other, enabling functions not providing responsive services and customers duplicating functions as they do not believe they will get the required services.<sup>38</sup>

3.21 To address a finding from the 2015 First Principles Review, Defence is implementing an integrated Defence Service Delivery Model. Defence advised that it is in the process of reviewing and redesigning the governance arrangements for the Base Services contracts, including a redesign of the role performed by Regional Directors.

*Defence base roles*

3.22 The new Base Services contracts introduced the position of Estate Maintenance and Operations Services (EMOS) Manager at key Defence bases. This role is performed as part of the Estate Maintenance and Operations Services contract and assumes responsibility for most of the day-to-day delivery of contract services.<sup>39</sup> Some of these functions were previously performed by the Defence Base Support Manager. Figure 3.2 summarises the key service management positions at Defence bases.

**Figure 3.2: Key service management positions at a Defence base**



Source: ANAO interpretation of Defence documents.

38 Defence, *First Principles Review: Creating One Defence*, 2016, p. 50.

39 The EMOS Manager is usually co-located with the Base Support Manager.



## Guidance and training

### Guidance

3.23 Defence developed a suite of supporting documentation to coincide with the commencement of the new Base Services contracts. This suite principally comprised a *Defence Support Operations Contract Governance Framework* (June 2014), a *Contract Governance Directive* (July 2014), and associated *Instruments of Contract Authority*.

3.24 The new documentation gave greater emphasis to national contract management, while preserving a role at Defence bases in requesting and delivering on-base services. Given the move to national-level management of the Base Services contracts, the aim was to allow contract management and administrative resources, contract governance principles, processes and measures to be shared nationally—to support a consistent, common and resource-efficient approach to managing contracts.

3.25 The 2014 Contract Governance Directive required Defence’s Service Delivery Division to submit Contract Governance Plans for each Base Services contract. The Plans provide instruction and clarification on key contract management responsibilities, functions and activities. The Directive did not set a date for the Plans to be submitted and, as at July 2016, only four of the required ten Plans had been completed—those for Brookfield, Broadspectrum, Spotless and Compass Group.

3.26 Defence personnel interviewed by the ANAO indicated that they rely on a 2008 *Base Accountabilities Model* document to provide general guidance on the key management roles at Defence bases across Australia. This document has not been updated to reflect the changed governance arrangements at a regional level on Defence bases, for example, the addition of EMOS Managers.

3.27 A number of Defence reviews and surveys have highlighted the importance of clear messaging around the role of EMOS Managers (Box 2).

#### Box 2 Estate Maintenance and Operations Services (EMOS) Managers

Under the new Base Services contracts model, Defence customers use the EMOS Manager as the first point of contact for Base Services issues. A 2015 Defence review noted that:

... [It is] quite clear that where the EMOS is promoted, visible and accessible, the base operates relatively smoothly, whilst the contrary is also quite clear; where the EMOS is not promoted, has a minimal presence and is not readily accessible, the base has unhappy and frustrated customers.<sup>a</sup>

A later Defence survey (February 2016) reported that only seven per cent of respondents sought assistance from the EMOS Manager as the first point of contact, whereas 26 per cent raised issues directly with the Base Support Manager or other Service Delivery Division positions.

In early 2016, Service Delivery Division held three workshops to support a closer relationship between EMOS Managers and Base Support Managers. These workshops were considered to be useful by the staff who attended. In September 2016, Defence advised the ANAO that it ‘plans to continue the workshops as required’.

Note a: Defence, internal brief on a *Review of the Base Support Function*, 2015.

## Training

3.28 Around half of the Service Delivery Division's 1900 military and civilian personnel (in regional and national positions) changed roles under the new Operating Model. However, Defence decided that a staff transition plan was not required, as no staff would lose their jobs, or be forced to relocate.<sup>40</sup> In April 2015, Service Delivery Division commissioned a Base Support Function Review, which found that:

... there is a large difference in the tasks that Base Staff perform, or believe that they should do. The consistency of service delivery, expected from the implementation of the operating model, was not evident. ... There is an inconsistent message in the communications, and more importantly, a lack of a consistent understanding by base and Estate Maintenance and Operations Services (EMOS) staff, of the intent of the model.<sup>41</sup>

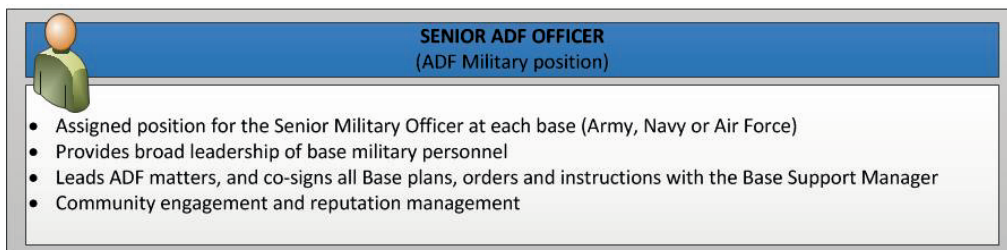
3.29 Defence ran training courses and provided online training materials for staff involved with the Base Services contracts. For example, Defence designed a 'Professionalising Contract Management' training course for staff, which was run between October 2014 and April 2015. However, based on feedback from staff, the implementation of the training program was ineffective. A number of Defence personnel interviewed by the ANAO indicated that they were not aware that training had been provided, were not able to attend training or were not satisfied with the quality of the training. Defence was not able to advise the ANAO on how many of the 14 Product and Services Managers, 37 Base Support Managers or the 42 Estate Maintenance and Operations Services (EMOS) Managers attended the course. ANAO analysis of the course attendance registers identified three Base Support Managers and two Product and Services Managers who had attended this course. The ANAO also observed that some Defence personnel did not make use of the online training materials provided.

3.30 Shortcomings in training for staff involved with the Base Services contracts were related to both poor communication and implementation by Defence and failure by staff to proactively access the training resources provided.

## Managing the relationship between Australian Defence Force personnel and Defence's Estate and Infrastructure Group

### Senior ADF Officer

**Figure 3.3: Key Australian Defence Force management position at a Defence base**



Source: ANAO interpretation of Defence documents.

40 As at 18 July 2016, the average vacancy rate in Service Delivery Division was 14 per cent. In some areas, more than 21 per cent of positions were vacant.

41 Defence, internal brief on a *Review of the Base Support Function*, 2015.

3.31 Each Defence base has a designated Senior ADF Officer who is responsible for a variety of leadership roles, community engagement and other corporate roles. Thirteen of the 23 Senior ADF Officers interviewed by the ANAO expressed concern that under the new Base Services contracting model, they do not have a detailed understanding of the contract deliverables.<sup>42</sup> A 2016 internal Defence audit also indicated that 62 per cent of sampled Unit Commanders were not familiar with the Base Services Contract Deliverables/Statement of Works, and were therefore unaware of what the contractor was required to deliver. Under the previous model, Senior ADF Officers were accustomed to receiving support materials.

3.32 Defence advised the ANAO that it was creating a 'Service Portal' to provide information on specific services and give access information to customers on how to request assistance for the specified service.<sup>43</sup> Defence further advised the ANAO that most Senior ADF Officers were provided with training on the Base Services contracts when they commenced the role. Material provided to Senior ADF Officers in 2014 made it clear that:

The new Contract model is outcome-based rather than prescriptive rules based.

Defence Partners should consider whether the service meets the desired outcome (fuel available, grass cut, office cleaned, meals available), rather than how many contract staff will complete the task or how often the task will be completed.<sup>44</sup>

3.33 Defence advised the ANAO that the Service Delivery Division was considering how to enhance this training. As noted in paragraph 3.30, training is a joint responsibility and the effectiveness of training initiatives relies on both its provision by the employer and take-up by personnel.

### *Service Level Partnering Agreements*

3.34 In February 2015, Defence introduced national Service Level Partnering Agreements between the Defence Estate and Infrastructure Group and its customers (Navy, Army, Air Force). These Agreements are intended to articulate the requirements and priorities of the customer, outline the products and services provided by the Service Delivery Division, and describe issue resolution processes and other governance matters. These agreements are an important mechanism to manage the relationship between Australian Defence Force personnel and Defence Estate and Infrastructure Group. Inconsistency between these documents can affect expectations of service delivery. As at August 2016, fewer than half of the 11 Service Level Partnering Agreements had been finalised (Table 3.3).<sup>45</sup>

3.35 In September 2016, Defence advised the ANAO that it was reviewing whether 'corporate enabler' groups needed to be covered by Service Level Partnering Agreements.

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42 The ANAO observed that those Senior ADF Officers interviewed for the audit who considered that they had a good relationship with the EMOS Manager were less likely to have this concern.

43 In the interim, a variety of information is available on the Defence intranet.

44 Defence, *Defence Support Operations Base Services Guide*, 2014.

45 A 2016 KPMG survey found that the new form of Partnering Agreements has value, including the relationships and networks formed during their development, and as a reference point.

**Table 3.3: Status of Service Level Partnering Agreements, as at August 2016**

	Status
Air Force	Signed
Navy	Signed
Army	Comments provided by Estate and Infrastructure Group (E&IG) for Army to review and finalise
Vice Chief of the Defence Force	Signed
Capability, Acquisition and Sustainment Group (CASG)	Comments provided by E&IG for CASG to review and finalise
Chief Finance Officer Group	Signed
Chief Information Officer Group	Under review by E&IG
Defence People Group	Signed by E&IG, but not Defence People Group
Defence Science and Technology Group	Completed, but not signed
Strategic Policy and Intelligence Group	Signed (Intelligence only) <sup>a</sup>
Joint Operations Command	Under review by E&IG

Note a: Following an organisational restructure, the Strategic Policy element of the Group is to be incorporated into the Intelligence Service Level Partnering Agreement.

Source: Defence documentation.

### *Base Support Agreements*

3.36 At the regional level, Base Support Agreements are intended to establish the management and accountability arrangements at each base. However, 50 out of 59 (84.7 per cent) of Base Support Agreements pre-date the current Base Services contracts, and 16 (27 per cent) are more than five years old. Defence advised the ANAO that some of the Base Support Agreements need to be reviewed, to align with the new Service Level Partnering Agreements.

## **Has Defence effectively implemented the planned Estate Management IT system to support the administration of the Base Services contracts?**

Defence has not effectively implemented the planned Estate Management IT system. Defence currently expects the new system to be deployed nationally at the end of 2017—some five years late.<sup>46</sup> When additional project costs and other costs are taken into account, upgrading the system has cost the taxpayer \$39.81 million (32 per cent) more than initially planned.

Defence’s interim Estate Management IT system remains in use, and has limited functionality. The system does not support service providers to effectively communicate the status of work orders to Defence customers, or enable Defence to collect and analyse data relating to its estate and the Base Services contracts.

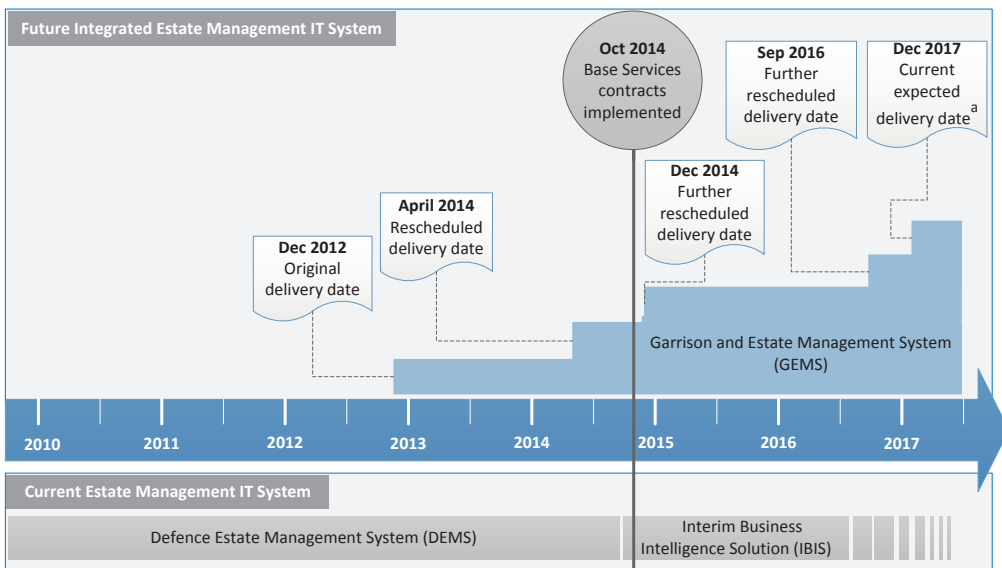
46 Defence advised the ANAO in November 2016 that parts of the system were technically deployed in January 2015, but that no users were provisioned.

3.37 A key feature of the new Base Services contracts is that contractors are required to use their own IT systems (rather than Defence systems) to manage their contracts and provide reports to Defence. Defence intended to upgrade its Estate Management IT system, by providing a new integrated system<sup>47</sup> compatible with the contractor’s IT systems. Tenderers were required to respond to the tender assuming that this new system would be in place at the time of contract signature.

3.38 The integrated IT system was intended for release in 2012, but the project has experienced many delays. Defence currently forecasts that the integrated IT system will be rolled out nationally by the end of 2017 (Figure 3.4). In 2013, Defence internal reporting noted that the reasons for project delays were:

- (a) A lack of understanding of the complexity of the project and the business impacts;
- (b) Inadequate internal stakeholder engagement in the first 18 months of the project;
- (c) Defence project team lacking in required expertise; and
- (d) Sub-optimal contractor performance which has not been managed effectively by Defence.<sup>48</sup>

**Figure 3.4: Defence’s Estate Management IT systems timeline**



Note a: Defence advised the ANAO in November 2016 that the expected delivery date includes a roll out period. See footnote 4. In July 2016, the contracted IT system developer advised Defence that there would be additional delays to the initial deployment date, but the delays would not impact the expected national roll out in 2017.

Source: ANAO analysis of Defence documentation.

47 Defence intends that the new integrated Estate Management IT system will deliver improved functionality for Defence in managing its estate including: a project management workflow; risk, compliance, financial and environmental management tools; and improved reporting capabilities. The integrated IT system is also expected to support Defence’s strategic management of the Base Services contracts, by enabling Defence to collect and analyse data that could help improve efficiency and service delivery.

48 Defence, internal brief on *Future Options for the Build and Implementation of GEMS* (the integrated IT system), 2013.

3.39 The integrated IT system received approval from Government in December 2010, with a total budget of \$121.29 million. This comprised a capital acquisition budget of \$84.39 million, \$20 million in net personnel and operating costs for sustainment for 10 years, and contingency of \$16.9 million. Since 2010 the total project budget has increased to \$135 million. This increase is due to additional costs that were not anticipated in the original business case such as additional computer hardware and software requirements and the engagement of external service providers (business analysts). The significance of introducing the system to the broader Defence information technology environment was underestimated and resulted in additional work. As at 30 June 2016, Defence had spent and committed \$92.7 million (excluding Defence Project Office personnel costs) to design and implement the new integrated Estate Management IT system. In September 2016, Defence advised the ANAO that ‘Australian Public Service personnel costs are not attributed to the project, in line with all Defence projects’.<sup>49</sup>

3.40 Additionally, delays to the development of the integrated IT system have cost Defence \$26.1 million for the development and maintenance of an interim IT system and reimbursements to contractors (Table 3.4).<sup>50</sup> The total cost of upgrading the Estate Management IT system is \$39.81 million (32 per cent) more than the planned cost of \$121.29 million.

**Table 3.4: Costs associated with the integrated and interim IT systems**

Item	Cost (\$m)
Build of the interim IT system	1.2
Maintenance costs for the interim IT system	8 <sup>a</sup>
Reimbursements paid to Base Services contractors to adapt internal systems to work with the interim IT system	16.9 <sup>b</sup>
Costs to develop the new Integrated IT system (project costs)	135
<b>Total</b>	<b>161.1</b>

Note a: The current estimate is based on a cumulative cost of \$2 million per financial year from 2013–14 to 2017–18.

Note b: Includes \$12.1 million paid and an estimated \$4.8 million in future reimbursements.

Source: ANAO analysis of Defence documentation.

3.41 The Base Services contracts are currently managed using an interim IT system which was intended as a temporary solution to support the Base Services contracts during the transition period. The interim system holds key data sets relating to the Defence estate but it does not provide the functionality promised by the new integrated system. When it was built, Defence noted that the interim system was:

... not transactional, will only have historical data (up to one month delay depending on timing of uploads of contractor data), and will not provide visibility of expenditure. It will require manual effort to draw reports and information ... Further, the interim database will not provide the vital business intelligence/analysis to support the reform efficiencies expected from the new

49 The 2015 First Principles Review and a 2016 Total Cost of Ownership review advised that Defence should capture Australian Public Service personnel costs in Defence project budgets. See Table 2.1, Table Note g.

50 Defence advised that there would be additional reimbursements to base services providers for the cost associated with adapting to the new integrated IT system when it is rolled out in 2017.

contracts and will not support the wider ... estate management functions such as major capital facilities projects.<sup>51</sup>

3.42 These limitations prevent effective reporting on contractor performance, and Defence has acknowledged that it is not able to effectively collect and analyse data relating to its estate and the Base Services contracts.

3.43 The delay in implementing the new system has also affected the relationship between Defence personnel on bases and the Base Services providers. The service providers use IT support systems that are not integrated with Defence's IT systems. This limits opportunities for the contractor to communicate with Defence personnel, particularly in relation to the status of Service Requests. As the interim IT system was only intended to be a temporary solution, training was initially limited. A Defence customer satisfaction survey in February 2016 reported that 61 per cent of surveyed Defence personnel did not think that Base Services contracted staff kept them informed about the progress of a Service Request. Of the 65 regional Defence personnel interviewed by the ANAO, 19 commented on the difficulty in tracking the status of work orders due to the incompatibility of the contractors' and Defence's IT systems.

3.44 The risks associated with developing IT systems are well known to Defence.<sup>52</sup> Defence had identified the risk of a delayed implementation of the new IT system, and sought to mitigate the risk by developing an interim system. Nonetheless, the IT component of the Base Services initiative remains five years behind schedule, as integration risks and project complexity were underestimated.

## Has Defence implemented arrangements to assure the performance of its Base Services contractors?

Two years into the Base Services contracts, Defence has not fully implemented a consistent and structured approach to assure itself over contractor performance. For example, Performance Assurance Instructions for contract management personnel remain in draft form.

In the absence of finalised Instructions and subsidiary national guidance, the responsible Product and Services Managers have developed local approaches to assuring contractor service performance on Defence bases. A 2016 internal Defence audit concluded that existing processes do not provide adequate assurance that the self-assessment results provided by contractors are a fair and reasonable reflection of the actual performance standards delivered. Defence advised the ANAO that it has initiated a review of its process for performance assessment, reporting and assurance.

3.45 Consistent with its outcome-focussed model, the Base Services contracts incorporate a Performance Management Framework that requires the contractors to:

- manage and maintain a Quality Management System certified to comply with AS/NZS ISO 9001:2008 (ISO 9001) and implement their own internal controls; and

51 Defence, internal brief on *Future Options for the Build and Implementation of GEMS* [the integrated IT system], 2013.

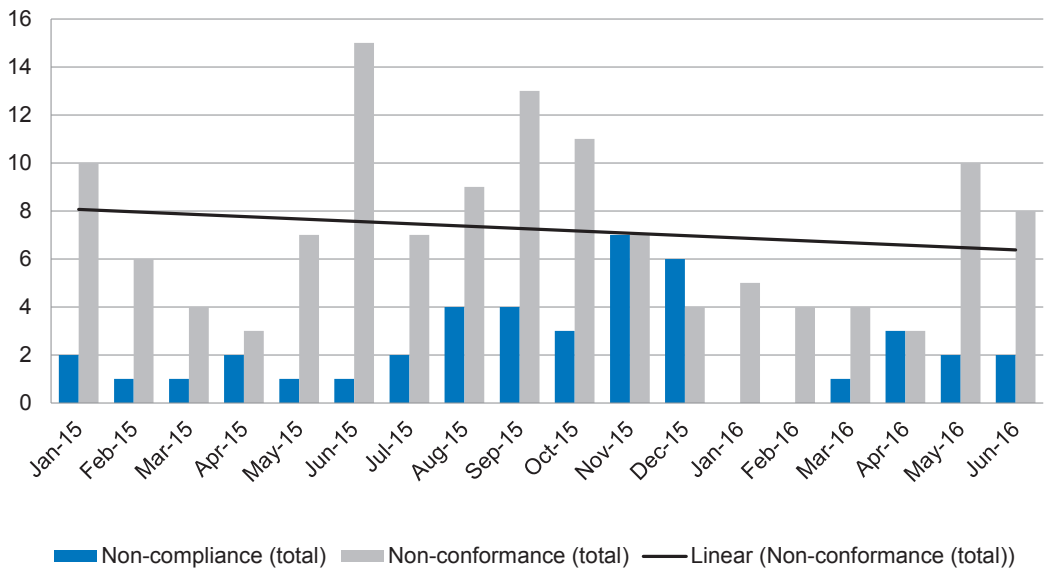
52 See, for example, ANAO Audit Report No. 27 2014–15, *Electronic Health Records for Defence Personnel*.

- self-assess and identify, investigate and remediate any non-conformances and record all non-conformances in the contractor’s Quality Management Systems.

3.46 Under the Framework, the onus is on the contractor to report any non-conformances or non-compliance.<sup>53</sup> In 2015, the Base Services contractors provided Defence with between 95 and 98 per cent of the required monthly reports on conformance and compliance. This decreased in 2016, with 80 per cent of the required reports delivered to Defence.<sup>54</sup>

3.47 Since contract commencement in July and October 2014, there have been 130 non-conformances and 42 non-compliances reported by the contractors. As at May 2016, this has resulted in 14 abatements<sup>55</sup> with a total value of \$856 133. On average, the number of reported non-conformances is trending down (Figure 3.5).

**Figure 3.5: Incidents of non-conformance and non-compliance reported by the Base Services contractors**



Source: ANAO analysis of Defence documentation.

3.48 In February 2016, a Defence evaluation concluded that the Base Services contractors had mature Quality Management Systems in place.

53 Conformance Indicators relate to the contractual requirements, and Compliance Indicators measure Contractor compliance with legislative, regulatory, Australian Standards and Defence policy requirements.

54 Service Delivery Division’s Contract Governance Directorate has reported that, due to a changed email account at the beginning of 2016, some monthly reports were not received. The Directorate is in the process of sourcing these reports from the Contract Authorities.

55 Abatement is the reduction of the value of monies owed for goods or services that have been supplied as a result of not meeting compliance or performance thresholds. The contractors had a nine-month ‘grace period’ during transition where abatements would not be raised in response to non-conformance with Performance Indicators. Compliance Indicators were abatable from day one of the contracts.



## Defence's assurance processes

3.49 Defence's draft 2016 Performance Assurance Instructions state that Defence has an obligation to take measures to be satisfied that the performance assessments undertaken by the contractors are fair and reasonable. This includes whether the contractor has correctly reported each non-conformance and/or met the required compliance and performance targets and indicators. The instructions recognise that the level of Defence's assurance effort and frequency should take into account the level of trust and confidence in the Base Services contractor, with decreasing assurance effort and frequency as trust levels increase, and vice versa.

3.50 Two years into the Base Services contracts, guidance is still being drafted and Defence has not fully implemented a consistent and structured approach to performance assurance. In the absence of finalised Instructions and subsidiary national guidance, the ANAO observed that the responsible Product and Services Managers had developed local approaches to assuring contractor service performance on Defence bases.<sup>56</sup> These approaches typically involve:

- Performance Assurance Plans;
- performance assurance checklists<sup>57</sup>; and
- registers to record issues raised and resolved.

3.51 One example of differing local practices relates to assurance checklists, which can vary from a few focussed questions to over 80 highly detailed questions.

3.52 There is also little evidence that Defence reviews the assurance checklists to respond to changing risk profiles, or to identified areas of non-conformance or non-compliance. Defence's draft 2016 Performance Assurance Instructions state that Product and Services Managers are expected to perform a monthly reconciliation between the results of their performance assurance activities, and the contractor's reporting of non-conformance and non-compliance.

3.53 A 2016 internal Defence audit of the Base Services contracts concluded that:

The existing assurance processes do not provide adequate assurance that the self-assessment results provided by the Contractors are a fair and reasonable reflection of the actual performance standards delivered. Therefore Defence may not be achieving value for money.<sup>58</sup>

3.54 In September 2016, Defence advised the ANAO that in response to the internal Defence audit, the Service Delivery Division had initiated a review of its process for performance assessment, reporting and assurance.

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56 One Product and Services Manager interviewed by the ANAO was not aware they were responsible for performance assurance tasks, and as such, this task had not been performed until mid-2016.

57 Defence advised the ANAO in June 2016 that all Product and Services Managers are expected to review the assurance checklists. This has occurred across a number of service lines.

58 Defence, 2016, internal audit of the Base Services contracts.

## Recommendation No.2

3.55 That Defence:

- (a) finalises its Contract Governance Plans, Service Level Partnering Agreements and Base Support Agreements;
- (b) ensures that personnel performing key roles in the Base Services contracts model are provided with up-to-date guidance on the requirements of their roles; and
- (c) develops a cost-effective approach for obtaining assurance over (validating) self-reported information provided by contractors.

**Defence response:** *Agreed.*

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Grant Hehir  
Auditor-General

Canberra ACT  
14 December 2016

# Appendices



## Appendix 1 Entity response to Section 19 proposed report



Australian Government  
Department of Defence

SEC/OUT/2016/292  
CDF/OUT/2016/972

Dr. Tom Ioannou  
Group Executive Director  
Performance Audit Services Group  
Australian National Audit Office  
PO Box 707  
Canberra ACT 2601

### AUSTRALIAN NATIONAL AUDIT OFFICE REPORT PREPARATION PAPERS ON DESIGN AND IMPLEMENTATION OF DEFENCE'S BASE SERVICES CONTRACTS

1. Thank you for your correspondence which contained the s19 Proposed Report for the subject audit.
2. Attached to this letter are Defence's Proposed Amendments, Editorials and Comments (Attachment 1), Responses to Requests for Information (Attachment 2), Responses to Recommendations (Attachment 3) and Agency Response (Attachment 4), which contain Defence's formal response to the Papers.
3. We would like to take this opportunity to formally thank the ANAO for the time and resources they have allocated to the audit. Defence acknowledges the findings identified in this report and will undertake to implement all recommendations.

**Brendan Sargeant**  
Acting Secretary

27 November 2016

R1-5-CDF Suite  
PO Box 7900  
Canberra BC ACT 2610

#### Attachments:

- A. Proposed Amendments, Editorials and Comments
- B. Responses to Requests for Information
- C. Response to Recommendations
- D. Agency Response

**MD Binskin, AC**  
Air Chief Marshal  
Chief of the Defence Force

27 November 2016

### AGENCY RESPONSE

- Defence acknowledges the findings contained in the audit report, and accepts the two recommendations.
- The Strategic Reform Program required a budget reduction in enablers, such as base services, to support the delivery of the 2009 Defence White Paper. That program and approach is now obsolete. Defence now operates within a new environment, with government support for enablers established through the 2016 Defence White Paper.
- The establishment of the new Base Services Contracts provided opportunities for Defence to improve its value for money outcomes by leveraging volume, increasing standardisation, and better managing supply and demand, whilst introducing innovation and efficiency provisions.
- The changing strategic context of the Defence business directly impacts the demand on base services, and consequently, the costs of these services. For example, the program for future capability builds, demands an increased service delivery capability response. This places increasing demand on our services and bottom line expenditure.
- The ANAO highlights the complexity of the Base Services Retender process, emphasising the size and scale of the changes involved.
- Whilst it is noted that the ANAO states contract rates have not increased, Defence considers that the ANAO's finding, that value for money objectives have not been demonstrated, are based on comparing the negotiated price with the actual expenditure in 2015–16. Similar comparisons have been made in relation to 10 year forecasts.
- Defence seeks to monitor and report on value for money objectives by assessing any additional expenditure against the value of additional services received.
- Defence is of the view that the Base Services contracts have resulted in a lower cost to Defence for the increased base service demands than if this increased output had occurred under previous arrangements.

## Appendix 2 Introducing incentives to promote contract cost efficiency and innovation

### Incentives to promote contract cost efficiency and innovation

The Base Services contracts contain a long-term incentive to drive contractor performance efficiencies: potential contract extensions (up to four years) for achieving or exceeding strategic and/or performance dimensions. The contracts also contain provisions to promote innovation and efficiency throughout the life of the contract, including:

- gain-share initiatives;
- Business Improvement Plans; and
- Customer-Pays provisions for certain services.

#### Gain-share initiatives

‘Gain-share’ refers to a collaborative agreement between Defence and the Contractor about initiatives which result in more efficient and cost-effective service delivery. Both parties share in cost savings.

During contract negotiations, Defence and Veolia (national waste contractor) agreed a gain-share initiative. The net savings from the initiative were shared 50/50 for the first 12 months, and after that period, all savings are harvested by the Commonwealth, and the Contractor is remunerated to deliver the initiative. The current rebate to Defence is \$850 000 per annum.

Defence advised that, as at August 2016, no further gain-share initiatives had been finalised, but two were being considered (out of 10 contracts). This low level of take-up is consistent with overseas experiences in the use of gain-share incentives in supplier contracts.<sup>59</sup>

#### Business Improvement Plans

Contractors are required to develop Business Improvement Plans, which aim to provide ongoing improvements in efficiency and effectiveness over the contract duration, including service optimisation strategies. Each Base Services contractor was required to provide a Business Improvement Plan within six months of the contract commencement date and to update the Plan annually. Defence is also required to review these Plans annually. The ANAO observed that:

- only three of the 10 Base Services contractors submitted a Business Improvement Plan within the required timeframe. As at August 2016, two contractors had still not submitted their Plans; and
- Defence has not provided the ANAO with evidence that it has had reviewed the contractor’s Business Improvement Plans.

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59 A 2013 United Kingdom National Audit Office review of contract management found that ‘Suppliers do not typically originate opportunities and there is a perceived reluctance towards innovation (change) by suppliers, even where gain share mechanisms are in place ... In some instances, lack of supplier innovation may be due to suppliers having difficulty in meeting minimum service thresholds and having limited time and resources to consider improvements.’ Stakeholders consulted by the ANAO during the audit highlighted that the significant time and resources for service providers and Defence personnel to adjust to the new contracts militated against the earlier introduction of gain-sharing innovations.

Defence's guidance for Business Improvement Plans was finalised in August 2016.

### Customer-Pays

Under the Base Services contracts, Defence introduced a nationally-consistent 'Customer-Pays' arrangement for selected services (Table A.1 has Customer-Pays examples).

**Table A.1: Examples of Customer-Pays items**

Service Line	Type of Service	Customer-Pays guidance
Transport	Transport to ANZAC day events	<b>Estate and Infrastructure Group pays:</b> Movement of groups of ADF personnel to and from parades and ceremonial events  <b>Customer-Pays:</b> Meetings to plan ANZAC Day activities. Self-drive unit or pool vehicles or taxi should be utilised. Approved by Service Provider.
Access Control	Additional Guards	<b>Customer-Pays:</b> Includes additional guards required for the delivery of capital projects, dining in nights, open days or to escort people without appropriate clearance.
Housekeeping	Valet Services	<b>Customer-Pays:</b> Valet services were excluded from Base Services contracts.
Hospitality and Catering	Unit Working Meals	<b>Customer-Pays:</b> For meals and light refreshments provided to enable the transacting of official business. Working meals may include morning/afternoon teas, breakfast, lunch and dinner.
Transport	Sporting activities included on the ADF Sports Council Rolling Program of Activities	<b>Estate and Infrastructure Group pays:</b> For the movement of teams to rail/air/bus terminals within the geographic location of the team for events. Defence policy limits Estate and Infrastructure Group funding responsibility to movement of personnel to departure hubs (air, bus or rail terminal) within their geographic area.

Source: Defence.

If customers (Defence Bases and Units) decide to use these services they are required to pay the Base Services contractor directly at the rates specified in the contracts. For some services, the customer groups were returned amounts in their budgets to allow for the extra costs, and where Estate and Infrastructure Group would fund the services, the relevant funds were transferred from the customer groups.

Nationally-consistent Customer-Pays arrangements were intended to enable Defence to better manage demand and supply for these services. While Defence has not yet conducted any comparison with pre-Base Services contract costs or demonstrated any change in demand, Defence's Service Delivery Division intends to conduct this analysis in late 2016. Defence advised the ANAO they were unable to extract the number of Customer-Pays requests and associated expenditure from their systems.



## Appendix 3 Potential sources of data to assure contractor service delivery performance

### Base Management Forums

Military and Service Delivery Division staff on Defence bases are required under the Base Accountabilities Model to hold Base Management Forums every month between February and November. The minutes from each Base Management Forum are expected to be available on the Defence intranet.

- Defence does not review the Forum outcomes to identify service performance issues that are arising across the regions or to identify useful regional solutions that could have wider potential application.
- Analysis would also assist Defence to identify non-compliance with the requirement to hold Forum meetings. For example, the ANAO found that 19 ADF bases (33 per cent) had not held Forum meetings each month in 2016 and two bases had not held them at all.

### Customer Satisfaction Surveys

Defence conducts regular internal customer satisfaction surveys of its 76 000 personnel on a range of subjects. Satisfaction with base services is low, but it has improved marginally in 2016.

**Table A.2: Results from the Customer Satisfaction Surveys**

	August 2015	February 2016	June 2016
Satisfied and very satisfied response to 'overall satisfaction with the base services'	41%	44%	45%

Source: Base Services Customer Satisfaction Surveys, Orima.

The existing survey instrument is broadly focussed and asks few detailed questions about the performance of Base Service contractors. Enhancements to this survey, or preparing a more targeted survey instrument, could provide Defence with a cost-effective source of insight into perceived contractor performance.

### Analysing complaints information

Defence has introduced regional 'Transparency Registers' to provide a database of service delivery issues and provide up-to-date tracking on the status of each issue. Data from these registers show that while approximately 39 per cent of tasks (489/1249) are completed within seven days, 40 per cent of tasks (505/1249) take at least one to two months to be resolved. Defence advised the ANAO that there is currently no national-level analysis undertaken of the regional Transparency Registers, and Defence is in the process of creating national-level Transparency Registers.

If issues cannot be solved at a regional level, or the issue is perceived to have an impact on that unit's capability, preparedness or ability to generate force requirements, Military staff can raise it directly to Senior Executives in the Defence Estate and Infrastructure Group by using the Partner Engagement Relationship Management Tool (PERMT). This is intended to be the final step in the issues resolution process. PERMT is not linked to other issues resolution processes, limiting Defence's ability to compare and contrast issues raised at a regional and national level.

At 15 August 2016, Defence advised the ANAO that since the commencement of the Base Services contracts, there have been 344 issues raised in PERMT, 262 of which had been resolved and took an average 124 days to resolve.

### *Data analytics*

At present, Defence systems do not support the systematic analysis of data for contract performance assurance purposes. Defence could collect a wide range of management information about its service requirements at its bases including:

- building maintenance schedules;
- transport pool vehicle use and mileage; and
- course enrolments and training exercises to forecast requirements for accommodation bookings, room keys and meal volumes.



