



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

**Reference: Financial management and equipment acquisition at the Department of
Defence and Defence Materiel Organisation**

THURSDAY, 19 OCTOBER 2006

CANBERRA

BY AUTHORITY OF THE PARLIAMENT

**JOINT STATUTORY COMMITTEE OF
PUBLIC ACCOUNTS AND AUDIT**

Thursday, 19 October 2006

Members: Mr Anthony Smith (*Chair*), Ms Grierson (*Deputy Chair*), Senators Mark Bishop, Hogg, Humphries, Murray, Nash and Watson and Mrs Bronwyn Bishop, Mr Broadbent, Dr Emerson, Dr Jensen, Miss Jackie Kelly, Ms King, Mr Laming and Mr Tanner

Members in attendance: Senators Mark Bishop and Hogg and Mrs Bronwyn Bishop, Mr Broadbent, Dr Jensen, Ms Jackie Kelly, Mr Anthony Smith and Mr Tanner

Terms of reference for the inquiry:

To inquire into and report on:

Progress in implementing systematic reforms in the areas of financial reporting and equipment acquisition at the Department of Defence and the Defence Materiel Organisation (DMO), as identified in ANAO financial and performance audits, the Defence Procurement Review 2003 (the Kinnaird Review) and the Senate Foreign Affairs, Defence and Trade References Committee's 2003 Report on the Inquiry into Materiel Acquisition and Management in Defence, including the following:

- Progress in implementing Defence's financial remediation plans, relative to international best practice in these areas, and recommend any further measures that can be adopted;
- Progress in implementing the Kinnaird Reforms, relative to international best practice in these areas, and recommend any further measures that can be adopted;
- Review Australia's relative achievements in procurement and financial reform relative to international best practice in these areas of defence administration; and
- Assess progress in Defence's adoption of international business accounting standards relative to international best practice in this area of defence administration.

INTERNET

The Proof and Official Hansard transcripts of Senate committee hearings, some House of Representatives committee hearings and some joint committee hearings are available on the Internet. Some House of Representatives committees and some joint committees make available only Official Hansard transcripts.

The Internet address is: **<http://www.aph.gov.au/hansard>**

To search the parliamentary database, go to:
<http://parlinfoweb.aph.gov.au>

WITNESSES

COONAN, Mr Darren, Senior Director, Performance Audit Services Group, Australian National Audit Office1

CRONIN, Mr Colin, Executive Director, Performance Audit Services Group, Australian National Audit Office1

McPHEE, Mr Ian, Auditor-General, Australian National Audit Office1

MEERT, Mr John, Group Executive Director, Performance Audit Services Group, Australian National Audit Office1

ROBERTS, Mr Brendan, Board Director, Australian Aerospace1

SAPORITO, Mr Joseph, Chief Executive Officer, Australian Aerospace1

WILSON, Mr Bob, Acquisition Contract Manager, Australian Aerospace1

Committee met at 10.41 am

ROBERTS, Mr Brendan, Board Director, Australian Aerospace

SAPORITO, Mr Joseph, Chief Executive Officer, Australian Aerospace

WILSON, Mr Bob, Acquisition Contract Manager, Australian Aerospace

COONAN, Mr Darren, Senior Director, Performance Audit Services Group, Australian National Audit Office

CRONIN, Mr Colin, Executive Director, Performance Audit Services Group, Australian National Audit Office

McPHEE, Mr Ian, Auditor-General, Australian National Audit Office

MEERT, Mr John, Group Executive Director, Performance Audit Services Group, Australian National Audit Office

CHAIR (Mr Anthony Smith)—I welcome everyone here this morning to our hearing for the committee's inquiry into financial reporting and equipment acquisition at the Department of Defence and the Defence Materiel Organisation. As many of you know, as part of this inquiry we are examining several defence projects in detail, with a focus on acquisitions and project management processes at Defence and the DMO. Last week we looked in some detail at the fast frigate upgrade project and today, similarly, we are investigating the acquisition and project management of the Tiger armed reconnaissance helicopter project.

Earlier this year, the Audit Office released a critical report on the Tiger helicopter project. The report found that DMO had accepted three of the helicopters despite them not meeting the performance criteria set out in the contract. This has impacted on the ability to train aircrews and subsequently defence capability, as there was not yet an operational Tiger helicopter. The committee is aware that during Senate estimates hearings Defence disputed some of the Audit Office's findings.

This morning's hearing will take evidence from Australian Aerospace Ltd, who is the prime contractor for the Tiger project. If time permits, we will also take evidence from DMO. If we do not get around to that today, as with last week, we will take evidence from DMO at a later date. We also have the Audit Office here for this public hearing.

Before beginning, as always, I advise witnesses that the hearings today are legal proceedings of the parliament and warrant the same respect as the proceedings of the House itself. The giving of false or misleading evidence is a serious matter and may be regarded as contempt of the parliament. The evidence given today is being recorded by Hansard and will attract parliamentary privilege. Would you like to make an opening statement before we proceed to questions?

Mr Saporito—First of all, I would like to mention that it would have been preferable for us to have present today the former ARH project director, Marc Jouan, who was in charge of the

project for six years. Marc has been promoted to a new position in Eurocopter. After six years in Australia, he has left Australian Aerospace to go back to the parent company. So we have Bob Wilson, who is the acquisition project manager and has been in this position for one year. Maybe all of us do not have the complete detailed history about the project, but we will do our best to answer your questions.

The Tiger helicopter is a world leader in its class. It will give the Australian Defence Force the best armed reconnaissance helicopter system available and because it can be upgraded it will continue to be the cutting edge for decades to come. I can assure the committee that the acquisition program is completely on budget. It is a fixed price contract so it has to be on budget. The Commonwealth of Australia has not paid and will not pay one additional dollar.

The Tiger armed reconnaissance helicopter uses the most advanced technology. It is made of the latest composite fibre materials and incorporates some genuinely ground-breaking systems. For example, we have successfully integrated the hellfire missile system into the Tiger. This is a world first, achieved here in Australia. Also, we have developed and integrated a customised communication suite to meet the specific requirements of the Australian Defence Force. We have achieved this and other milestones through the extensive Australian Industry Involvement program, which means a large proportion of the work on the Tiger is being carried out in Australia. So far the Australian Industry Involvement program has generated direct investment in the order of \$40 million, around 300 new long-term jobs and a planned injection of \$640 million into the Australian economy which is now in implementation. The investment and the jobs this program is creating are in highly skilled areas such as system engineering, software engineering and complex aircraft assembly and maintenance. Australia and Australian Aerospace can be justifiably proud of this helicopter, the development program and the contribution it is making to the Australian economy in highly skilled local jobs.

Having said that, this is an extremely complex project and like all projects as complex as this one there have been some challenges—that is inevitable. Australian Aerospace and the Defence Materiel Organisation are working hard together to develop innovative solutions and to solve all the problems. Technical training for the Army is well under way. It has been going on for over one year. The Army believes these courses are of an extremely high standard. Systems training has been carried out and, again, this training course is highly regarded. The training of ground crew is starting and technical training of aircrew is also under way. Flying training has not progressed as planned. This delay in flying training is directly associated with a delay in establishing the full flight simulator in Oakey, and we are no longer reliant on training using aircraft. Thus, for trying training, Australian Aerospace has created a topnotch training team, which includes outstanding ex-Army pilots, not only from Australia but also from the United Kingdom, the United States and France. This has brought experience and expertise which previously has not been available in Australia. I think this clearly demonstrates Australian Aerospace's commitment to this project.

In summary, Australian Aerospace, the Australian Defence Force and the Defence Materiel Organisation are working together cooperatively and tirelessly to ensure the Tiger armed reconnaissance helicopter gives Australia the best aircraft of its type anywhere in the world. We have promised to do that and we will deliver on the promise. In conclusion, Australian Aerospace is proud of what we have achieved with the Tiger program. I remember when we were digging the first soil for the new facility in Brisbane—it was a bare piece of land—in

September 2002. In May 2003, we officially opened the building in the presence of the Minister for Defence and we launched the Tiger assembly line. Today at the same place we have more than 70 workers and managers, mostly in highly skilled jobs which we have created, who are working on delivering to Australia the most advanced helicopter in the world. So far we have delivered six aircraft. These aircraft have flown 1,200 hours. Sixteen are in process in the Brisbane facility assembly line. The bare structure of the last ARH arrived two weeks ago and is in process and being assembled in Brisbane.

As of today, the Australian economy has received an injection of about \$350 million. It consists of assembly line manufacturing of components, harnesses and subsystems, software engineering, system engineering and training devices. This is, to date, 53 per cent of the planned \$640 million that we have in the Australian industry program. Australian Aerospace is proud of what we have achieved with the Tiger program in Australia. Thank you for giving me the opportunity to give this statement and provide a background on the Tiger project.

If I may add a more personal comment. This statement is not a strategic speech to soften the questions we will get this morning. It is just to acknowledge the outstanding job done by the Australian teams to make this project as successful as possible. We will spend the next hour speaking about the program and what could have been done differently, but it is worth spending some minutes to reward all of their efforts. I can honestly tell you that I have been working for 23 years in the rotor-wing industry and, in my career, it is the first time I have had to face such a challenge. I am so proud of my team in facing such a complex challenge. Thank you.

CHAIR—Thank you for your opening statement. Mr Wilson, you said you are now the head of the project—is that correct?

Mr Wilson—On the day-to-day basis, yes. I am the acquisition manager.

CHAIR—How long have you been doing that?

Mr Wilson—For 12 months. Since August last year. It was an internal promotion to that position.

CHAIR—It was mentioned in the opening statement that your predecessor did the job for six years.

Mr Saporito—Six years, yes.

CHAIR—Where has he gone? Was it back to the parent company?

Mr Saporito—Marc Jouan is now in charge of marketing for all attack helicopters. He has a senior position in the company. Given the experience he got here in Australia working on this complex platform, he was promoted.

CHAIR—I appreciate your point that with that change you might not readily have at hand answers to everything today. I just point that out for members. Would you be happy to take any questions you cannot answer today on notice—as we call it here in the parliamentary business—

and track down some of those answers in detail and provide them back to the committee, if there is a gap that we cannot fill today?

Mr Saporito—Yes, not a problem.

CHAIR—That is good. How many helicopters have been delivered?

Mr Saporito—Six.

CHAIR—At the time of the audit report in May 2006 there were four—is that right?

Mr Saporito—Yes.

Mr Cronin—That is when it was tabled on 2 May. When we finished it, four had been delivered at the time of preparation of the report.

CHAIR—So it was January-February—is that right?

Mr Cronin—Yes, around there.

Mr Saporito—Six have been delivered and ARH7 and 8 are ready for acceptance or will be delivered very soon.

CHAIR—So there are six and a couple more very soon. Could I open up some questioning on the contractual process, which is what we are particularly interested in. As I said last week, we have chosen a number of audit reports on big contracts as case studies for our wider inquiry. You would be aware that our inquiry really is on the contracting process at Defence and DMO. Mr Wilson, do you think that the contract, in hindsight, was well enough defined?

Mr Wilson—Yes, I believe it was, but it was a very compressed negotiating session, from what I have read—I was not involved in that. We were dealing with a very complex system and actually defining that closely led to some interpretation. I believe that if you sit down and read the statements of work, you will find they are very well done. But even with that level of detail, they can still not necessarily catch all the nuances—though, I guess, one should not use that word ‘nuances’ in contracting—of either parts of the negotiating team. The statements of work are quite comprehensive.

CHAIR—With the additions to the contract, what were the major elements that required the contract changes? You would be dealing with those now, would you not?

Mr Wilson—Yes. The significant changes are to do with the full flight mission simulator—in fact, the image projectors, part of the simulator and a decision to apply motion to the simulator in two areas instead of one area as originally intended.

CHAIR—How did you go about documenting those changes with Defence or DMO?

Mr Wilson—They would have been through a full CCP process.

CHAIR—What is that?

Mr Wilson—Contract change process. In the development of that contract change process, a detailed statement of work would have been prepared which describes the technical aspects of the requirement and the schedule aspects of the requirement, and the cost of the requirement.

Mr TANNER—Firstly, the impression from the audit report which the Audit Office essentially confirmed this morning is that this contract started life as an off-the-shelf purchase, albeit with a new product, and that gradually over time it morphed into the purchase of a more customised product where the effective changes to the product were made. Therefore, the problems that have emerged with respect to delivery on time according to specifications can perhaps be attributed to that change. Is that an accurate description of what has occurred and how has that come about?

Secondly, in September 2004 your company proposed that the price of the through-life support contract be increased by 84 per cent, according to the audit report. Could you explain to the committee what was the cause of that claim for a very substantial increase in price of that contract. To what extent was that connected with the shift from an off-the-shelf design to a customised design?

Mr Saporito—In answer to the first question, from an industry perspective, the ARH is an off-the-shelf aircraft because it is mainly based on an aircraft that designed for the European program—the Franco-German program. The basic vehicle is exactly the same. We have just taken some equipment from the French aircraft and some equipment from the German aircraft to build an ARH. It is an off-the-shelf aircraft. There have been two major customisations. One was the integration of the hellfire system, which has been fully successful. It is a US missile and it is the first time a US missile has been integrated in a European platform. It was a challenge but we did it. It has been completely successful.

Mr TANNER—Was that intended to occur at the point where the contract was signed?

Mr Saporito—Yes.

Mr TANNER—In other words, it was not totally an off-the-shelf product, even at the time of the contract being entered into—is that right?

Mr Saporito—I was just saying off the shelf except for the integration—

Mr TANNER—I just want to clarify whether the time you are talking about was at the commencement of the contract.

Mr Saporito—Yes. At the commencement of the contract we knew that we had to integrate the hellfire missile and we knew that we had to customise a radio communication system, which is specific to it. It is always the case that we have to customise it. Every nation has a radio communication system.

Mr TANNER—Have there been subsequent customisations of aspects of the platform that were agreed post the entering into of the contract?

Mr Saporito—No.

Mr TANNER—That seems to be a very different picture from the one that the Audit Office painted.

Mr Wilson—There are further customisations that range from providing two litres of drinking water up to developments of video replay on the mission management system. So yes, there are customisations, but—

Mr TANNER—By the sound of it they are smaller.

Mr Wilson—From the small to the large are the result of refinements in technology that have occurred since the contract signature. We have gone to digital video replay instead of analog replay, for example.

Mr TANNER—Presumably they would not be major variations in the contract.

Mr Wilson—They can have an impact in the sense that, whilst they may seem minor, we have to apply a full design process and a systems engineering process that involve a series of hurdles that have to be crossed. That requires close cooperation between the customer and us to work through the design process. That is usually the delaying factor or the most complex factor in some of these technical things.

Mr TANNER—Would it be fair to say that those kinds of things—given the length of time that it would take to complete a project of this kind—would often occur by normal process and that during the course of the contract there might be some change in technology or something like that where it would be natural to take that opportunity?

Mr Saporito—Yes.

Mr TANNER—My second question was on the claim for an increase in the through-life support contract.

Mr Saporito—At the time of initial discussions with DMO and signing the contract we were aware the aircraft was not totally in serial production—it was being produced but not completely delivered—so some of the cost had to be based on estimates. We are now better equipped on both sides to understand how to maintain the platform. We have a better understanding of what is requested of industry and so we are working with DMO to find a better vision of and a better approach to the TLS cost of the platform.

Mr TANNER—Given my initial assumption is not correct, this raises a reasonably serious concern for this committee, which is that a big question mark is cast over the quality of the decision making with respect to the original contract if there is such a large variation in the subsequent estimate of the cost of the through-life support contract. That means that, in effect, the original decision is being made, by the sound of it, with a degree of ignorance or guesswork which I would certainly regard as unacceptable. Can you respond to that?

Mr Saporito—First of all, the figure mentioned in the annual report is not a figure we have in our books. We do not understand the figure that was mentioned.

Mr TANNER—Do you have an alternative figure?

CHAIR—On that point, could I ask the Audit Office, for the purposes of the public hearing, to give a brief summary of their thinking in coming to that figure and the rationale for it? This will help not just members and senators asking questions but also anyone here at the hearing.

Mr Cronin—There are two things: the first thing is the question of what is military off-the-shelf, and that is defined in the *Defence Capability Development Manual* and quoted in the ANAO's audit report No. 26 on page 11 at footnote 2:

The Defence Capability Development Manual 2005 defines 'off-the-shelf' as a product that will be available for purchase, and will have been delivered to another Military or Government body or Commercial enterprise in a similar form to that being purchased at the time of the approval being sought.

That is what military off-the-shelf is. The figure of \$625 million, which is the basis of the 84 per cent, is a number that we agreed with Defence when they did their analysis. You will notice that the Defence response is attached to this report.

CHAIR—Could you take us to that?

Mr Cronin—That is at page 97.

CHAIR—This is a letter to you, dated 12 April?

Mr Cronin—That is correct. This is saying that Defence agrees with everything in this report. The \$625 million was agreed between the ANAO and Defence; it is a—

CHAIR—Just for the purposes of people at the hearing, it is a short letter, but what is the pertinent point? Could you read that into the record.

Mr Cronin—It is in the first paragraph:

I now provide you with the whole of Defence and DMO response to the draft report to be included verbatim in the final report.

Then it says 'see Annex A'. Annex A is attached and you will note that DMO has a short statement in there, which is repeated in the summary of the report, and their responses to each of the recommendations.

Mr TANNER—Can I clarify something. I think I have misunderstood what the Audit Office was saying here. Are you effectively saying that Defence identified this project originally as an off-the-shelf product?

Mr Cronin—Yes.

Mr TANNER—And they were clearly in error in doing so?

Mr Cronin—Yes.

Mr TANNER—Now I understand.

CHAIR—Any further questions?

Mr TANNER—I do not think the company completed its answer. I was asking: if 84 per cent is wrong, do you have an estimate of what a correct figure would be, and do you have an explanation? Given my assumption that this was caused by customisation was not correct, doesn't that cast a question mark over the process of initial estimation? If there is such a substantial variation, doesn't that cause us to ask whether the initial contracting process on the part of Defence was adequate?

Mr Saporito—There are different aspects. In January 2006 we wrote a letter to the Audit Office mentioning that the figure for us was not a \$625 million but a \$265 million increase. There are different ways to calculate what the cost increase will be. You can take 15 years or 10 years. You can take one particular year and consider that it will be material and linear. Maybe we were too transparent at the very beginning when we had the first estimates for what the cost could be while we were negotiating with the suppliers.

When we were building the different TLS contract proposals one year ago with DMO, the total increase, after having renegotiated with the supplier, for a period of 10 years was \$208 million. This was also based not only on an increase coming from industry but on clarifications about the scope, and also on the additional scope of work requested by Defence. So it is not just an increase coming from an estimate—

Mr TANNER—Can you see that the obvious problem from the point of view of public finance is that, if you have a tender process where a decision is made to accept a particular bid on a given amount and then subsequently that amount is varied, that calls into question the rigour and integrity of the tender process? You have been awarded the contract on the basis of a certain figure for a specific set of requirements and then you come back later and say, 'Sorry, that is actually going to cost a lot more.' To me, that is a serious question from the public finance management point of view.

Mr Saporito—For the moment—

Mr TANNER—It is a serious question for Defence. You are entitled to get away with whatever you can get away with—you are a private company. If you put one over them, good luck to you. It is a serious question for Defence. So I want to hear what your version of this is.

Mr Saporito—For the moment there is no cost increase because no contracts have been signed or accepted.

Mr TANNER—So negotiations are still—

Mr Saporito—Negotiations are still ongoing.

Mr TANNER—Best of luck.

Mr Saporito—Instead of negotiating for weeks and months about what the estimate could be, we have decided to have a different approach with Defence. We will work on the period of five years, based on actual costs, in order to have a real vision of what the maintenance of the aircraft will cost. We will review the figure if necessary after five years.

Mr TANNER—Does that amount to a variation in the contract?

Mr Saporito—It may be a variation. We do not know today how much it is. It will be based on actual cost and we will be totally transparent.

Mr TANNER—That is what you are proposing to Defence at the moment?

Mr Saporito—Yes.

Senator MARK BISHOP—Who bears the cost of the capital for that five years?

CHAIR—We will move to the next lot of questions. We are going to do them in order, Senator Bishop. We will go to Dr Jensen and then to Senator Bishop. You can then get the answer to that question and all of your other questions.

Dr JENSEN—I am interested in the variations with the current contract versus the original request for tender back in 1999. What differences have there been in that time period? I am talking about relatively major differences here. For instance, I believe that there was talk in the request for tender about Australia building some commercial helicopters here.

Mr Saporito—Yes.

Dr JENSEN—What happened with that?

Mr Saporito—That is happening. Our commitment was to establish an assembly line in Brisbane for the Tiger armed reconnaissance helicopter ARH and also to establish an assembly line for the so-called EC 120, which is a single-engine civil helicopter. This has happened. We have already assembled 11 aircraft in Brisbane. This aircraft is for the civil Australian and New Zealand markets, but it has also been exported to the US, Indonesia and Malaysia. So it is happening.

Dr JENSEN—I would be interested in other variations, either technical operation, logistical or contractual, between the request for tender and the current contract. I guess that is something that you will probably need to take on notice.

Mr Wilson—At the top level the most significant variation is in fact the full flight mission simulator. There was a change to the projection system.

CHAIR—Was that as a result of technological change?

Mr Wilson—Yes.

CHAIR—Could you just perhaps explain that to the committee? I noticed that there was a mention of it in Defence's response to the audit report. Perhaps you can just take us through that for the benefit of Dr Jensen and the rest of us.

Mr Wilson—If I may say as a layperson not expert in that area—

CHAIR—That will probably mean we understand it with greater clarity.

Mr Wilson—it was to do with the projection system, the angle of view and the clarity of the projected image down to being able to pin lights in the distance and the level of blackness of the night. These are all the sorts of visual cues that the pilots have to work with and it was viewed as a step up or a change of technology—

CHAIR—So modern advances occurred that meant that it was sensible to upgrade to have the most up-to-date technology.

Mr Wilson—Yes, that is what the intent was. The second one was in fact the full flight mission simulator. We had originally planned that the pilots' simulator would be subject to a six degree of freedom motion system and the battle captains would be fixed and there was a change to include motion in both the pilot and the battle captain and this has been installed at Oakey.

Dr JENSEN—I am also interested in the issue of the identification of risk. The statement that Mr Saporito made was that this is an off-the-shelf technology. The evidence that we have heard from the Australian National Audit Office is that it is not, and I have heard similar statements from Defence that we are now the lead customer on this capability, which does not indicate that it is in fact a military off-the-shelf system. What concerns me is that this appears to have been recognised by Defence at the time of the original signing of the contract. Given that, and looking at the audit report, Defence, up to 30 June, had spent \$310,000 on testing and evaluation and they had an approved budget of \$22.7 million. In your view, given a project in which, from two sources, we are the lead customer, would you say that that is enough money to have spent on test and evaluation of a new combat capability?

Mr Saporito—First of all, I would not argue about whether it is off the shelf or not—the definition of off the shelf will be different in the specific Defence document to that which we consider in industry. The definition about off the shelf is more about risk and development and, as I mentioned, except the Hellfire missile system and the radio communication, everything was off the shelf—I mean, already developed for a European program.

Dr JENSEN—In your view, Defence and the audit office's assessment that Australia is now effectively the lead customer on the Tiger armed reconnaissance helicopter project is incorrect?

Mr Saporito—That is a different aspect. Leading customer means the first to have an aircraft delivered. When the contract was signed, Australia was supposed to have the first aircraft delivered after the first European one, which has not been the case because we have been more advanced in Australia than in Europe.

Dr JENSEN—That seems to indicate to me that we are at the cutting edge and that any issues that are identified will likely be identified here first because we are going to get the first production item.

Mr Saporito—No, in fact the Tiger is flying in Europe as well and the certification of the Tiger in Australia is based on what is certified in Europe. So Australia has been the first to have aircraft delivered here but the problems of the improvements that have to be made on the aircraft before it is completely mature are mostly discovered in Europe, because a lot of the helicopters are flying in Europe.

Dr JENSEN—For instance, one of the issues that was identified by the Australian National Audit Office was the issue of engines that were under-powered. What effect does that have on the war load? For instance, it is designed to have, if I recall, six Hellfire missiles. In hot and high conditions what is that doing to either war load or otherwise payload range capability or range?

Mr Saporito—I will start to give you the answer on some details and Bob Wilson will follow. Regarding the engine power, the situation was the following: there is a specification about the engine and the engine has to deliver on basic power for the aircraft. In addition to that, we were requested to provide some margins according to different flying configurations.

Dr JENSEN—Were those margins in the contract or was it just a request?

Mr Saporito—Yes, they were in the contract. Everything was clear from the very beginning, and we were sure to be compliant. What happened is that in one specific flying condition, with the aircraft totally loaded, high temperatures and high altitude, it appeared that instead of a 10 per cent margin above the nominal power we had a seven per cent margin. This has been identified. This has been discussed with Defence and with our engine supplier. The engine supplier has modified the engine to reach the 10 per cent margin instead of the seven per cent margin.

Dr JENSEN—What modifications were made and what effect does that have on payload range and also reliability?

Mr Saporito—No effect on the performance of the aircraft. It is a modification on the nozzle of the engine, so it is a technical modification that has been implemented, and all of the aircraft, except ARH 5 for the moment, have the engine modified. ARH 5 will be done very soon. This engine issue has been solved at no cost to the Commonwealth. We did not ask for any additional dollars for this.

Dr JENSEN—I know that you were discussing the issue of fixed price contracting at no cost and so on. I guess I have a philosophical problem with the idea that you have a fixed price contract and therefore if things slip it is not costing us anything. If programs slip to the right or if capabilities are not met in time, it is a cost. Maybe the government or Defence do not have to pay you a certain bucket of money more, but it is a cost in terms of a capability we do not have, it is a cost in terms of people sitting around waiting to be trained up—those sorts of issues. How do you respond to that? In terms of fixed price contracts, shouldn't there be—and you probably will not agree with this—some sort of mechanism whereby if that capability is not actually delivered in time then there should be some penalty clauses associated?

Mr Saporito—Scheduling is a problem for the customer and a problem for industry as well. You try as much as possible to avoid this. When there is a slippage or when the milestone is not achieved on time, of course there is an additional cost for us, but we do not ask for any more money because it is a fixed price contract. We bear this cost. It may not affect the customer or it may affect the customer lightly, but if it is a critical milestone and the customer has identified that this could create additional cost, we have in the contract liquidated damages. In that case, the customer can ask for liquidated damages to cover the additional cost due to the late delivery of a milestone. So it is already embedded the contract.

Dr JENSEN—A classic example of the issue of fixed price not actually meaning no cost would be another one of your parent company's products, the A380, where the time line has slipped by two years and companies are actually getting compensation for not actually having that aircraft in service at the time that they had contracted. I know you might argue that a military system is different, but in reality it is a capability that we require, that we need to fill that gap somehow or other and we need to pay and train people for a capability we do not have.

Mr Saporito—I cannot comment about the specific aircraft and what depends on the A380. I can tell you that in this contract and in different contracts we have with Defence, there are some clauses and the possibility to pay liquidated damages to cover the additional cost Defence will have if we are late for some milestones. It is already embedded in the contract. If we have to pay liquidated damages, it will be additional costs for us, in addition to the fixed price contract, but we will not ask for any money for that.

Dr JENSEN—You have undoubtedly read the ANAO report. What are your views of the ANAO report? Do you believe that is a fair comment on the ARH at the time that the report came out?

Mr Saporito—It is difficult for me to comment on a report which is not written to assess performance of industry. The ANAO report is to comment about performance of a defence organisation. I just make a general comment: the ANAO report was mainly reflecting the problems. Sometimes they were historical problems, like the engine, which was solved when the ANAO report was written and we consider it did not give a fair view of the problem. It was too negative and pessimistic.

Dr JENSEN—What about the other issues that the ANAO report identified, including their view of risk that Defence was exposed to?

Mr Saporito—I have one example. It was written that the Tiger cannot fly over water. This is not true. The Tiger can fly over water. There is no technical problem to fly over water. It is just a question of regulation and a question of ensuring that if the Tiger was to go into the water, the pilot can jettison the window in a completely safe way. We may be asked to modify the jettison system a little bit, because it is already in place.

Dr JENSEN—That surely would have been in the original contract?

Mr Saporito—We have a jettison system, so the Tiger is compliant from this point of view. There is no technical restriction to fly above water.

Dr JENSEN—Can I have ANAO's response to that?

Mr Coonan—On the issue of flight over water, if you turn to page 62, table 4.3, and look at note (f), you will see that we said exactly what Mr Saporito said just now. At note (f) we highlighted that the restrictions had been imposed by Defence to manage a technical issue in terms of safety.

Mr Cronin—This is not what the ANAO is saying. This is what Defence documentation is saying. This table is reporting what Defence documentation is saying.

CHAIR—Is there any other commentary on that issue in the report?

Mr Coonan—For a long flight over water?

CHAIR—Yes.

Mr Coonan—No.

CHAIR—So that is the only mention of it, at footnote (f)?

Mr Coonan—That is the only mention of it.

Mr MARK BISHOP—It is a safety ejection issue.

CHAIR—Perhaps you can read it.

Mr Coonan—Brigadier Patch brought it up during Senate estimates, and it is the same issue.

CHAIR—You might just read it for the record so our guests here at the hearing can have the benefit of it. They do not all have your report. As much as they keep them and read them, they do not carry them around with them.

Mr Coonan—It states:

The ARH flight over water restrictions are imposed because there are unresolved issues related to underwater egress. Defence had not been satisfied that all issues related to underwater egress had been tested and analysed by the Contractor, and therefore imposed this flight restriction.

Dr JENSEN—Going back to what this really is highlighting is that Defence were stating that they were buying a military off-the-shelf system and in fact what they were buying was not quite that. It was still a developmental program, and I understand the development is still being undertaken. As such, there was a whole lot of inherent risk associated that Defence had not actually accepted at the time. And the result is things like Mr Tanner identified: increases in maintenance and through-life costs. Yet your view is that Defence was buying an off-the-shelf system?

Mr Wilson—You are inferring that there was a risk in the aircraft's certification for flight over water. That is not the case. The aircraft was certified for flight over water. It is Australian Aerospace's understanding that the certified method for jettisoning the windows was not acceptable to the Australian Defence Force from an occupational health duty of care aspect. So it was not a matter of saying the aircraft did not have a compliant system to remove the windows. It did. We can demonstrate that and have done that. Australia decided that it needed to take an extra step which was above the base certification, which the aircraft offered and delivered.

Dr JENSEN—The point that I am making—and I am not suggesting for a moment that we should have bought another platform—is that, as an example, one of your competitors actually had the capability in operational service. The ARH was not in operational service and you have agreed that Australia will be the first country to actually have ARHs in operational service. I guess I have a problem in identifying that as being an off-the-shelf system when there is still clearly a lot of development work to be done.

Mr Saporito—The aircraft was not in the development stage. It was already in service production, not finished and not delivered. The development phase of the program was finished. When you have such a complex platform and a completely new platform, you can predict everything in theory and test everything, but you need to fly a little bit. You need to fly some hours to discover some improvements that need to be made. That is what is being done on the Tiger. When the Tiger was selected, again, it was completely developed. Some equipment or some technical aspects had to be improved. We knew that and it was in process to be improved. The European program was supposed to be developed before the first aircraft was delivered in Australia. That has not been the case. In terms of leading customer it is because we have delivered the first aircraft in Australia some months before the first aircraft in Europe.

Dr JENSEN—All this is indicating to me that, particularly when the contract was signed, it was not an off-the-shelf system. Five years later and it is still not in service anywhere?

Mr Saporito—It is already in service in Australia and in France. It has now been developed.

Dr JENSEN—Have they been accepted for operational service in France?

Mr Saporito—For training, yes.

Dr JENSEN—But not for operation—

Mr Saporito—You cannot accept the aircraft for total operational service. At the beginning there is a phase to train pilots. It is not the complete operational phase, as it is not in Australia. But the aircraft is already flying. We are using the aircraft for training and to test the weapons system and equipment.

Dr JENSEN—The point is yes, it can be used for training, but let me suggest that you get a full squadron of ARHs in France in the current configuration. You train all your pilots and your maintenance crew and so on. Could you guarantee that in that configuration it will be accepted for operational service, with no modifications whatsoever?

Mr Saporito—No, but we are not at the end of the program.

Dr JENSEN—I guess that is the point that I am getting at.

Mr Saporito—We are not at the end of the acquisition program in Australia, so we still have to continue to equip the aircraft and to make it fully operational and to train the pilots. Even if a system is delivered on the aircraft today, the pilots are not fully trained, so they cannot—

Dr JENSEN—What I am getting at is let us say you have a full squadron of aircraft delivered, you are training all your pilots and your ground crew et cetera, and we go to 2010, will the aircraft, in its current configuration, be accepted for operational service?

Mr Saporito—In the current configuration, no. From ARH 12, yes.

Dr JENSEN—What is concerning me is that five years ago we signed a contract for what was supposed to be an off-the-shelf system, and yet you are still saying that there has not been any ARH delivered in operational configuration?

Mr Saporito—That is true.

CHAIR—We will have a five-minute suspension.

[11.35 am]

CHAIR—Dr Jensen had finished his questioning, so we will resume with Senator Bishop.

Senator MARK BISHOP—I welcome the gentlemen from Australian Aerospace Ltd. I have three issues I wish to pursue: firstly, a residual question arising from Mr Tanner's examination as to the cost of capital for the through-life support; secondly, the aspects of the initial contract price and through-life support as to how this company gained a contract; and, thirdly, with the chair's indulgence, some issues going to performance capability of the final product and delivery dates.

Firstly, Mr Saporito, as I recall the discussion with Mr Tanner, you indicated there was going to be a change in practice in payment of consideration of a through-life support contract. You were going to a five-year payment system based on actual cost and presumably a margin. My question in that context is: for each of those five-year periods as the contract goes over time, who bears the cost of capital for payment of that through-life support? Is it provided by the Commonwealth? If so, how are payments made, and have any payments been made as yet?

Mr Wilson—I am not sure. The proposed model that we are looking at developing is payment of invoice on a monthly or quarterly basis. So other than matters like creditors and debtors on a balance sheet there will not be any capital impact, in my opinion.

Senator MARK BISHOP—So it is not yet agreed.

Mr Wilson—It is being worked up, as a model.

Senator MARK BISHOP—You are in negotiations with DMO.

Mr Wilson—Yes.

Senator MARK BISHOP—And you anticipate to be on a monthly or quarterly payment based on actual cost and there will be a process for verification.

Mr Wilson—Correct.

Senator MARK BISHOP—Right, so no capital has to be provided by—

Mr Wilson—Other than debtors and creditors, in that classic accounting sense.

Mr Saporito—Regarding the payments, so far we have received some payments for the TLS phase and it has been based on the current contract arrangements.

CHAIR—We are having difficulty hearing you, Mr Saporito.

Mr Saporito—Regarding the payments made so far, we are using the current contractual system and we have received payments. In fact, we did not invoice one person with what we could have invoiced just because we were late in training and in flying. So we have invoiced what in fact were our real costs.

Senator MARK BISHOP—I now want to go to the awarding of the original contract and I refer you to three separate paragraphs in the ANAO report. I refer you initially to page 43, paragraph 2.21. The last sentence reads:

The winning bid's largest comparative advantage on cost—

that is, yours—

was found to be in the through-life-support element, from years 4 to 15, where it was nearly one-third less than the nearest competitive bid.

So your low tender price on the through-life support contract was absolutely critical to your company gaining the eventual project. I now ask you to go back to paragraph 2.23 on pages 43 to 44, and you will see there in the first sentence:

The Contractor has subsequently reviewed the tendered, and now contracted through-life-support costs, which has given rise to a request for Defence to increase the through-life-support payments by an additional \$365 million for the life of the Through-Life-Support Contract.

So the contract was awarded, critically, on the through-life support pricing. There has been a request by you after the event for an increase of \$365 million. Defence go on in the next sentence:

Defence analysed the whole-of-capability costs, and found that this increase, if applied over 15 years, would result in an increased cost of ownership for the capability to the order of \$625 million.

That is the blow-out in costs that has been in the public area. I now ask you to turn to page 83 of the ANAO document. I direct your attention to footnote 121. For the record, I will read out that footnote. It says:

In effect, Defence noted that the successful Contractor's air platform solution was marginally less preferred than that of the nearest rival in cost, from a platform capability based perspective. However—

this is the critical part—

in terms of a complete package, Defence made the assessment that the ARH Tiger represented better value for money.

To synthesise those three key points, your company was awarded the project on the basis it had marginally more capability and marginally less cost. That marginally less cost is attributable to significantly lower through-life cost support over the 15-year contract and, after the contract was accepted, you have applied for an increase in through-life support of \$365 million, which Defence say, over the whole of the contract, turns out to be 625 million. It seems to this untutored person that there has been, at best, an irregularity in the tendering process to the tune of hundreds of millions of dollars, which has resulted in your company getting the contract. How do you respond to that? How can you be out in through-life costs, which give you the contract, somewhere between \$365 million or \$625 million?

Mr Saporito—We do not know exactly what the selection process was and all the figures were established or evaluated by Defence when we submitted the offers. What I can tell you is that our competitor's platforms were at the same stage of development or at the same state of the program because none was delivered. So it was difficult to know exactly what the cost of the TLS would be for the competitor as well. We did our best to give some estimates according to the understanding we had of the program and the service we had to provide at that time. It appears that now we have a different vision, a different quotation about what can be done. Again, I mention some estimates were not correct, but I am sure there is a change in the scope of work, so all the increase is not coming just from industry.

Senator MARK BISHOP—I do not think that is quite a satisfactory answer. How can the through-life support costs increase over a relatively short period after signing of the contract by \$365 million or \$625 million? Doesn't that necessarily mean that your company was grossly in error in its original tender price negotiations or that the DMO—the other side of the table—was grossly in error in awarding that contract to you on the basis of your subsequently admitted request for much higher through-life support contract reward? Who is at fault—you or the DMO?

Mr Saporito—The figure is different. We did not do it purpose. We did it based on the estimate we had at that time and we did it as honestly as possible.

Senator MARK BISHOP—But two years later you did it differently.

Mr Saporito—Five years later.

Senator MARK BISHOP—Five years later, you did it differently.

Mr Saporito—Yes.

Senator MARK BISHOP—Have you analysed the difference between the original preparation by your company and the subsequent preparation five years later? You know the reason for the difference.

Mr Saporito—We did analyse the costs.

Senator MARK BISHOP—What is the reason?

Mr Saporito—One reason is that we were negotiating in parallel with not only DMO but also our suppliers, and we took on some of the assumptions of our supplier that some of the cost would be based on reimbursables. Now that we have to sign a contract, the suppliers want to—

CHAIR—Sorry to cut you off but, just for the benefit of the committee again, could you go through the elements of those additional costs—just a broad overview of the required contract changes.

Mr Wilson—At a very top level, the proposed areas of change were in training, engineering, support at the Aircraft Research and Development Unit in Edinburgh, South Australia, and GME video replay. Once again, as I said, in the acquisition area we have gone from an analog system to a digital system, and that drives a different cost basis in the TLS support area.

Senator MARK BISHOP—Mr Wilson, can you just stop there and I will help out the chair. For each of those four problem areas you have identified, can you tell us the increase in cost you are seeking so we can get an idea of the proportions—a ballpark figure.

CHAIR—If you have them, if you are not breaching any commercial-in-confidence arrangements and if you would like to provide them to us.

Mr Wilson—Can I recap? Those items I read off are in groups. So I have training-engineering in one group, video replay in another group and vendor supply in another. So I might have 10 headings, but I only have three groups.

Senator MARK BISHOP—I understand.

CHAIR—Would you be happy if he took that on notice?

Senator MARK BISHOP—I would.

CHAIR—The question is: where are the big ticket items?

Senator MARK BISHOP—That is what we really want to know.

CHAIR—We are dealing with hundreds of millions of dollars here, and that means some big ticket items.

Senator MARK BISHOP—If analog to digital is \$1 million, we do not care; if it is \$100 million, we are really interested!

Mr Wilson—Yes, I understand.

CHAIR—I hope Hansard recorded that! We want to know precisely, and if you have not got the precise figures can you provide them at a later date. If they can be made public, we will do that. If they cannot, we can take them as a private submission.

Mr Wilson—I think we would be concerned about them being public, but we have absolutely no objection to providing them for the clarity of this committee.

Mr Saporito—What we are doing with DMO is we have separated the total cost contract proposal into different packages just to understand where it is coming from.

CHAIR—If you can give us the breakdown of that.

Mr Saporito—So we can give you a breakdown, but again it is not yet finalised and not yet negotiated, so it is a base of—

CHAIR—Hence my reticence before. You have got the question, we will leave it with you and you can provide something a bit later on. Senator Bishop, any further questions?

Senator MARK BISHOP—I might turn to my second topic now. You told us in your opening comments that six aircraft had been delivered—

Mr Saporito—Yes.

Senator MARK BISHOP—and that 16 were in process, and ARH7 and ARH8 were ready for acceptance, so soon we are going to have eight of the 22. We know ‘delivered’ means one thing: ‘delivered’ means you under contract believe you have complied with all contract obligations in manufacturing the product and delivering it to the purchaser. How many of those six that have been delivered to date have been signed off by the purchaser as meeting all specifications in the contract?

Mr Saporito—‘Delivered’ means accepted by the customer. So we manufacture the aircraft and at some point in time it is ready for acceptance, and then the Commonwealth sends a team to sign off the paperwork and to flight-test the aircraft before it is accepted. ‘Delivered’ means after it has been accepted by the customer. Today, six aircraft have been accepted by the customer based on an agreed configuration at that point in the program. So they have been totally accepted by the customer. No. 7 is ready for—

Senator MARK BISHOP—Let’s stop at six. So you say six have been delivered to the customer and totally accepted by the customer. Does that mean the customer has signed off that they are satisfied under all contract requirements?

Mr Saporito—That means that the customer is satisfied with what we agreed to deliver at that point in the program. The aircraft are not in their final configuration; we know that we will have

to do some retrofits or some upgrades, and these will be done progressively. It is agreed that, from ARH12, all of the aircraft will be in their final configurations. We will progressively upgrade and complete the aircraft, from Nos 1 to 12. ARH1 is already in progress. So at the end of the acquisition program—that means when we deliver the last ARH in 2008—all the aircraft will be in the same configuration.

Senator MARK BISHOP—Let me ask the question in a slightly different way: when can we expect all six helicopters to be at a level where they can deliver their full contracted capability to the Army?

Mr Wilson—I am struggling to find my paper on that, but we believe—

CHAIR—You have it?

Mr Wilson—I have it in this file, it is just that I am—

CHAIR—Do you have a year in mind—just generally, rather than taking us to the hour of the day?

Mr Wilson—Broadly—and I say that in an informed sense—we are looking at aircraft 12 and we believe that we will have aircraft 12 for customer acceptance, signed off and accepted by the Commonwealth, in the third quarter 2007.

CHAIR—So that is about a year away. Is that right?

Mr Wilson—Yes. That is the production acceptance and test plan that we are working with at the moment.

Mrs BRONWYN BISHOP—In listening to your answers, there seems to be a concept of interim agreement delivery—

Mr Saporito—Yes.

Mrs BRONWYN BISHOP—So, if for one reason or another Defence says, ‘We want to accept this aircraft knowing these deficiencies have to be dealt with and we agree to that’, that then becomes an interim delivery or an interim acceptance?

Mr Saporito—Exactly.

Mrs BRONWYN BISHOP—But those other things still have to be rectified?

Mr Saporito—Yes.

Mrs BRONWYN BISHOP—As I understood it, the question from my colleague was when will the six that have been delivered on the interim basis fully comply—not the 12th aircraft but the six already delivered.

Mr Wilson—My apologies.

Mrs BRONWYN BISHOP—When will they meet that specification? I have to add that I do not have a problem with having a two-stage delivery process if there is a good reason—and the reason being put to me from time to time is that in fact the Australian program is ahead of the French program and therefore there are grounds for taking that interim delivery—but when would you expect the full sign-off for those six delivered aircraft?

Mr Saporito—I agree. We have a problem. We are struggling to find the answer, but we will answer it even if we do not find the answer immediately. There is a program agreed with the Commonwealth for the retrofit of ARH1 to ARH6. We have a date and, as I mentioned, ARH1 is already in the facility to be—

Senator MARK BISHOP—I can help. Mr Saporito or Mr Wilson, I refer you to page 35 of the ANAO report. There is a table there which says that the required delivery of an initial operational capability is in June 2007. Note (c) defines ‘initial operational capability’ as:

Initial Operational Capability is the term associated with the capability achieved when one Tiger Squadron of six aircraft is fully equipped, and capable of armed reconnaissance operations.

We know six have been delivered, so we have a squadron. Are you going to be able to adhere to that date of June 2007? If not, what date do you expect that we will have initial operational capability?

Mr Saporito—We have a program for the retrofit of 1 to 6 and we know exactly which date 1 to 6 will be in full configuration. We will give you an answer but the answer is not in this table. When we speak about initial operational capability, we speak about contractual milestones where industry has to provide 11 aircraft, 16 trained air crew, enough spares—so it is different.

CHAIR—I will just stop you there. For the purposes of Senator Bishop’s question, he has read to you from a schedule in the report that was prepared at best in February-March this year. You have said you have another more up-to-date schedule. That is what we are interested in. If you have it, we would be interested in it now, but if you have not you could provide it later on.

Mr Saporito—We will give you an accurate schedule of upgrade, on which we will put ARH1 to ARH6 and even up to 12, because we have it for each aircraft.

CHAIR—That would be good. This audit report is DMO’s schedule, isn’t it?

Senator MARK BISHOP—You are correct, Chair: it is DMO’s schedule. But it is based upon material provided by Defence and DMO to the audit office. They put this schedule together. My question about initial operational capability is: if the government, in its wisdom, chooses to be engaged in operations offshore as it has in recent years, and it needs to put the ARHs into the field to carry out that task, will the government be able to do that at June 2007, which is the date for initial operational capability? If not, when?

CHAIR—I think you said the third quarter, didn’t you? That is, by definition, Senator Bishop—

Senator MARK BISHOP—Very close to it. But I am not sure that is the case.

Mr Wilson—May I offer some information?

CHAIR—Yes

Mr Wilson—We have the internal workshop minutes of 14 June from Australian Aerospace. We have developed a point at which aircraft, up to seven, will be capable. I would like to go on notice and refine the dates—provide three months better information since the workshop that we did on 14 June.

CHAIR—Give us an update?

Mr Wilson—Yes.

CHAIR—If you can do that that would be good.

Senator MARK BISHOP—As at the middle of June you had some forward projections.

CHAIR—Senator Bishop, you know that I am renowned for my fairness in the allocation of questioning time.

Senator MARK BISHOP—Do you want to go elsewhere?

CHAIR—No, I do not want to go elsewhere. I would like the committee to share the questioning around. You have had half an hour, so we will give Jackie Kelly, who is renowned for her patience, time to ask questions.

Senator MARK BISHOP—Thank you, Chair; you have been very generous.

Miss JACKIE KELLY—Obviously, as you mentioned before, this is an ANAO assessment of Defence's project management. You are not responsible for that. You have to deal with it on a daily basis. This is the ANAO telling us there are shortfalls in Defence's management of the project. From my reading, a lot of it goes back to the developing of the request for tender. There ended up being only four tenders, and it seemed to be a pretty easy decision to make. When was the first time that Defence approached your company or that someone in your company approached Defence saying, 'The Australians are looking for project Air 87'?

Mr Roberts—This project goes back years. The Air 87 project began, I think, around about 1990.

Miss JACKIE KELLY—A bit later than that. It was in the mid-nineties.

Mr Wilson—There were two cycles.

Mr Saporito—There was one in 1998, or something like that.

Mr Roberts—Pre-approval.

Miss JACKIE KELLY—So your company had people dealing with people in Defence from the early 1990s. You knew the age of our Iroquois and you knew, obviously, that, of all the defence forces around the world, we were going to be—

Mr Saporito—It was not a constant contact. Maybe early in the nineties we gave some indication about the technical aspects of the product, but there were not detailed workshops about the program.

Miss JACKIE KELLY—When did it get more detailed? At what stage did you—

Mr Roberts—They initially issued an RFP, a request for proposal. If I recall correctly, it was the second half of the 1990s. It may have been around 1997—something like that. That RFP was an open RFP, so any manufacturer or supplier in the world was free to make a proposal, as is the normal case, and we did that with Eurocopter.

Miss JACKIE KELLY—In developing that RFP, who were you talking to in Defence?

Mr Roberts—The normal correspondents within the Defence Department are the capability development people who are responsible for developing these projects.

Miss JACKIE KELLY—What were their names?

Mr Roberts—No idea.

Miss JACKIE KELLY—About any of them?

Mr Roberts—It was 10 years ago.

Miss JACKIE KELLY—I am wondering if they went to Aerospace.

Mr Roberts—Ms Kelly, the personnel change regularly. Over a period of six or seven years, you will be dealing with many, many, many different people who occupy very similar jobs. One takes over from the other. So it is difficult.

CHAIR—The reason Miss Kelly is asking that is that we find this is a regular thing. It is obviously just part and parcel of the industry. Would you have records of any of that?

Mr Roberts—No.

CHAIR—We do not expect you to have 10-year perfect recall, but—

Miss JACKIE KELLY—Has anyone been with your company 10 years?

Mr Saporito—As I mentioned, Marc Jouan, the project director, was already there. He might be able to answer. Maybe he has some records.

CHAIR—But he is still with the company, isn't he?

Mr Saporito—He is back in Europe.

Miss JACKIE KELLY—So you would be able to find out from someone in your company?

Mr Saporito—We may try to, yes.

Miss JACKIE KELLY—What I am trying to locate is just a name within Defence, someone in Defence 10 years ago in terms of who was—

Mr Saporito—If it is important, we will do our best to find one name.

Miss JACKIE KELLY—And whether they were in uniform or—

Mr Roberts—All these names would be readily available within the defence department because they all have jobs associated with it. They should be readily available, I would think.

Miss JACKIE KELLY—In going through the tender and getting an outcome favourable to your company, obviously you must have sourced personnel with some knowledge of the Australian Defence Force. Who did you pick up? Did you pick up any Australian personnel?

Mr Roberts—In fact we did not do any of that. I was involved at the time in assisting Eurocopter, which is the parent company for Australian Aerospace; I am an old bloke so my activity spans this whole period. There was nobody from the DMO, nobody from the Army. The correct answer to your question is: there are experts within the Eurocopter company who came out and delivered expert presentations.

Miss JACKIE KELLY—So Defence was relying largely on commercial expertise?

Mr Roberts—Within the defence department they have their own expertise to decide what they think of a presentation—whether it is just a marketing song or there is something solid behind it and, if so, what. We did not have anybody in the local Australian helicopter industry plugging this, no.

Miss JACKIE KELLY—What is your background? Before you worked for Australian Aerospace, where were you?

Mr Roberts—I am currently the CEO of EADS Australia, which is the parent company, ultimately, of Australian Aerospace through Eurocopter, and before that I assisted French companies, including Eurocopter, from here. Before that I was an Air Force officer for 25 years.

Miss JACKIE KELLY—In the Royal Australian Air Force?

Mr Roberts—Royal Australian Air Force.

Miss JACKIE KELLY—When did you leave the Royal Australian Air Force?

Mr Roberts—In 1987.

Miss JACKIE KELLY—So you were involved with the RAAF. Were you a helicopter pilot?

Mr Roberts—No, a fighter pilot.

Miss JACKIE KELLY—So your knowledge of the Defence Force was prior to this whole project, but you would have had some knowledge of acquisitions?

Mr Roberts—Yes, it was part of my job to be aware of how the process was performed and the regularity with which it was revised.

Miss JACKIE KELLY—When the contract was signed off on, obviously at that time Defence was aware—and I am trying to find out who in Defence was aware—that the aircraft actually did not have a French airworthiness certificate. They did not know that at the tender process, but from the ANAO's internal investigation it was known at the time of signing the contract. Do you know who in Defence had that knowledge at that time?

Mr Roberts—Knowledge that the aircraft was not certified—

Miss JACKIE KELLY—In France; that is right.

Mr Roberts—at the time of the signing of the contract? It would have been common knowledge.

Mr Saporito—Everybody knew.

Mr Roberts—It was common knowledge.

Mr Saporito—It was public information.

Mr Roberts—This also points out the tension here between a line in a publication perhaps which people have to follow in their jobs when the government department says, 'You shall buy military off-the-shelf,' and what that means. For example, a few months ago we bought military off-the-shelf in this country; four beautiful C17 aircraft. They were absolutely military off-the-shelf. You go down to the garage and you buy them, and you get exactly what they offer—no changes at all, whether you wanted them or not. That is military off-the-shelf. In the end, the test is whether this is good for the ADF and especially the people operating these aircraft.

Now we have a situation with the Air 87 program where our aircraft was reaching the end of its development program—fully documented, by the way, in France and Germany, with First World oversight. Do we disqualify this aircraft from consideration because it is not, strictly speaking, military off-the-shelf? That is, you cannot go down to the garage tomorrow and buy it, but within two or three years you will have the world's best armed reconnaissance helicopter capability and you will have it for the next 30 or 40 years. Do you turn your back on that and instead pick up something which is already in service, possibly 10 or even 20 years, because you had very little to choose from? The competition was Vietnam era, and the upgrade for that relied on the same Vietnam era design but upgraded. That was the real competition. The other two

tenders were much bigger and heavier aircraft and not suited at all to this role really. So do we say, in this country, 'No, we are not going to provide the best possible capability because it is not military off-the-shelf under this definition'? I think we will do very poorly by our people if we do that.

Miss JACKIE KELLY—I think there is a lot in what you are saying, because clearly there were only four bids and the decision was made in six weeks, so it was a pretty standout easy decision to make. But, that decision having been made, I think that, when we sign the contract, we would like Defence to build in or at least be aware of their rights under that contract. Just to give you a very easy example, one that we have been discussing today is through-life support. Through-life support is currently in negotiation, so it is probably a bad example. But on the costs blowing out: most usually, in contracts, if you have not got back to someone with the repair unit costs, there is a penalty clause on the contractor for not doing something on time. Defence have some rights to say, 'Look, if you don't do this, there's a penalty for every day's delay or month's delay,' or whatever, and there is some incentive for the contractor to be on time. There should be someone in Defence exercising their rights and saying, 'Look.' But that does not seem to have happened in this contract, and hence we have seen a few slippages. That is what I am trying to understand. Who—rank, level and experience—is responsible for what ANAO has observed in the slippages, in Defence's role to just keep driving this contract forward to be on time on costs? Because you are very busy people. You have lots of contracts around the world. Defence have to really get their value for money. Let's just start with the through-life support bit at the moment.

Mr Roberts—The other gentlemen have spoken on through-life support, but I will have my sixpence worth, if you do not mind. It is perfectly true that we take no joy at all in asking for more money for through-life support. We have one role here and that is to partner the Australian Defence Force in providing them the best possible capability and keeping it available for them—the best in the world—just like we have in other equipment buy-power. We do not like at all having to ask for extra money, because it sours a relationship that we value greatly, and it embarrasses them, and we have to give good reasons.

In the case of the through-life support requested increase, about 30 to 40 per cent of that is associated with scope creep, we have heard—in other words, doing extra work; therefore more money. The remainder is our own fault, because we made poor estimates back then, five years ago. They could only have been estimates because at the time there was no mature production chain of vendors. So we go with the best information at the time. We allocate our own factor as to whether that is reasonable or not and come up with a figure. We have absolutely no idea what the costings are of our competitors. So we are not in any position at all to do this in any deliberate sense. However, we like to deliver what we say we will deliver at the price we say, so it gives us no joy to come up with this issue. Of course, as we all know here, it has not been agreed at all. The customer of course says, 'What? I beg your pardon? How much?'

CHAIR—You are in discussions?

Mr Roberts—We are, yes.

Miss JACKIE KELLY—So this is actually a contract dispute? Obviously, I think it is a very poor showing on Defence to reject things under a contract, because normally things like foreign exchange, increased labour costs and all those sorts of things are built into the contract, so we

know that when we sign a contract we are not going to get it for that price—there are built-in increases that we expect over the life of a contract. Normally there is a bunch of clauses in the contract that give you certain rights in those circumstances. They clearly are not in this contract, or they are not very obvious in this contract, or they have been waived by Defence, or they have been waived by you.

Mr Wilson—Just to clarify, if I may: price variation and exchange rate variation is in the contract, and we are exercising it, and DMO is meeting our—

Miss JACKIE KELLY—That was an example. But I am talking about the \$300 or \$400 million that is in dispute. Is any of that—

Mr Wilson—I think, as Mr Roberts said, that there is a ratio—that we believe the increase was due to changes, the Commonwealth's requirements for through-life support, and then estimation errors on our part in the first place. No pleasure in trying to improve our position on that, but that is what we—

Miss JACKIE KELLY—There is no clause in the contract giving Defence any rights in this area?

Mr Wilson—Yes, you can reject a proposed CCP, which Defence has done.

Miss JACKIE KELLY—What is the consequence of that, that you will deliver it for the original price?

Mr Saporito—Yes.

Mr Wilson—With current contract operators, yes. And we are negotiating a position to include—

Mr Saporito—As I mentioned before, we are delivering and we are paid according to the current contract.

Senator HOGG—Are you inferring that there are difficulties with whole-of-life contracts? Do you do these with other companies, whether commercial or other defence organisations?

Mr Roberts—The complication arises when the whole-of-life system is not mature. So you do not have evidence factored costings because at this point they do not exist in a mature ongoing fashion. You should be smart enough to get very close to the mark.

Senator HOGG—I presume you have sold these aircraft to other defence forces, not necessarily with exactly the same specifications, and I accept that. But have you done it on the basis of whole-of-life contracts, or have you done it on the basis that you have sold the aircraft, given a specific period where you have entered into a contract phase for the maintenance of these aircraft and then had a review process for the contract maybe to a second or third stage for whole-of-life? I am trying to get some feel for how you deal with these contracts.

Mr Roberts—I think everybody should understand that the advent of long-term through-life support contracts is quite new here. It was especially new at the time these contracts were signed, which was five years ago. I think the first contract which involved a long-term support element as a second contract was with our lead-in fighter, the Hawk aircraft. The Tiger may have been the next one, looking back. Of course there are elements of risk associated with bedding these things. Everybody is paid and is supposed to have the expertise to determine those, and in the end you make your best estimate.

Senator HOGG—I accept that. But in terms of other defence forces or other commercial entities that you may deal with where you are in a similar situation, have you gone down the path of whole-of-life contracts?

Mr Wilson—With the equivalent aircraft in Europe, some of the major systems such as the engine are government furnished equipment. So the maintenance of that item is in fact in a government system and is not part of the TLS cost associated with the helicopter directly. That is not the case here, and so the costs of the engine are reflected here and, candidly, that is one of the cost drivers of the change in requested funding—the engine, for example. That is a significant subsystem of the helicopter, obviously.

Miss JACKIE KELLY—Thirty to 40 per cent of this blow-out in cost is through changing scope, so Defence has clearly come back and said, ‘It would be nice if ...’ Could you fill me in a bit on that scoping, because we come back to the request for tender again and that somehow they got something wrong. I notice in terms of engine performance Defence says, ‘Wow, we want a helicopter that can land on the highest range in Papua New Guinea on a 90-degree angle or whatever,’ but that is unlikely to be a requirement in normal training or operational activities. That is a worst-case scenario, so that is not ticked as being essential. So if we put that out there, we pay for a capability that is not realistic. I think that is reflected in the ANAO’s report when it says, ‘Your engine performance is there,’ but then clearly on the flip side of the coin Defence has come back and is paying more for a capability it did not put in the RFP but that it now finds it wants and has to pay more for. Can you give me some examples of that?

Mr Saporito—The engine specification was clear from the very beginning. We were convinced that the European helicopter with the European engine would be capable and would have the necessary capability, including the 10 per cent margin. We just made a mistake because, instead of having a 10 per cent margin, we had a seven per cent margin. Honestly, three per cent is close to the accuracy to measure.

CHAIR—As you said earlier, you are retrofitting all that at your cost.

Mr Saporito—And it has been completely retrofitted at our cost.

CHAIR—So that is not part of the additional cost?

Mr Saporito—No. That is purely an acquisition and it has been completely retrofitted, corrected, at our cost.

CHAIR—It is part of the warranty.

Mr Saporito—Exactly.

Miss JACKIE KELLY—I thought Defence had just reduced their requirement for range weapons—

Mr Wilson—We do not understand that analysis. I have got the printed report. I believe that the report mixes up two elements of engine performance. The engine performance element we are talking about is in fact the three per cent deficit and that has been completely rectified by a turbine nozzle geometry change, and the engine now meets its power requirement inside the required temperature limit, inside the required specific fuel consumption limit.

Mr Saporito—When we had the discussion about the power margin, it was identified by Defence during the time that we were working on the possible engine upgrade, a totally different engine, for a new customer in Spain. It is an engine with its nominal power increased by 14 or 15 per cent. This engine was not developed; this engine was requested by a customer, and we had no agreement and no contract with this Spanish customer to develop, at that time, this engine. So of course we had a question from DMO, ‘What if we want to have this engine which has more power?’ and we were very cautious not to give any figure or commit too much to providing this engine. We just mention that because we could offer it to Australia with very attractive commercial conditions because the development was already being paid for by another country. I think somebody made an estimate that it could cost an additional \$110 million for the acquisition program to buy this new engine. But this is totally different. It is not the engine and it is not linked to the margin power we had and the three per cent issue. They are two separate problems.

CHAIR—Does the Audit Office want to comment on that?

Mr Coonan—We covered the issue which Mr Saporito brought up on page 24, in paragraphs 34, 35 and 36, and we highlight that:

The Contractor is currently trialling—

at the time of this audit—

engineering improvements that may address the power shortfall.

Clearly, they think they have done it.

This increase in power, however, may come at the cost—

If you then skip to paragraph 36, to manage that, Defence put an overlay of operational constraints on the helicopter at that time. You will have to ask Defence what they have done since this has happened.

Miss JACKIE KELLY—A recurring feature in a lot of these acquisition contracts is that, because we have such huge distances and we have got a huge fuel payload, we put a lot of extra stress on these things we acquire, stresses that do not apply in Europe or anywhere else. Again,

we get back to the contractor, this repetitive error by Defence; they know these things and they—

Mr Wilson—No. Let's be quite clear: in paragraphs 34, 35 and 36, two issues are melded together that probably lead to confusion. There should be a paragraph 36(a), starting somewhere around where it says:

The current list price for an existing main engine is in the order of \$2.5 million. The option to replace the existing engines may exceed \$110 million.

From a lay reading of that, it could be inferred that that \$110 million is associated with the three per cent issue. It is not.

Mr Saporito—It is not.

Mr Wilson—The \$110 million is associated with a completely different engine.

CHAIR—If they wanted to take up that option.

Mr Wilson—If they wanted to take it up—and it is a further 14 per cent increase in power.

CHAIR—So, to draw an analogy that laypeople like myself can relate to, basically it is like buying a car and the engine is not quite performing. The manufacturer said, 'We will fix it for nothing to the specifications you wanted,' and then, as a separate issue, there is a new you-beaut engine that has been developed in the meantime so I ask, 'If I wanted to buy that, how much would that be?'

Mr Wilson—If I may extend that analogy, we have a six-cylinder car that has performance issues and warranty repairs them, but we can give you a V8 if you want at your cost.

Mr Saporito—The current engine is fully compliant with the specification.

CHAIR—That is right. In the meantime, the new generation 3 Chevrolet engine has hit the market.

Miss JACKIE KELLY—Defence is always going to want the V8. We have to pay for it, so we are always saying, 'Hey—

Mr Saporito—We did not say that.

Miss JACKIE KELLY—This is where I get back to the request for tender. We get back to the original scoping of the contract. It is very difficult to go down this line without a look at what was originally contracted for.

Mr Wilson—On the engine side, be under no illusion: Defence contracted correctly for a certain level of horsepower, fuel consumption and temperature limits. In a very minor area of the aircraft's performance we could not deliver that as specified in the first place.

Miss JACKIE KELLY—In a minor area. Can you clarify that for me. You are saying that, with full personnel, full weapons load, full tanks and extra positioned tanks to make it from here to Darwin or whatever—

Mr Saporito—It was requested to have an additional power margin of 10 per cent above the nominal power, and we were able to reach seven per cent. So three per cent was missing. This has been corrected at no cost. But the specification was okay and we candidly and honestly believed at the beginning that the engine would be able to perform. It is a question of margin and it is also, to be completely honest, a question of how you measure it. As I mentioned before, three per cent is close to the accuracy of the measure. We may discuss for years whether it is three, two or one. Today, with the current measurement process, we can—

CHAIR—But your point is this: there was a rectification needed. You fully admitted that was your responsibility. You met your responsibility in rectifying it, which you are doing it now. I think you said at the start that you have one more to retrofit?

Mr Saporito—All of them except ARH5 have the retrofitted engine, and doing it will be at our cost.

CHAIR—That has all been done at your cost, and then the separate issue is that in the meantime a new, more powerful engine is out and about on the market, but that does not apply now because you have done the retrofitting. That is the point.

Mr Wilson—That is correct.

CHAIR—And the decision was taken to—

Mr Wilson—And DMO and ADF correctly specified the engine in the first place. It was a shortcoming on our part. The performance was—

CHAIR—They are not about to go and buy the new ones right now, given you have just retrofitted them?

Mr Wilson—That could well be a decade-on upgrade.

CHAIR—And there will probably be another engine by then anyway.

Mr Saporito—Yes.

CHAIR—Last week the contractor agreed to take some questions on notice, which you have done through the morning. If there are any outstanding questions that members and senators want to put to you through the secretariat—and there will certainly be a range of those, particularly on some of those personnel issues that Miss Kelly was raising—they will come to you within the next week. As there are no further questions, I thank you for appearing today, particularly for your generosity with your time in appearing for a couple of hours.

Resolved (on motion by **Mr Tanner**, seconded **Senator Hogg**):

That this committee authorises publication, including publication on the parliamentary database, of the transcript of the evidence given before it at public hearing this day.

Committee adjourned at 12.29 pm