

Department of Defence

JCPAA Review of Auditor-General's reports Nos 50 and 52 – 24 October 2014

Question on Notice No. 1 - Dollar value being delivered to Australian industry

Mr Conroy asked on Friday, 24 October 2014, Hansard page 10:

Mr King: Quite often a manufacturer will claim that it is an Australian content, but in fact it is a fully imported item or something.

Mr CONROY: Can I ask you to take on notice to provide your dollar estimation based on your view, not Australian Aerospace's view, of how much value is actually being delivered to Australian industry out of this \$4 billion project. Secondly, I want to go to paragraph 4.85 of the audit where Australian Aerospace highlighted the global supply chain opportunities of getting into the NH90 project, and identified six areas where access was to include the following items being sourced from Australia for the world market. Has any of that eventuated? Have we got Australian companies involved in tail rotor, or blades production, or avionics equipment production, or anything like that for the global supply chain, not just in Australia?

Brig. Mathewson: Yes. Absolutely.

Mr CONROY: If you are happy to take on notice, do you have a dollar estimate for the—

Brig. Mathewson: Not here and now, but I could take that on notice.

Response:

Table 1 below provides an estimation of the value, and summary of those activities being delivered by Australian Industry under the AIR 9000 Phase 2/4/6 Acquisition Contract, out-turned to 2014 figures for reporting purposes. The value of the investment in Australia is expected to continue to grow over the remaining three years of the program.

Description	Estimated Value (A\$)
Strategic Relationship Services and Supplies Management	11,216,069
Full Assembly Line of MRH90	191,411,078
Production of Helmet Mounted Sight and Display	18,040,694
Provision of Electronic Warfare Self Protection Support System	6,955,267
Groundbased Mission Management System	80,257,204
MRH90 Software Support Centre	64,260,264
Procurement of Thales avionics equipment	20,434,080
Procurement and Handling of Initial stock	34,819,108

Integrated Logistic Support Services	21,137,108
Procurement of International Sourced Services and Supplies	58,415,179
Production of Inter-Communication System	11,302,752
Training Needs Analysis	8,326,028
Aircrew and Maintenance Training	35,634,523
Training Courseware	18,318,031
Training Program Management	20,511,793
Earned Value Management	6,718,177
ADI Project Management and System Engineering Services	3,293,041
Australian Aerospace Program Management	68,469,285
Final assembly & test of RTM 322	13,773,881
Virtual System Trainer Development	9,299,377
Production of Composite Tail Rotor Blades.	1,597,017
Instrumented Aircraft System for MRH90	679,262
Production of Electrical Harnesses	17,467,176
Final Assembly and Test of Auxillary Power Unit	538,057
NH90 Composite Parts Global Supply Chain	21,429,877
Various Machined Parts Global Supply Chain	2,561,178
NH90 Electrical Harnesses Global Supply	6,620,601
Cooperative Research on Battle Damage Repair	1,574,103
Sponsoring of Students	1,050,571
Apprentice, Undergraduate and Post-Graduate Training	6,511,014
Australian Trade Business Facilitator	1,569,608
Virtual System Trainer Transfer of Technology	4,380,300
NH90 Tail Rotor Blade Global Supply Chain	37,256,153
Extension of CRC-ACS Collaboration via additional	2,703,375

Research & Development funding	
Helmet Mounted Sight and Display Global Supply Chain	3,633,827
Inter-Communication System Global Supply Chain	309,256
Aerospace Systems Research Development Facility	2,248,554
Network Centric Warfare Virtual Laboratory	2,248,554
New Industrial Packaging Development	6,740,372
Purchase of Engines Test Bed and Storage Buildings	1,864,052
Final Operational Capability Transfer of Technical Documentation, Training and Assistance	17,852,887
Free of Charge Engine Test Equipment Renting	7,549,097
Free of Charge Grant of Other Infrastructure Items	5,447,405
Repair of Turbomeca Aerial Helicopter Engines	22,092,043
Advanced Consultants Services and Products	3,475,156
Procurement of CNC Tool Sharpening grinder	456,329
	882,448,763

Table 2 below provides an estimation of the value and summary of those activities under the AIR 9000 Phase 2/4/6 Acquisition Contract where Australian Industry is delivering products into the NH90 Global Supply Chain, out-turned to 2014 figures for reporting purposes. The value of the investment in Australia is expected to continue to grow over the remaining three years of the program.

Paragraph 4.85 ANAO MRH Performance Audit report No. 52	Description	Australian Industry	Estimated Value (A\$)
NH90 Tail Rotor blades production and support	NH90 Tail Rotor Blade Global Supply Chain	Airbus Helicopters Composites	37,256,153
NH90 Major Composite structures production and support	NH90 Composite Parts Global Supply Chain	Airbus Helicopters Composites	21,429,877
NH90 and Auxiliary Power Unit electrical harnesses production and support	NH90 Electrical Harnesses Global Supply	Cablex	6,620,601
Avionics and Defence Electronic Equipment Production and Support	HMSD Global Supply Chain	Thales Australia	3,633,827
	ICS Global Supply Chain	Thales Australia	309,256
Mechanical Parts Production	Various Machined Parts Global Supply Chain	Lowitt/Honeywell/Ferra Engineering/Production Parts	2,561,178
			71,810,892

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Question on Notice No. 2 - Global supply chain

Senator Conroy asked on 24 October 2014, Hansard page 12:

Rear Adm. Dalton: We sign some heads of agreement with the industry partners—Lockheed Martin in particular for the 60 Romeo program—for Australian industry to compete inside the global supply chain, and we have actually seen Australian industry have some degree of success. Ferra Engineering in Queensland is building FLIR mounts and wings, not just for our 60 Romeos, but for the entire 60 Romeo worldwide fleet.

Mr King: In fact, the global supply chain approach is having much better—

Mr CONROY: It is a much better approach, I agree 100 per cent. Can you take on notice and provide those examples, if that is okay?

Mr King: Certainly.

Response:

The Global Supply Chain (GSC) Program aligns with policy goals established in the Defence Industry Policy Statement 2010, to increase the global competitiveness of Australian industry, particularly Small to Medium Enterprises, and facilitate access to export markets. Bid opportunities are identified, globally competed and awarded on merit. The GSC Program's flow-on benefit to Defence is its contribution to a more cost-effective and sustainable industry base.

Lockheed Martin signed its GSC Deed in January 2011 as an element of its tender for AIR9000 Phase 8. GSC funding enabled Lockheed Martin to create its Office of Australian Industry Participation (OAIP) in February 2012.

Approaching three years into the GSC Program, Lockheed Martin has facilitated GSC contracts worth over AUD 13 million, to 12 Australian companies. The GSC program has enabled Australian companies to engage Lockheed Martin across its defence and commercial business interests, that is, well beyond the limited stovepipe of the MH-60R acquisition and its relatively mature supply chain.

- (a) Examples of other Lockheed Martin GSC contracts include R&D collaboration on quantum physics, cyber security, photonics and advanced propulsion.
- (b) GSC contracts have also involved radar, simulation software and aerial surveillance systems.

As part of its GSC commitments, Lockheed Martin also offers mentoring and training for selected Australian SMEs to improve their global competitiveness and export readiness. It provides valuable market assistance to Australian companies through focussed meetings, with targeted procurement and supplier managers throughout Lockheed Martin.

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Question on Notice No. 3 - Australian Industry Content

Ms Brodtmann asked on 24 October 2014, Hansard page 13:

Ms BRODTMANN: You made mention of the fact that you have tightened up the definition of AIC. Can you give a generic document on what AIC or—

Mr King: We are using the 'manufactured in Australia' standard. I can get it for you.

Ms BRODTMANN: If you could get it, that would be great.

Mr King: It comes up regularly, particularly when we are in contention with our supplier who is claiming—

Ms BRODTMANN: That something is Australian when it is not.

Mr King: Yes, we can get that.

Response:

In this context, Defence use of the term 'manufactured in Australia' is based around the standards related to manufacturing origin as defined in the Competition and Consumer Act 2010, Part 5-3 – Country of Origins Representations (vol. 3) – excerpts attached.

***EXCERPT COMPETITION AND CONSUMER ACT 2010 – PART 5-3
– COUNTRY OF ORIGINS REPRESENTATION***

Part 5 -3 – Country of origin representations

254 Overview

This Part provides that certain country of origin representations made about goods do not contravene:

- (a) section 18 (which deals with misleading or deceptive conduct); or
- (b) section 29(1)(a) or (k) or 151(1)(a) or (k) (which deal with false or misleading representations).

255 Country of origin representations do not contravene certain provisions

- (1) A person does not contravene section 18, 29(1)(a) or (k) or 151(1)(a) or (k) only by making a representation of a kind referred to in an item in the first column of this table, if the requirements of the corresponding item in the second column are met.

Country of origin representations		
Item	Representation	Requirements to be met
1	A representation as to the country of origin of goods	(a) the goods have been substantially transformed in that country; and (b) 50% or more of the total cost of producing or manufacturing the goods as worked out under section 256 is attributable to production or manufacturing processes that occurred in that country; and (c) the representation is not a representation to which item 2 or 3 of this table applies.
2	A representation that goods are the produce of a particular country	(a) the country was the country of origin of each significant ingredient or significant component of the goods; and (b) all, or virtually all, processes involved in the production or manufacture happened in that country.
3	A representation as to the country of origin of goods by means of a logo specified in the regulations	(a) the goods have been substantially transformed in the country represented by the logo as the country of origin of the goods; and (b) the prescribed percentage of the cost of producing or manufacturing the goods as worked out under section 256 is attributable to production or manufacturing processes that happened in that country.
4	A representation that goods were grown in a particular country	(a) the country is the country that could, but for subsection (2), be represented, in accordance with this Part, as the country of origin of the goods, or the country of which the goods are the produce; and (b) each significant ingredient or significant component of the goods was grown in that country; and (c) all, or virtually all, processes involved in the production or manufacture happened in that country.

Country of origin representations		
Item	Representation	Requirements to be met
5	A representation that ingredients or components of goods were grown in a particular country	<p>(a) the country is the country that could, but for subsection (2), be represented, in accordance with this Part, as the country of origin of the goods, or the country of which the goods are the produce; and</p> <p>(b) each ingredient or component that is claimed to be grown in that country was grown only in that country; and</p> <p>(c) each ingredient or component that is claimed to be grown in that country was processed only in that country; and</p> <p>(d) 50% or more of the total weight of the goods is comprised of ingredients or components that were grown and processed only in that country.</p>

Note: The regulations may prescribe rules for determining the percentage of the total costs of production or manufacture of goods attributable to production or manufacturing processes that occurred in a particular country, see section 257.

- (2) Despite subsection (1), this section does not apply to a representation of a kind referred to in item 4 or 5 in the first column of the table in that subsection if the representation is made together with another representation of a kind referred to in item 1 or 2 in that first column.
- (3) Goods are *substantially transformed* in a country if they undergo a fundamental change in that country in form, appearance or nature such that the goods existing after the change are new and different goods from those existing before the change.
- (4) Without limiting subsection (3), the regulations:
 - (a) may prescribe changes (whether in relation to particular classes of goods or otherwise) that are not fundamental changes for the purposes of that subsection; and
 - (b) may include examples (in relation to particular classes of goods or otherwise) of changes which are fundamental changes for the purposes of that subsection.
- (5) Item 2 of the table in subsection (1) applies to a representation that goods are the produce of a particular country whether the representation uses the words “product of”, “produce of” or any other grammatical variation of the word “produce”.
- (6) The regulations made for the purposes of item 3 of the table in subsection (1) may, in relation to a specified logo, prescribe a percentage in the range of 51% to 100% as the percentage applicable to goods for the purposes of paragraph (b) in the second column of that item.
- (7) Goods, or ingredients or components of goods, are *grown* in a country if they:
 - (a) are materially increased in size or materially altered in substance in that country by natural development; or
 - (b) germinated or otherwise arose in, or issued in, that country; or
 - (c) are harvested, extracted or otherwise derived from an organism that has been materially increased in size, or materially altered in substance, in that country by natural development.
- (8) For the purposes of items 4 and 5 in the table in subsection (1) in relation to particular goods:

- (a) packaging materials are not treated as ingredients or components of the goods; and
 - (b) disregard the weight of packaging materials in working out the weight of the goods.
- (9) For the purposes of items 4 and 5 in the table in subsection (1) in relation to an ingredient or component that has been dried or concentrated by the evaporation of water, and to which water has been added to return the water content of the ingredient or component to no more than its natural level:
- (a) the weight of the water so added is included in the weight of the ingredient or component; and
 - (b) the water so added is treated as having the same origin as the ingredient or component, regardless of its actual origin.

256 Cost of producing or manufacturing goods

- (1) The cost of producing or manufacturing goods is worked out, for the purposes of section 255, by adding up the following amounts:
- (a) the amount of expenditure on materials in respect of the goods;
 - (b) the amount of expenditure on labour in respect of the goods;
 - (c) the amount of expenditure on overheads in respect of the goods;
- each worked out in accordance with this table:

Cost of producing or manufacturing goods		
Item	This amount of expenditure:	is worked out as follows:
1	Expenditure on materials in respect of the goods	The cost of materials used in the production or manufacture of the goods: (a) that is incurred by the manufacturer of the goods; and (b) that has not been prescribed by regulations made for the purposes of subsection (2)(a).
2	Expenditure on labour in respect of the goods	The sum of each labour cost: (a) that is incurred by the manufacturer of the goods; and (b) that relates to the production or manufacture of the goods; and (c) that can reasonably be allocated to the production or manufacture of the goods; and (d) that has not been prescribed by regulations made for the purposes of subsection (2)(b).
3	Expenditure on overheads in respect of the goods	The sum of each overhead cost: (a) that is incurred by the manufacturer of the goods; and (b) that relates to the production or manufacture of the goods; and (c) that can reasonably be allocated to the production or manufacture of the goods; and (d) that has not been prescribed by regulations made for the purposes of subsection (2)(c).

- (2) The regulations may, for the purposes of subsection (1), prescribe that:
- (a) the cost of a particular material, or a part of such a cost; or
 - (b) a particular labour cost, or a part of a labour cost; or
 - (c) a particular overhead cost, or a part of an overhead cost;
- is not allowable in respect of goods, or classes of goods.

- (3) The regulations may, for the purposes of subsection (1), prescribe the manner of working out:
- (a) the cost of a material, or part of the cost; or
 - (b) a labour cost, or part of the cost; or
 - (c) an overhead cost, or part of the cost.

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Question on Notice No. 4 - Reporting requirement regarding breaches

Senator Lundy asked on Friday, 24 October 2014, Hansard page 16:

Senator LUNDY: Can I just ask each of the agencies at the table: what are your reporting requirements regarding breaches? What process do you go through when you experience either an internal or an external breach? Who do you report to and how do you handle that within your agency?

Response:

All breaches are reported to the Defence Security Authority through a standard reporting process. In addition Defence, as a federal government agency is subject to the Information Security Manual (ISM), which states that agencies must report cyber security incidents to Australian Signals Directorate (ASD). Cyber security incident reports are the basis for identifying and responding to cyber security incidents across government. ASD has established the Cyber Security Incident Reporting scheme for this purpose.

The specific measures the Department takes to counter the threats from internal or external security breaches is sensitive and to discuss them would reveal details of our capabilities to potential adversaries, but we take the defence of our information and capabilities very seriously. We have dedicated teams of highly specialised, well trained operators who monitor our cyber environment, conduct vulnerability scanning and assessments, and provide advice and assistance to our capability delivery areas to ensure that security is an essential element of everything we do.

Defence, upon detecting a breach, typically mitigates the vulnerability which caused it to prevent future breaches.