



Australian Government
Department of Defence

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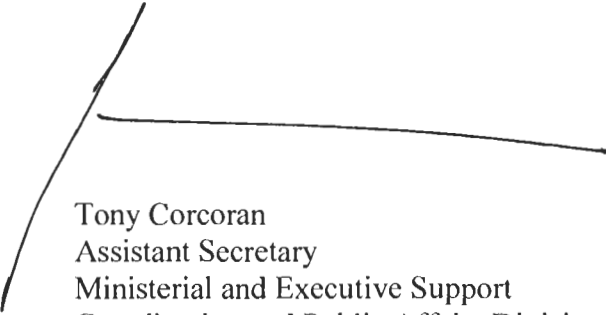
Dr Kris Veenstra
Secretary
Joint Committee of Public Accounts
and Audit
Parliament House
CANBERRA ACT 2600

~~Dear Dr Veenstra~~ *Kris*

I am pleased to enclose responses to questions on notice from the 29 March 2007 hearing into Financial Management and Equipment Acquisition at Defence and the DMO, as well as a number of written questions concerning the Armed Reconnaissance Helicopter project. These responses have been cleared by the Minister for Defence.

If you have any questions or concerns, please contact Mr Alex Tewes, Director Statutory Reporting and Accountability, on (02) 6265 6277.

Yours sincerely


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JOINT STANDING COMMITTEE ON PUBLIC ACCOUNTS AND AUDIT

**INQUIRY INTO FINANCIAL MANAGEMENT AND
EQUIPMENT ACQUISITION AT DEFENCE AND THE DMO**

QUESTIONS TAKEN ON NOTICE – 29 MARCH 2007

Question 1

Key controls

Mr Barresi, Hansard 29 March 2007, p 8

- a) Could Defence provide the Committee with updated statistics concerning key controls?
- b) How many key controls relate to inventory management and financial management information systems?

RESPONSE

- a) Attachment A provides a summary of both the key financial process controls and the controls around each of the Defence information systems that manage finance data.
- b) There are 289 key financial process controls that are configured within SDSS and ROMAN. There are approximately a further 38,900 application controls hard wired within information systems (SDSS, ROMAN, PMKeyS, ADFPAY, CENRESPAY, and COMSARM) that validate data and detect errors within the applications.

Defence Control Environment Statistics (May 2007)
(Number of Controls will vary with changes in business processes and improvements in controls)

Attachment A

Control Type	# Key Financial Process Controls	SDSS	ROMAN	PMKeys	ADFPAY	CENRESPAY	COMSARM	Total
A Location Specific Controls	539	0	0	0	0	0	0	539
B Multi-location Controls	341	0	0	0	0	0	0	341
C Number of Control Locations	2 - 539	0	0	0	0	0	0	
Multi-location Control Points (B x C)	37,589	0	0	0	0	0	0	37,589
E IT General & Security Controls	0	296	296	296	296	296	296	1,776
F System Application Controls	289	*14800	*600	*8500	*2500	*2500	*10000	39,189
Total number of Unique Controls (A+B+E+F)	1,169	15,096	896	8,796	2,796	2,796	10,296	41,845
Total Number of Control Points (A+D+E+F)	38,417	15,096	896	8,796	2,796	2,796	10,296	79,093

For the sake of Completeness these control numbers include process controls around:

- a. All Balance Sheet Accounts; and
- b. Financial Reporting.

Key Budgeting Controls will be added in FY 2007/08.

^ Key Application dependent process controls configured within the SDSS and ROMAN systems

* Application Control Estimates

Question 2

Training budget

Ms Grierson, Hansard 29 March 2007, p 18

What percentage of the current Defence budget is spent on financial training? How does this compare with previous years?

RESPONSE

	2004-05 Actual (\$m)	2005-06 Actual (\$m)	2006-07 Estimate (\$m)
Training expense	2,267	3,144	3,786
Defence Budget	14,694	17,299	19,291
Training expense as percentage of Defence Budget	0.015%	0.018%	0.020%

Question 3

COMSARM

Senator Bishop, Hansard 29 March 2007, p 30

Can the COMSARM system accurately track the number, status and location of rocket launchers?

RESPONSE

The COMSARM system is capable of tracking the number, status and location of items of the Explosive Ordnance inventory that are recorded in the system.

M72 Rocket Launchers are accounted for on COMSARM using their production batch and sealed crate identification numbers. This is because M72s do not have a unique identifier, such as a serial number or barcode.

The Weapon Security Performance Audit (Phase 1) has directed that the items currently in the inventory be marked with unique identifiers and that tracking in the COMSARM system until the item is issued. Future M72 Rocket Launchers to be acquired by Defence will be manufactured with unique identifiers and will be tracked in the COMSARM system until the item is issued.

Once the individually-marked rocket launchers are issued to an Army or Air Force unit, the actual number, status and location will not be visible in COMSARM; Army and Air Force procedures are used to record the items' number, status and location (the response to Question 5a contains details on these procedures). Consumption (ie. use or destruction of the item) must be reported to the COMSARM administrator.

The Weapon Security Performance Audit has also recommended that end-to-end management of weapons and munitions be standardised across Defence.

Question 4

Inventory Management

Ms Grierson, Hansard 29 March 2007, p. 31

In relation to explosive ordnance and COMSARM, could Defence provide an update on the last periodic review of the inventory management system?

RESPONSE

The latest review, conducted in March 2007, confirmed the integrity of the COMSARM Business Continuity (Disaster Recovery) Plan. User access controls were assessed and determined to be compliant, as were transaction recording and logging.

Question 5

Inventory management

Senator Bishop, Hansard 29 March 2007, p 32

- a) What is the system used by Defence or DMO for identifying inventory records of all ordnance?
- b) Is the system operating at 100 per cent efficiency? If not, why not?
- c) Can and does the system identify the geographic location of all ordnance used by the ADF both inside and outside Australia?
- d) Does the system identify locations of ordnance such as guns and rocket launchers?
- e) Has there been any recent advice to senior levels of Defence about rocket launchers, weapons and missiles that have gone missing without reason or without cause?

RESPONSE

- a) The statutory register in the Australian Defence Organisation for Explosive Ordnance is the COMSARM system. The records of all Explosive Ordnance under acquisition and in warehouses managed by the Joint Logistic Group are maintained in the COMSARM system.

Once the items are issued by the Joint Logistics Group to the unit level, each of the Services maintains records of the Explosive Ordnance in slightly different ways:

- The records of all items issued to the **Navy** are maintained in COMSARM. An item of Explosive Ordnance issued to the Navy is only ever registered in COMSARM as 'consumed' when actual consumption is reported by a Navy unit. The Navy gives information regarding the demand, movement, consumption and return of Explosive Ordnance a Confidential security rating; the use of the ADF paper-based accounting system and registers onboard HMA Ships in conjunction with COMSARM supports this security requirement.
- All items issued to the **Army** are identified in COMSARM as 'consumed' upon issue from the warehouse managed by the Joint Logistics Group. All records were previously maintained in either the Standard Defence Supply System, in accordance with the Defence Supply Chain Manual, or using the ADF paper-based accounting system. Army Logistic Instruction 6-15 *Unit Material Management Procedures*, issued 1 March 2007, now requires that all explosive ordnance transactions are recorded in the Standard Defence Supply System.

- **Air Force** management of Explosive Ordnance uses both COMSARM and ad-hoc manual systems at unit level. Management of high-cost items in the Air Force occurs in COMSARM and these items are only ever registered as 'consumed' in COMSARM when actual consumption is reported by an Air Force unit. For small arms ammunition and low-cost items, Air Force units use manual card systems and local procedures to manage inventory; these items are registered in COMSARM as 'consumed' upon issue from the warehouse managed by the Joint Logistics Group. The Air Force gives information regarding the demand, movement, consumption and return of Explosive Ordnance a Confidential security rating; the use of the COMSARM and manual card systems satisfies this security requirement.
- b) The maintenance contract requires a minimum level of maintenance of 95 per cent. During the last 12 months, this availability level has been exceeded.
- c) COMSARM identifies the geographic location of explosive ordnance in warehouses managed by the Joint Logistics Group. COMSARM records the designation of the ADF unit to which explosive ordnance is issued by the Joint Logistics Group.
- The Standard Defence Supply System identifies the unit to which explosive ordnance is issued if that unit records the information in the Standard Defence Supply System.
 - As the records of the items of explosive ordnance issued to the **Navy** are recorded in COMSARM until consumption, the storage location of the items in the custody of the Navy are recorded in COMSARM as being the ship to which it was issued.
 - The **Army** uses the Standard Defence Supply System to record information on the explosive ordnance in the custody of Army units. Information as to the unit to which the explosive ordnance was issued is maintained in the Standard Defence Supply System.
 - Those items issued to **Air Force** units that are identified as 'consumed' in COMSARM upon issue are managed using a manual card system (see the answer to Question 5a for details); changes in the location of that ordnance while it is in the custody of the Air Force unit are recorded in the manual card system. For the items of explosive ordnance issued to Air Force that are not managed using the manual card system, the geographic location information is recorded in COMSARM until consumption is reported.
 - The response to Question 5a contains further detail on each Service's inventory management procedures.
- d) The information on the location of armaments (such as rifles and pistols) is recorded in the Standard Defence Supply System; it is not recorded in COMSARM. The information on the location of explosive ordnance (such as rocket launchers, missiles and grenades) is recorded in the COMSARM system until it is identified in that system as 'consumed'. Where an item of explosive ordnance is issued to a unit and identified as 'consumed' in COMSARM, information on the location of that item is required to be recorded in other systems until actual consumption occurs. Items of explosive ordnance that are identified as 'consumed' in COMSARM upon issue are those items issued to Army units and some of the items issued to Air Force Units (see the answer to question 5a for further information).

- e) Following reports of weapons thefts late last year, the Minister for Defence announced that the Defence Security Authority would conduct a comprehensive audit of the security policies and practices applying to Defence weapons, munitions and explosives.

The audit's progress is reviewed regularly by an oversight board made up of senior members of Defence and provides updates to the Secretary and Minister as necessary. The first phase report was completed in January 2007. Further information may be found in the Minister's media releases MIN3/07 of 5 February 2007 and MIN53/07 of 5 June 2007.

Question 6

Inventory systems

Ms Grierson, Hansard 29 March 2007, p 37

Will the new inventory system interface with and be compatible with COMSARM when it is implemented in 2008?

RESPONSE

Defence is considering its options to strengthen the visibility of the explosive ordnance issued to unit level. Two options are currently being considered. One involves the tighter integration of serial number tracking functionality between COMSARM and the Standard Defence Supply System. This would be achieved by continuous reconciliation of serial number tracking data between the two systems supported by system control reporting. The second option involves deploying COMSARM to unit level, obviating the requirement for reconciliation between COMSARM and the Standard Defence Supply System. Both options are being studied and the preferred option will be determined within 12 months. Additionally, both options are capable of being integrated with the delivery of JP2077 2B.1 in late 2008, and neither option would require the building of an electronic interface.

Question 7

Allegations by Mr Ian Matthews

Senator Bishop, Hansard 29 March 2007, p 43

Could Defence provide the Committee with a formal written response to the allegations raised by Mr Ian Matthews at the JCPAA hearing on 8 February 2007?

RESPONSE

Defence's response to the assertions raised by Mr Ian Matthews in his submission to the JCPAA and his testimony before the Committee on 8 February 2007 is provided at Attachment A.

In summary, Defence disagrees with Mr Matthews' assertion that it does not take accrual accounting seriously. Defence has prepared accrual-based financial statements for budgeting purposes from 1999-2000 and for reporting purposes from 1994-95. While the Australian National Audit Office has identified shortcomings, Defence has made significant progress in its financial reporting which has also been publicly acknowledged by the Auditor-General.

Resolving financial reporting shortcomings has been, and continues to be, a high priority for Defence, as demonstrated by the significant investment made in remediation plans that have been executed in recent years and the personal attention given to these tasks by senior management.

Defence acknowledges that inventory reporting issues remain an area of remediation. These issues are being addressed in a structured manner and receive the focused attention of senior management.

JCPAA Inquiry into Financial Reporting and Equipment Acquisition at Defence and DMO - Defence Response to the Issues raised by Mr Ian Matthews

Purpose:

The purpose of this paper is to address the issues raised by Mr Ian Matthews in his written submission dated 3 April 2006 and his testimony before the Committee on 8 February 2007.

Defence's Financial Remediation Plans:

Defence disagrees with Mr Matthews' assertions in relation to ".....significant focus has been placed on the remediation plans. However, without grasping the concepts of financial management contained in accounting standards...." (Matthews' submission page 7, para 1)

Defence's financial remediation plans have been developed with the concepts of financial management contained in accounting standards. Defence's aim is to prepare accrual-based financial statements in accordance with Australian Accounting Standards.

Defence developed 16 remediation plans following the 2003-04 financial statements as an integrated approach to addressing the audit findings and other business process issues. These plans have delivered significant outcomes as outlined in the *2005-06 Defence Annual Report* at pages 65 to 67.

One of the remediation plans was to improve Defence's Financial Management Framework which focuses on the implementation of better financial management practices. This framework addresses areas including:

- documenting and standardising key financial processes including the adoption of better practices (where relevant);
- financial management training including senior officer training;
- developing a financial certification framework and re-engineering business skilling requirements;
- access to all financial management policies, processes and procedures via Defence's intranet;
- benchmarking processes against better practices; and
- implementing a structured quality assurance program.

The ANAO has acknowledged the efforts that Defence has taken in addressing financial management issues [refer to page 8 of the ANAO submission to the committee].

Financial Reporting in Defence:

Defence disagrees with Mr Matthews' assertions in relation to "...Defence may not embrace the financial management principles of accrual accounting" (Matthews' submission page 7, para 1) and "Due to the focus on cash rather than financial management, Defence sees little benefit in recording assets." (Matthews' submission page 2, para 7)

Defence does embrace the financial management principles of accrual accounting and the need to ensure effective reporting of its assets.

Since 1994-95, Defence has sought to prepare accrual-based financial statements in accordance with the Financial Minister's Orders (FMOs) and the Australian Accounting Standards. In particular, the Australian Defence organisation is further advanced in adopting the requirements of the International Financial Reporting Standards than its US, UK, Canadian and New Zealand counterparts.

Through its remediation plans and ongoing activity, Defence has actively pursued improvements in its financial management, including accrual accounting. This was demonstrated by the significant financial reporting improvements achieved for 2005-06 in the areas of explosive ordnance inventory, infrastructure, plant and equipment, and military and civilian leave balances.

Defence notes that further work remains to be done in accounting for general stores inventory and repairable items and has established a dedicated team to oversight the resolution of the outstanding issues over the next two years.

Where accounting standards do not adequately align with the business needs of not-for-profit public sector organisations, Defence has raised these issues with the Department of Finance and Administration and the Australian Accounting Standards Board seeking clarification or proposing amendments to accounting standards or FMOs.

Cash Management

Defence disagrees with Mr Matthews' assertion that "Defence's continued focus on cash accounting is the prime reason for their continual failure to meet the requirements of accounting standards." (Matthews' submission page 2, para 4)

Defence's focus on financial information includes both cash and accrual information. Defence continues to implement improvements in financial management principles of accrual accounting, which is evident with the development of 16 financial remediation plans.

With the implementation of an accrual framework, Defence has focused on accrual information relating to assets and liabilities (including receivables, payables, and employee liabilities) to effectively and efficiently manage its business.

However, Defence uses cash information to plan cash requirements for its operating, investing and financing activities, eg. planning for cash payments made to suppliers for major acquisition projects.

Management of Specialist Military Equipment (SME)

Defence's comments on the assertions made by Mr Matthews in regard to the management of SME are outlined below.

- (1) "... if Defence complied with accounting standards, spare parts related to assets should not be included in this value of obsolete inventory". [Matthews' submission page 4, paragraph 2]
- (2) "...focus on purchase costs rather than the ongoing financial management of the assets also leads to poor record keeping...." [Matthews' submission page 5 paragraph 2] and "Such dates [useful life] are often very inaccurate within Defence records and therefore results in these assets being incorrectly valued in the accounts...". - [Matthews' submission page 5, paragraph 5]
- (3) "...currently little post acquisition review to determine whether those assets are actually providing the benefits used to justify their acquisition". - [Matthews' submission page 5, paragraph 1]
- (4) "Why are assets that have been stripped for parts valued as if they are operational" [Matthews' submission page 5 paragraph 1]
- (5) "The warehouse does not open these [cartons/crates] to determine whether the item inside is actually the item on the paperwork." and "... they do not have the technical knowledge to identify the item or whether it is operational." [Matthews' submission page 5, paragraph 4]

(1) Capitalisation of SME (including thresholds) and Related Major Spares

It is Defence policy to recognise repairable items and major spares as depreciable assets and not as inventory. As a result, these items would not have been included in obsolete inventory.

Defence recognises Specialist Military Equipment (SME) in its financial statements, including repairable major spares (such as aircraft engines) as assets. Capitalisation thresholds are subject to regular review to ensure they remain valid. The most recent review of thresholds has resulted in changes in the thresholds for most categories of property, plant and equipment, which has subjected more assets to capitalisation than had previously been the case.

Repairable major spares are capitalised and depreciated over the asset's useful lives, as required by the accounting standards. Non-repairable or minor spares, including washers and nuts and bolts, are categorised as inventory. Defence reviews its accounting policies annually to ensure consistency with the accounting standards and the FMOs.

(2) Financial Management of Assets including Useful Life

Defence focuses on both the costs of asset purchases as well as the ongoing financial management of assets.

Defence assets are subject to annual review, as required by the accounting standards, in relation to useful lives, componentisation, decommissioning costs, impairment and obsolescence.

Specifically, the Defence Capability Committee reviews the planned withdrawal dates and useful lives of major SME platform assets, including related spares, annually. Decisions are then reflected in the fixed asset register and hence the financial statements.

(3) Assets Management

Defence has formal processes to ensure purchased assets are fit for purpose before being formally accepted into service.

Defence's SME acquisition program is professionally managed by the DMO. Defence also ensures that it appropriately accounts for the potential costs of decommissioning and major inspections when purchasing assets. After acquisition, Defence manages its SME assets effectively to ensure that they are fully maintained and ready for operational activities as evidenced by the significant sustainment activity carried out on behalf of Defence by the DMO.

Furthermore, annual impairment assessments are carried out to ensure that SME including assets under construction is carried at the appropriate value in Defence's accounts. Project costs capitalised are reviewed regularly to ensure that they only contain capital expenditure.

(4) Assets Stripped for Spare Parts

It is not Defence policy to value assets stripped for spare parts as if they are operational.

There are processes and procedures in place to manage and account for assets which are used to provide parts for assets retained in use. Defence undertakes a review of these items on an annual basis to ensure appropriate recording and reporting of these items.

(5) Receipts of Equipment and Inventory into Warehouses

Defence has robust processes for receipting goods into warehouses.

Equipment (assets) and inventory received into warehouses are checked by Logistics Managers on a regular basis. They identify items which are not delivered according to specification and appropriate corrective action is taken.

Inventory Management

Defence's comments on the assertions made by Mr Matthews in regard to inventory management are outlined below.

- (1) *"Many of the items received into warehouses are expensed at the time they are purchased". - [Matthews' submission page 6 paragraph 6]*
- (2) *"That is, they have purchased billions of dollars in inventory that they believe offer no benefit to them." - [Matthews' submission page 4 paragraph 1]*
- (3) *"Defence could comply with this [inventory] accounting standard without changes to their existing system and with minimal cost. Their current approach is based on a very narrow definition of the goalposts and not knowing the actual application of the rules". - [Public hearing transcripts of 29 March - page 35 paragraph 2]*

- (4) *“Defence has reported in their accounts that around half of their inventory is obsolete” - [Matthews’ submission page 4 paragraph 1] and “Defence often associates these inventory write-offs on their need for war reserves.”- [Matthews’ submission page 4, paragraph 4]*
- (5) *“...Defence could not adequately track the issuing of spare parts and consumables from their warehouses. ...This meant that a large portion of these expenses could not be tracked to the correct division within Defence (i.e. Army, Navy or Air Force)...” [Matthews’ submission page 6 paragraph 5]*
- (6) *“This lack of knowledge of specialised equipment also causes issues within warehouse and other storage facilities. This also applies to stocktakes.” [Matthews’ submission page 5, paragraph 4]*

(1) Recognition of Inventory

Inventory items received into warehouses are not expensed but recognised as assets.

Defence’s inventory includes explosive ordnance (EO), General Stores Inventory (GSI) and fuel. GSI includes clothing and other personal issue items, ration packs, pharmaceuticals, minor spares and other consumable items. Inventory items are recognised as an asset and are subject to regular management reviews to identify obsolete and excess inventory items. Defence is currently addressing issues specifically affecting the accurate accounting and management of inventory, including the validation and remediation of GSI quantities and pricing.

(2) Inventory Purchases

Defence inventory purchase decisions are made on the basis of operational and capability sustainment requirements ultimately based on preparedness directives issued by the CDF and Service Chiefs.

Sometimes this includes the purchase of inventory items that are held on a ‘just in case’ basis. This does not mean that these items do not provide a benefit to Defence. Inventory purchases include purchases for immediate use, purchases to support platform assets and war reserves.

The prescription of the DMO has provided the opportunity to specify in Materiel Sustainment Agreements (MSAs) Defence’s requirements for platform availability. These MSAs help to determine the procurement plans for inventory and repairable items.

Purchasing decisions made by delegates are always made with regard to the requirements of the *Financial Management and Accountability Act 1997* for the efficient, effective and ethical use of public monies. While purchasing may be devolved regionally, global ADF Logistics Managers have responsibility for monitoring procurement activity to ensure that stock levels match requirements.

(3) Inventory Valuation

Defence seeks to ensure that it implements the financial management principles of accrual accounting and the need to effectively report its assets.

Defence has attempted to apply the existing accounting standard (AASB 102) to value its inventory. This standard requires inventory to be valued at the lower of cost and current

replacement cost (CRC). Defence had practical difficulties in implementing this standard to around 600,000 inventory types or over 150 million items. This would have required Defence to maintain at least two prices (weighted average cost and CRC) for all the inventory items and to have done an annual comparison of these two prices at each year end.

Defence has raised these issues with the Australian Accounting Standards Board and, as a result, comments are being sought on an exposure draft (ED54) which amends the inventory accounting standard to enable non-for-profit organisations to value their inventory at cost, adjusting for any loss of service potential. Defence believes that the revised inventory valuation methodology is more appropriate, and therefore supports the amendment to the standard.

(4) Inventory Write-Downs

Defence did not report half of its inventory as obsolete in its 2004-05 financial statements.

Generally, the majority of the net write-downs relates to obsolete and slow-moving items in accordance with the Australian Accounting Standards. Defence also makes write-down adjustments resulting from the outcome of periodic stock counts. Defence does have a need to maintain war reserve holdings beyond what would be justified by normal consumption patterns. These items may be held for relatively long periods and would be subject to regular review for obsolescence and then write off.

The percentage of inventory written down in 2004-05 was approximately 28 per cent net of provision for obsolescence (PFO) and not 50 per cent as asserted by Mr Matthews. Over half of this write-down related to EO pricing remediation activity. In particular, a write-down of this proportion does not represent the average inventory write-down in any year (eg. 3 per cent write down in 2005-06). The PFO for inventory items is reviewed annually by the responsible logistics managers.

(5) Tracking the issue of spare parts and consumables

Defence has policies and processes in place to appropriately track (assign) the costs of inventory as it is issued for consumption.

Inventory items remain in the balance sheet until issued to end users. The appropriate consumption expense is then assigned to Defence users and reflected in the financial statements.

(6) Inventory Stock Counts, Handling of Discrepancies

It is Defence policy that appropriate stocktaking processes are adhered to.

Stocktaking processes have been subject to significant improvements in the last two years including:

- the commencement of a strengthened two-year cyclical stocktake program from 1 July 2005;
- stocktake teams now include staff and contractors with relevant skills and knowledge to conduct the stock counts;
- a stocktake reporting system has been implemented to report stock take results to senior management;
- a separate sampling program has also been developed. This is used to determine a program of confirmatory stocktakes conducted by dedicated logistics compliance and assurance teams from within the Joint Logistics Group to ensure completeness and accuracy of stocktakes; and
- business process controls have been implemented to ensure financial adjustments arising from stock counts are processed in the inventory management system.

Question 8

Procurement Improvement Program

Senator Bishop, Hansard 29 March 2007, p 46

Could Defence provide the Committee with detailed advice concerning the payments made to each of the firms involved in the Procurement Improvement Program that was under the supervision of Ms Gillian Marks? This should include the full name of each firm, the amounts of funds paid and a general description of the services provided.

RESPONSE

The Defence Materiel Organisation engaged four firms for the Procurement Improvement Program at a total cost of \$4,850,221.09. The full name of each firm, the amount of funds paid and a general description of the service provided is as follows:

- Freehills – \$1,914,105.94. Review and revision of procurement and contracting policies, practices, guidance, templates and training.
- Malcolm Johns & Company – \$348,031.07. Review of the Freehills work, and advice on the merits and quality of the three procurement and contracting approaches (ASDEFCON [the extant Defence contracting suite], COMPACT [the Procurement Improvement Program outcomes produced by Freehills], and the Exposure Drafts (prepared by Pillsbury Winthrop Shaw Pittman).
- Pillsbury Winthrop Shaw Pittman (PWSP) – \$887,051.32. Review of Freehills work and production of contracting and procurement templates and other documents.
- Alston & Bird – \$1,701,032.76. Continuation of the work commenced by PWSP as key personnel move from that firm to Alston & Bird.

Question 9

Project cost increases

Ms Grierson, Hansard 29 March 2007, p 53

Could you please provide the Committee with a breakdown of increases in project costs? What is the value of the 72 per cent of projects that are on schedule, and the 28 per cent of projects that are experiencing delays?

RESPONSE

There are currently 230 funded Major Capital Equipment projects managed within DMO with a total current value of \$59 billion.

The overall DMO project schedule statistics during the period January 2007 to March 2007 are as follows:

- Projects representing 81.5 per cent of the DMO budget (\$48 billion) are either on schedule or subject to less than 12 months' schedule slippage.
- Projects representing 18.5 per cent of the DMO budget (\$11 billion) are expecting schedule slippage of greater than 12 months.
- There is only one project that currently requires additional funds associated with schedule delay.

Question 10

DMO General Counsel

Senator Bishop, Hansard 29 March 2007, p 53

- a) Was Mr Gillian Marks previously employed at the Freehills legal firm?
- b) Is Defence aware whether Ms Marks had any financial or illegal or other interest in any of the firms that were contracted to work on the Procurement Improvement Program, both in the United States and in Australia?
- c) Is Defence aware whether Ms Marks retained any obligations that involved consideration from her former employer after she left her former employer and came to work for the DMO?
- d) Does Defence have any rules or guidelines that either permit or authorise, or prohibit employees at a senior level from retaining any interest in former places of employment?

RESPONSE

a) Yes.

b) to d) As Defence told Senator Bishop at the hearing, all senior executives in the Defence organisation are required to file a declaration of financial and personal interests. That is retained by the Secretary of Defence, and accessed as needed, and is a private matter between an employer and an employee. As such, it would not be appropriate to make any public comment. Guidelines regarding conflict of interest are contained in the *Australian Public Service and Code of Conduct in Practice*, published by the Australian Public Service Commission. Defence has in place internal practices that reflect those guidelines.

Joint Committee of Public Accounts and Audit

Inquiry into Financial Management and Equipment Acquisition at Defence and the DMO

Responses to Questions on Notice

Question 1

Project AIR 87 (Tiger helicopters) flight simulators

Can Defence confirm the media reports of 7 July 2007 that payments to Australian Aerospace Pty Ltd for failure to deliver flight simulators for the Tiger helicopters have been suspended?

If so,

- a) how many simulators were ordered;
- b) when was the contract for the supply of the simulators signed;
- c) what was the total value of the contract;
- d) what other services including maintenance and support were contained within the contract and at what cost;
- e) what was the contracted delivery date;
- f) what variations to the original contract have been made, for what reason and at what cost;
- g) what penalties apply for failure to deliver the simulators on time;
- h) what further delays will occur to the finalisation of full training for all necessary pilots for all aircraft; and
- i) what amount has been paid so far of the total contracted price?

RESPONSE

Payment to Australian Aerospace Pty Ltd under the acquisition contract was suspended on 1 June 2007 due to the company's failure to meet the requirements of Initial Operational Capability. The primary cause of the failure to meet this milestone was the delay in the training of aircrew.

Delays in the delivery of the flight simulators has affected the training and delays in the Franco-German program meant that the instructors were not trained in France as contracted.

- a) Three, as follows:
 - One Full Flight and Mission Simulator (to be located at the Army Aviation Training Centre, Oakey, Queensland), incorporating independent Pilot and Battle Captain modules, which can be connected electronically to act as a single aircraft or operated as two separate simulators;
 - One Cockpit Procedural Trainer (to be located at the Army Aviation Training Centre, Oakey, Queensland); and
 - One Cockpit Procedural Trainer (to be located with 1 Aviation Regiment, Robertson Barracks, Darwin, Northern Territory).
- b) 21 December 2001.

- c) The total value of the ARH Project (Project AIR 87 Phase 2) is \$2.012 billion, as noted on page 258 of the *Portfolio Budget Statements 2007-08*. At the time of contract signature in 2001, the value of the simulator acquisition was \$150m.
- d) The ARH Acquisition Contract provided for the supply of the ARH System and incorporated a number of services within the Aircrew Training Devices element. These included ancillary activities associated with program management, systems engineering, courseware development, delivery and introduction into service. These were embedded within the overall cost of \$150m.

A separate contract for the Through Life Support (TLS) of the ARH capability, was signed between the Government and Australian Aerospace on 21 December 2001.

The total value of the ARH Through Life Support Contract is \$484m, which includes \$154m for the conduct of aircrew training using the simulators, maintenance, logistics and engineering support.

- e) The simulators were originally contracted for delivery from January 2005 but following a Contract Change Proposal (CCP), initiated by the Government, this was amended to June 2005.
- f) Two variations to the ARH Acquisition Contract at a fixed cost of \$10.8m have been agreed between the Government and Australian Aerospace relating to the supply of the simulators:
- Highlight Brightness (CCP 030). Effected changes to the contract specification to reflect the incorporation of modern Liquid Crystal Display (LCD) projectors into the Full Flight and Mission Simulator design, which were not envisaged under the original technical specification
 - Enhanced ARH Full Flight and Mission Simulator Field of View and addition of motion for the Full Flight and Mission Simulator (Battle Captain) (CCP 031). Effected changes to the contract specification to reflect the incorporation of an increased Field of View for the Full Flight and Mission System out the window visual system to enhance the simulated environment presentation, and the addition of a six-axis motion system for the Full Flight and Mission Simulator (Battle Captain) to increase the fidelity of the simulation and align with the design of the Full Flight and Mission Simulator (Pilot).
- g) The ARH Acquisition Contract includes provision for the recovery by the Government of Liquidated Damages from Australian Aerospace for failure to achieve contracted milestones. The Liquidated Damages may be recovered as a debt, or by agreed compensation from Australian Aerospace.

Within the training element of the Acquisition Contract the following amount of Liquidated Damages that can be applied:

- Full Flight and Mission Simulator: \$0.484m and €1.760m;

- Cockpit Procedures Trainers: \$0.242m and €0.880m for each Cockpit Procedures Trainer; and
- Ground Crew Training Devices: \$0.242m.

A further amount in Liquidated Damages per month, comprising \$0.048m and €0.176m to a maximum of \$0.242m and €0.880m, is also recoverable in the event of failure by Australian Aerospace to achieve Training System Readiness.

Total Liquidated Damages recoverable for late delivery of the simulators and commencement of training (\$1.210m and €5.280m) equates to \$10.2m. The Government has preserved its rights in regard to these Liquidated Damages, which will be considered upon delivery of the simulators and achievement of all associated milestone deliverables.

- h) Defence is working with Australian Aerospace on initiatives to complete training and delivery of operational capability to Army. Training is currently two years behind schedule.
- i) As of 30 June 2007, under the ARH Acquisition Contract a total of \$981.775m has been paid. Seven ARH have been accepted (these have now logged 1500 flying hours) and nine aircrew have been trained with basic qualifications. The support infrastructure, including software support facilities, is being matured.

Question 2

Training for pilots and instructors

How many pilots and instructors have now been trained (a) in France and (b) Australia, and of those how many have left the program?

RESPONSE

Three Army ARH Test Pilots, two Army ARH Qualified Flying Instructors (QFIs) and one Industry QFI undertook training in France in 2005. Of these, one Army QFI resigned on return to Australia and the Industry QFI failed to meet the required standard. The remaining Army QFI is completing QFI training in Australia, and expected to do so by the end of July 2007.

One Army Test Pilot was trained and qualified in Australia in 2006.

An additional Army QFI and three Industry QFIs have completed pilot training in Australia, and should complete QFI training by the end of July 2007.

Question 3**Provision of training**

Has agreement now been reached with the contractor on the provision of training, as referred to at page 155 of Senate Estimates of 31 May 2006? If so, at what cost and with what saving to the Commonwealth?

RESPONSE

Yes. Agreement has been reached in principle with the contractor on the provision of training. However, the scope of contract change is currently being negotiated; consequently, costs or savings involved cannot yet be quantified.

Question 4**Liquidated damages – readiness for training**

With reference to the answer given at page 3 of the JCPAA transcript of 1 March 2007 concerning the provision for liquidated damages of \$10.2 million for failure to meet 'readiness for training', has this now been paid? If not, why not?

RESPONSE

No. Under the terms of the contract, the Liquidated Damages are settled on completion of the milestone, when payment is normally made. The readiness for training milestone has not yet been achieved; therefore, although Liquidated Damages have accrued, payment has not yet been made.