

Executive summary and recommendations

In October 2009, the Department of Defence (Defence) elected to re-test the market and commence a new procurement process for air sustainment services to the Middle East Area of Operation (MEAO).

From the start, there were clear indicators that this tender required particular and special attention. Indeed, both past experiences and current circumstances signalled significant probity risks, particularly in respect of conflicts of interest, breaches of confidentiality and proponent grievances about these matters, including:

- a notorious history of controversy associated with the MEAO contracts, particularly proponent grievances about the probity of an earlier tender process in 2005 and a record of personal animosity between some companies as played out in the national media;
- the small and extremely competitive nature of the commercial air charter market—in the lead up to the 2010 tender there had been active market monitoring and lobbying activities of suppliers, including an unsolicited proposal;
- the high value of the contract and the limited timeframe for the procurement; (just over eight weeks);
- the movement of personnel between tenderers and between Defence and tenderers;
- prior to the release of the request, the incumbent contractor raised concerns about probity matters involving the alleged disclosure of confidential tender information by a Reservist who, in his civilian capacity, was employed as a consultant to a potential tenderer;
- the Reservist's continuing association with that tenderer after the release of the request;
- early concerns raised by the incumbent contractor about the changed tender specifications, particularly the increased cargo volumetric capacity and the preference for a single aircraft solution with suggestions that the changes could advantage a particular tenderer; and
- the complexity of the proposed procurement arrangements, particularly the use of the standing offer panel to purchase longer term, scheduled air sustainment services.

Although Defence had at least constructive knowledge of these circumstances and the associated probity risks, it failed to implement measures to enable the systematic identification and management of potential probity risks arising from these circumstances—for example, documenting a probity plan, integrating probity issues into the risk assessment framework and appointing a probity advisor.

Confronted by serious allegations of impropriety and before the contract was finalised, Defence initiated four separate reviews of the tender process by the Audit and Fraud

Control Division in Defence, PricewaterhouseCoopers, Deloitte and the Australian Government Solicitor. They identified a raft of serious deficiencies in the process but, overall, concluded that the flaws were not sufficiently material to render the process unsound.

While not fully convinced, the committee agrees with their findings. It could find no compelling evidence of outright fraud; of the use of insider knowledge; of designing the tender to unfairly favour a preferred tenderer; or of the successful tenderer's inability to deliver services as specified under the contract. Finally, there was no concrete evidence to suggest that the successful tenderer was not fit and proper for the purposes of contracting with the Commonwealth.

The committee is strongly of the view, however, that Defence should not take comfort from these findings. This tender was not only valued at over \$122 million but provides a critical service to Australian forces serving in the Middle East Area of Operations.¹ Aspects of the tender process were plain sloppy and, in light of the nature of the industry and the behaviour of people in the industry, Defence was notably inattentive when it came to identifying and managing probity risks, especially conflicts of interests. Thus a cloud of uncertainty lingers over the integrity of this tender.

The reviews and the committee also uncovered weaknesses in the procedures for preparing and evaluating the tender. For example, inadequate documentation, poor consultation and lack of certification gave rise to confusion, inconsistency and a failure to correct an error in calculations during the evaluation. Although the Source Evaluation Report was re-validated and confirmed the successful tender as top ranked, the problems identified in the process cannot help but undermine the committee's confidence in the robustness of the decision-making processes.

Undoubtedly, the circumstances which prompted the significant parliamentary and public scrutiny of the 2010 tender process have damaged Defence's image and reputation. It must also have undermined the industry's confidence in the integrity of the process. While the lessons emerging from this incident need not have been learned at such significant cost, the committee welcomes the reforms announced by Defence during the inquiry. These measures may go some way towards addressing the governance and procedural shortcomings evident in the 2010 tender process. The committee has made recommendations for further reforms to enhance those already in train. It has also requested the Auditor-General to conduct a review of the tender process and the reforms announced by Defence, to identify any additional lessons to be learned.

The committee has also highlighted the need for ongoing monitoring of the implementation and effects of these reforms to avoid an 'implementation gap' between documented policy reforms and procurement practice and has recommended that Defence provides the committee with periodic updates on these matters.

1 The estimated annual contract price is approximately AUD \$30.937 m (exclusive of fuel costs) with a contract period of two years, plus two one year options.

The committee's recommendations are listed below.

Recommendation 1

paragraph 9.28

The committee recommends that Defence:

- requires the documentation of a dedicated probity plan for all future procurements of air sustainment services to the MEAO;
- ensures probity plans for all future procurements of air sustainment services to the MEAO identify expressly and address the risks associated with:
 - (i) proponent grievances and
 - (ii) the small and highly competitive nature of the commercial air charter market;
- implements its proposed policy of appointing probity advisors to all complex and strategic procurements and monitors closely the implementation progress and impact of this policy—in particular, ensures that a probity advisor is appointed to all future procurements of air sustainment services to the MEAO; and
- amends chapter 3.2 of the Defence Procurement Policy Manual on risk management in procurement to include references to probity risks. In particular, Defence should consider cross-referencing chapter 3.13 on ethics and probity in procurement.

Recommendation 2

paragraph 10.9

The committee recommends that Defence reviews all Defence Instructions and related documents in respect of Reservists, full or part time, to ensure that real and potential conflicts of interest that might arise as a result of past, current or post separation employment are identified, reported and managed appropriately. In particular:

- a) Defence considers whether Defence Instructions DI(G) PERS 25-2 (Employment and voluntary activities of ADF members in off-duty hours) and DI(G) PERS 25-3 (Disclosure of interests of members of the ADF) should be extended to Reservists who are not engaged in continuous full-time service; or
- b) if there is no intention to extend the application of DI(G) PERS 25-2 and DI(G) PERS 25-3 to Reservists who are not engaged in continuous full-time service, Defence develops specific policies covering the civilian employment of, and the disclosure of conflicts of interests by, those personnel.

Recommendation 3

paragraph 10.21

The committee recommends that, prior to the re-tendering of any future contracts for the provision of air sustainment services to the MEAO, Defence ensures that:

- a) all Reserve personnel involved in the procurement complete a conflict of interest declaration; and

- b) commanding officers or supervisors in 1JMOVGP:
- (i) make a risk-based assessment as to which other Reserve personnel must complete a conflict of interest declaration and which personnel do not;
 - (ii) in making a risk-based assessment, give consideration to identifying and obtaining conflict of interest declarations from Reservists who have associations with the commercial air charter industry. Such associations may include:
 - present or previous civilian employment with air transport providers;
 - financial interests in these companies or related companies; or
 - professional or social relationships with members or employees of these companies; and
 - (iii) document their decisions whether or not to require these Reservists to complete a conflict of interest declaration.

Recommendation 4

paragraph 10.22

The committee recommends Defence ensures that, in all future procurements of air sustainment services to the MEAO:

- All members of tender evaluation boards and working groups, and all persons involved in the development of requests, sign conflict of interest declarations. Such declarations:
 - a) should be signed prior to the commencement of the tender evaluation process or the development of the request (as applicable); and
 - b) include declarations about possible conflicts of interest arising from their employment, prior employment, financial interests in potential suppliers or relationships with persons who have interests in potential suppliers.
- All members of tender evaluation boards and working groups receive specific briefings on conflicts of interest and other probity matters, prior to the commencement of tender evaluations.

Recommendation 5

paragraph 11.20

The committee recommends that Defence:

- In line with the findings of the AFCD Review, considers strategies for the improved documentation of the business case for any future decisions to re-test the market for the provision of air sustainment services to the MEAO.
- Reviews its procurement plan for the current MEAO contract, to ensure that sufficient lead time is provided for the making of any future decisions to re-test the market, and the planning and execution of a procurement process.
- In all future procurements of air sustainment services to the MEAO:

- a) continues to include in procurement strategies a requirement that members of the Air Transport Standing Offer Panel are given advance notice of any decisions to re-tender the contract, prior to the release of the RFT; and
- b) ensures that such requirements are implemented.
- Implements strategies to ensure that potential tenderers have a clear and accurate understanding of how Australian industry participation is taken into account in the evaluation of tender responses, as part of the overall value for money assessment.
- On the release of future requests for air sustainment services to the MEAO, implements the following actions to minimise the risk of potential proponent grievances:
 - a) provides potential tenderers with an explanation of the reasons for re-tendering the contract and any changes to tender requirements from the previous request;
 - b) provides potential tenderers with an explanation of how the evaluation criteria in the request documentation will be assessed; and
 - c) includes in the request documentation, where applicable, an express statement of Defence's:
 - (i) preferred solution for meeting tender requirements, including technical specifications; and
 - (ii) intention to consider alternative solutions.
- As a matter of priority in future tender processes for the provision of air sustainment services to the MEAO, takes action on the tender evaluation issues identified by the Deloitte, AGS and AFCD Reviews, as documented at paragraph 11.15 of this report.

Recommendation 6

paragraph 12.10

The committee recommends that in all future procurements of air sustainment services to the MEAO, Defence develops and implements tender evaluation processes for assessing respondents' fitness and propriety to contract with the Commonwealth. Such evaluation processes should:

- a) identify criteria setting out requirements or indicators for being 'fit and proper' to contract with the Commonwealth;
- b) specify searches that may be conducted on tender respondents, their key personnel, proposed subcontractors and any associated companies (for example, parent or subsidiary companies)—including guidance on the scope of the searches;
- c) identify the possible implications of the findings of each of the specified searches; and

- d) enable the identification and assessment of potential risks arising from issues identified in these searches including:
- (i) reputational damage to the Commonwealth, should it proceed to contract with the relevant tenderer; and
 - (ii) proponent grievances about the relevant tenderer's fitness and propriety to contract with the Commonwealth.

Recommendation 7

paragraph 12.16

The committee recommends that Defence includes in all future tender evaluation documentation for the procurement of air sustainment services to the MEAO:

- specific provisions on conducting financial risk assessments of tender responses involving charter broker arrangements; and
- essential requirement that proposals involving any form of broker-based solution—including sub-contracting arrangements—must include the complete financial statements of the proposed air charter operator and any other proposed sub-contractors.

Request to Auditor-General

paragraph 12.22

The committee requests that the Auditor-General:

- Conduct a performance audit of the tender process in respect of RFT AO/014/09, with a focus on probity risk management. In particular, the audit should evaluate the following matters, with a view to identifying any further areas for future improvement:
 - a) Defence's governance arrangements for the identification and management of significant probity risks to the procurement process, including conflicts of interest, confidentiality and proponent grievances;
 - b) Defence's program of procurement governance and process reforms, including those outlined in its evidence to the committee; and
 - c) any other matters considered relevant to probity risk management, or related governance matters, in respect of the procurement of air sustainment services to the MEAO.
- After sufficient time has elapsed, conduct a second review to examine Defence's implementation of its program of procurement governance and process reforms. In particular the review should:
 - a) evaluate the implementation progress and impact of the reforms outlined in Defence's evidence to the committee; and
 - b) recommend, as necessary, any further reforms to probity risk management and other governance arrangements in respect of the procurement of air sustainment services to the MEAO.

Recommendation 8**paragraph 12.23**

The committee recommends that Defence report back to the committee by 1 May 2012 on the progress being made to implement the reforms it has announced including:

- the ongoing performance of the 2010 contract, including the cost per mission, the realisation of projected savings, the continuing need for the increased cargo volumetric requirements and the contractor's compliance with the tender requirements;
- progress on the establishment of the Centre of Excellence that is intended 'to support a more robust and consistent commercial approach to non-equipment procurement';
- the work of the newly created Non-Equipment Chief Procurement Officer; and
- the strategies for the recruitment and retention of suitably skilled procurement professionals.

Recommendation 9**paragraph 12.25**

Although the majority of recommendations apply to the procurement of air sustainment services to the MEAO, the committee recommends that Defence consider incorporating the principles and practices underpinning them as part of Defence wide non-equipment procurement policy.

