

# **Management of the Disposal of Specialist Military Equipment**

Department of Defence

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Canberra ACT  
5 February 2015

Dear Mr President  
Dear Madam Speaker

The Australian National Audit Office has undertaken an independent performance audit in the Department of Defence titled *Management of the Disposal of Specialist Military Equipment*. The audit was conducted in accordance with the authority contained in the *Auditor-General Act 1997*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of this audit to the Parliament.

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

Yours sincerely



Ian McPhee  
Auditor-General

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

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# Abbreviations

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ACM	Asbestos-containing material
ADF	Australian Defence Force
ADP	Accelerated Disposals Program
AGS	Australian Government Solicitor
AHOs	Australian Historical Organisations
AITT	Asbestos Inventory Tiger Team [ <i>in Defence</i> ]
ALSPO	Air Lift Systems Program Office
AMSO	Australian Military Sales Office
APS	Australian Public Service
ARPANSA	Australian Radiation Protection and Nuclear Safety Agency
AVLB	Armoured Vehicle Launch Bridge
CAF	Chief of Air Force
CEO DMO	Chief Executive Officer, Defence Materiel Organisation
CFO	Chief Finance Officer
CPGs	Commonwealth Procurement Guidelines
CPRs	Commonwealth Procurement Rules
DAS	Directorate of Disposals and Sales [ <i>within AMSO</i> ]
DDA	Defence Disposals Agency
DEWHA	[Former] Department of Environment, Water, Heritage and the Arts
DGDAIM	Director-General, Defence Assets and Inventory Management
DI(G)	Defence Instruction (General)
DMO	Defence Materiel Organisation
DSTO	Defence Science and Technology Organisation
DVA	Department of Veterans' Affairs
ESCM	Electronic Supply Chain Manual
FIS	Financial Investigation Service

FMA Act	<i>[Former] Financial Management and Accountability Act 1997</i>
HASRD	Head, Acquisition and Sustainment Reform Division, DMO
HCIP	Head, Commercial and Industry Programs Division, DMO
IGD	Inspector-General of Defence
ITAR	International Traffic in Arms Regulations <i>[US legislation]</i>
JLC	Joint Logistics Command
MSA	Materiel Sustainment Agreement
MRTT	Multi-Role Tanker and Transport aircraft
PAM	Pacific Aviation Museum
PGPA Act	<i>Public Governance, Performance and Accountability Act 2013</i> <i>[Replaced the FMA Act on 1 July 2014]</i>
RAAF	Royal Australian Air Force
RFP	Request-for-Proposal
RFT	Request-for-Tender
RSL	Returned and Services League
SER	Source Evaluation Report
SME	Specialist Military Equipment
SPO	System Program Office <i>[within DMO]</i>
SRCC	Safety, Rehabilitation and Compensation Commission
VCDF	Vice Chief of the Defence Force



## **Summary and Recommendations**



# Summary

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## Introduction

1. Defence manages Commonwealth assets worth some \$75 billion<sup>1</sup>, over half of which comprise specialist military equipment (SME)—including ships, vehicles and aircraft. Each type of SME must be managed through its life cycle, the final stage of which is disposal. Disposal can include re-use within Defence for a different purpose, including for heritage or display, as well as transfer, sale, gifting or destruction.
2. SME disposed of in recent years includes the Royal Australian Navy's (RAN's) frigates HMA Ships *Canberra* and *Adelaide*, which were scuttled as dive wrecks, but at unexpectedly high cost; the Australian Army's fleet of Leopard tanks, most of which were retained or gifted for display; and the Royal Australian Air Force's (RAAF's) F-111 long-range strike aircraft, a few of which were retained for display but most of which were destroyed because of asbestos content. Proceeds from SME disposals vary significantly across the years with changes in equipment sold—proceeds were \$12.5 million in 2012–13 and \$49.4 million in 2013–14. Defence disposal activity is expected to increase in the medium term due to Defence's major program of upgrading and replacing SME over the next 15 years.<sup>2</sup>
3. Managing SME disposals requires an understanding of possible markets for the surplus equipment. It also requires Defence to consider international obligations, particularly relating to demilitarisation and technology of United States (US) origin; and Australian obligations relating to the management of hazardous substances, such as asbestos; environmental protection; and the resource management framework applying to government entities. Disposing of SME is therefore a complex task, whether achieved through re-use, retention for heritage or display, gifting, sale or destruction. Disposal risks include the potential for excessive and unanticipated costs, stakeholder dissatisfaction, and loss of reputation should the equipment pass into the wrong hands.

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1 Defence, *Annual Report 2013–14*, Volume 2, p. 12.

2 See Appendix 4 for details of disposal sale proceeds between 2008–09 and 2013–14.

4. For the period considered by this audit, the primary legislation governing disposal of Commonwealth assets was the *Financial Management and Accountability Act 1997* (FMA Act).<sup>3</sup> Under the FMA framework, Defence's internal instructions imposed an obligation on staff managing disposals to optimise the outcome for the Commonwealth in each case<sup>4</sup>, having regard to: (i) legal, contractual, government and international requirements; (ii) ensuring that actions would withstand scrutiny; (iii) being fair, open and honest; and (iv) considering the cultural, historical and environmental significance of providing the item to appropriate organisations.

5. Disposal of SME is part of the Defence capability life cycle. The Defence Materiel Organisation (DMO) has overall responsibility for disposal of SME on behalf of Defence in conjunction with the Capability Manager, and the function is now co-ordinated by the Australian Military Sales Office (AMSO) in DMO's Defence Industry Division.<sup>5</sup> However, many parts of Defence may have an interest and involvement in any particular disposal.

## Audit objective and scope

6. Following difficulties experienced with two major disposals in recent years, the Secretary of Defence and Chief of the Defence Force (CDF) wrote to the Auditor-General in April 2013 and asked that he consider undertaking a performance audit of Defence's management of specialist military equipment disposals. In May 2013, the Auditor-General agreed to commence a performance audit as part of the Australian National Audit Office's (ANAO) 2013–14 work program.

7. The audit objective was to assess the effectiveness of Defence's management of the disposal of specialist military equipment. The audit considered (i) whether Defence has conducted disposals in accordance with applicable Commonwealth legislative and policy requirements and Defence policies, guidelines and instructions; and (ii) where relevant rules have been

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3 The main purpose of the FMA Act was 'to provide a framework for the proper management of public money and public property' and the Act contained rules about how public money and property were to be dealt with. On 1 July 2014, the *Public Governance, Performance and Accountability Act 2013* (PGPA Act) replaced the FMA Act.

4 The relevant instruction, Defence Instruction (General) LOG 4-3-008 *Disposal of Defence Assets*, states: 'Officials managing disposals are to optimise the outcome for Defence when implementing any disposal strategy.'

5 The directorate within AMSO responsible for disposals has been known under several names over the years but is referred to as 'Defence Disposals' within this audit report.

departed from, the main reasons and consequences. The audit examined Defence records of selected disposals that occurred over the last 15 years, especially the period from 2005 to 2013, including actions in response to disposals not proceeding as intended.

8. The high-level criteria developed to assist in evaluating Defence's performance were:

- Defence policies and procedures governing disposals comply with relevant Commonwealth legislation and policy;
- Defence disposal of SME is carried out effectively, in accordance with relevant legislation, policies and instructions; and
- recent reforms in the management of Defence disposals are suitably designed and progressing effectively.

## Overall conclusion

9. Defence expends a great deal of time, effort and public resources on the procurement of new SME such as ships, aircraft and vehicles, and the introduction of such capability into service. The service life of individual items may vary but, ultimately, all of that SME must be disposed of. While the work of disposing of equipment is unlikely to be as interesting or attractive as acquisition and sustainment, disposal of SME is complex and often time-consuming, and can give rise to financial and reputational risks for Defence and the Australian Government. To be effective, and achieve the best overall outcome, SME disposals require a balanced assessment of risks and potential benefits with appropriate senior leadership attention within Defence.

10. Overall, Defence's management of SME disposals has not been to the standard expected as insufficient attention was devoted to: achieving the best outcome for the Australian Government; reputational and other risks that arise in disposing of SME; managing hazardous substances; and adhering to Commonwealth legislation and policy for gifting public assets.

11. The major disposals examined as part of this audit have had a largely disappointing history. In the cases examined, disposals have generally taken a long time, incurred substantial and unanticipated costs, and incurred risks to Defence's reputation:

- the disposal of RAN ships has proven expensive and, where they have been gifted for use as dive wrecks, costly to the RAN's sustainment budget;
- the Army B Vehicles disposal was arranged through a request-for-tender, and the adequacy of the tender evaluation process has been questioned by internal and external advisers to Defence;
- the Boeing 707 aircraft disposal has been prolonged, involved, and yielded much less than the original contracted sale price; and
- the Caribou aircraft disposal remains ongoing after five years following a flawed tender process and uncertainty as to the identity and business of the major purchaser.

12. Problems relating to the Boeing 707 and Caribou aircraft disposals were already known to Defence and led the Secretary of Defence and Chief of the Defence Force to request that this audit be undertaken. The audit highlights a number of consistent underlying themes in the cases examined which go some way to explaining Defence's recent difficulties in managing SME disposals. The key issues relate to: a disproportionate focus on revenue without full regard to costs; insufficient attention to risk management; the quality of internal guidance; fragmented responsibilities; and limited senior management engagement.

13. Defence's disposal rules are not clear or fully developed for SME disposals, notwithstanding the proliferation of internal sources of guidance within Defence. In particular, Defence lacks a set of operational procedures to guide SME disposals and clearly identify roles and responsibilities across the large number of Defence stakeholders. As a consequence, Defence staff have limited guidance on key issues such as the potential costs of disposal activity, and there is no requirement to check on the identity or financial or other capacity of the entities with whom Defence is dealing. A number of the case studies examined in this audit indicate that shortcomings in Defence guidance relating to establishing the bona fides of third parties have contributed to increased risks to the Commonwealth's reputation. Further, some of Defence's internal rules—relating to gifting of assets—did not correctly reflect the long-standing requirements of the Australian Government's resource management framework, introducing risks of inappropriate or incorrect gifting of surplus Defence SME.

14. While the reform of SME disposals has been attempted in recent years, it has not consistently held the attention of senior leadership within Defence. The round of reform that commenced in 2011, announced by the then Minister

for Defence Materiel, was initiated with good intentions. However, it was not supported by sufficient analysis and was based on a flawed assessment of the prospect for making SME disposals into a net revenue-generating program. It was almost certainly over-optimistic in this objective, and underplayed the importance of adopting a balanced approach to managing risks. The initiative lacked ongoing senior leadership involvement and no arrangements were made to monitor and report on its progress. It appears now to have fallen away without tangible results.

15. A feature of recent major disposals has been a propensity for Defence staff to focus on the apparent revenue available from the sale of surplus equipment without full regard to the risks being taken in pursuit of that revenue. These risks, many of which have arisen in the case studies examined in this audit, include reputational risks and risks of further costs being incurred during the disposal process. As discussed, the then Minister's announcement of disposals reform in 2011 highlighted the gaining of revenue as an objective for SME disposals. Once the reform program had been announced, there was a tendency at the operational level to focus on maximising the revenue from each disposal transaction with much less attention to the costs incurred, some of which arose in other parts of the Defence Organisation beyond the immediate purview of those responsible for the disposal transaction. As the audit shows, when delays are incurred and risks crystallise, the costs to Defence can exceed the potential revenue available. In the case of the Caribou aircraft disposal, a sale price of \$540 000 was obtained from the principal purchaser while the DMO System Program Office responsible for the Caribou incurred an estimated \$743 000 in disposal costs, including some \$242 000 to pay contractors to identify and pack Caribou spare parts.

16. A major challenge for Defence in recent years has been the presence of asbestos in many of its items of military equipment. To meet clearly expressed ministerial expectations in 2008, Defence set about a vigorous remediation program to remove asbestos from its workplaces. Defence also resolved in late 2009, through a Vice Chief of the Defence Force (VCDF) directive, that items containing asbestos should be disposed of by sale or gift only where any asbestos contained within the item could not be accessed by future users, and as such would not pose a health risk to those future users. However, the audit has identified instances where the costs of identifying and removing asbestos from items being disposed of, and the prospect of greater disposal revenue, led Defence to dispose of items that may contain accessible asbestos without full regard to the management of the risks or transparent declaration of those risks to

potential purchasers. An example is the ongoing disposal of Army B Vehicles, where Defence stated to its Minister that its strategy would involve removal of all accessible asbestos-containing items, including gaskets. This has not occurred and the risk of the continued presence of such asbestos-containing items has not been drawn to the attention of the purchasers of the vehicles.

17. The history of SME disposals indicates that Defence ministers often wish to be involved in making decisions on the gifting of military equipment, which can attract considerable community interest. However, the Defence Minister does not hold the formal decision-making authority for gifting Commonwealth assets. It is a long-standing feature of the Australian Government's resource management framework that the Finance Minister has that authority and has delegated it to the Secretary of Defence. A challenge remains for Defence to develop an approach that provides early advice to ministers about the requirements and operation of the gifting delegation where any options for gifting are to be contemplated.

18. The key message from this audit of Defence SME disposals is that decision-making should be based on a broader understanding of the benefits, risks and costs of each disposal. To achieve an effective overall outcome, officials performing the disposals function need to have regard to the full picture, weighing up potential revenue against the cost of disposal action and the range of potential risks to Defence and the Australian Government—including the potential for reputational damage. The effective assessment and treatment of risks often requires experience and must be afforded higher priority within the Defence Organisation, including through senior leadership attention at key points in the disposal process for more sensitive items. Those who are assigned management responsibility for an SME disposal should be expected to develop the necessary breadth of understanding and be well placed to complete the disposal efficiently, effectively and properly.

19. The ANAO has made five recommendations aimed at strengthening Defence's SME disposals framework and practice through: the review and consolidation of Defence's internal guidance on disposals; the identification for each future major disposal of a project manager with the authority, access to funding through appropriate protocols and responsibility for completing that disposal; the collection of better cost information on each disposal; and reinforcement of Defence's conflict of interest and post-separation employment policies.



## Key findings by chapter

### Disposals Framework (Chapter 2)

20. Disposal of Defence SME is governed by a framework of legislation, policy and procedure which, for the period under review, was established by the FMA Act. The FMA framework placed an obligation on each chief executive officer to manage agency affairs in a way that promoted proper use of Commonwealth resources.<sup>6</sup> The Australian Government's general disposals policy was stated indirectly in the gifting delegation provided by the Finance Minister to chief executives: that the property being disposed of should be sold at market price or transferred to another Commonwealth agency. While the Commonwealth Procurement Rules (CPRs) provide a whole-of-government framework for procurement, they do not extend to disposal and there is not, and has not been, a counterpart to the CPRs for the disposal part of the asset life cycle. In the absence of an explicit Commonwealth policy, Defence developed internal procedures and processes for its disposal activities.

21. Within Defence there is a range of policy and guidance on disposals, some of which is inconsistent and requires review. Notwithstanding the proliferation of material, Defence's policy and guidance is cast at too high a level of generality and lacks a practical procedural focus. For instance, Defence offers no direction in how to estimate and capture the full costs of a disposal project; and guidance does not include a requirement to verify the identity, financial viability or business purposes of a party to whom Defence may be considering selling its surplus SME. These practical issues arose more than once in the case studies examined in this audit, affecting the successful conduct of SME disposals.<sup>7</sup> Another shortcoming in Defence's current disposals framework is the absence of well-defined and robust disposal tender processes, resulting in one tender examined in this audit attracting criticism from both internal and external advisers.<sup>8</sup> Sound guidance for the conduct of an SME disposal has been lacking for some years and, although DMO has been working on developing new policy and guidelines, these are not yet in place.

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6 'Proper use' was defined as efficient, effective, economical and ethical use not inconsistent with Commonwealth policies. Comparable high-level obligations are currently placed on accountable authorities (such as a departmental secretary) and officials by s.15 of the PGPA Act 2013.

7 See, for example, paragraphs 4.56 and 4.85.

8 See paragraphs 4.118 – 4.127.

Overall, Defence's disposals framework remains immature, particularly given the nature of Defence materiel subject to disposal, and the associated risks.

### **Reform of Disposals (Chapter 3)**

22. Defence initiated a first round of reform of SME disposals in 2011 with four priority areas: to reduce if not eliminate Defence major disposals cost<sup>9</sup>; to return funding to the sustainment of current capability; to generate and then maximise revenue from the sale of Defence's military assets; and to appropriately recognise and preserve Defence heritage, particularly war heritage.

23. Defence based this reform on comparison with overseas experience. However, the reform proposal was not underpinned by sufficient analysis or research to support the expectation of generating revenue from SME disposals. Defence set about implementing the reform primarily through establishing long-term strategies for the disposal of SME in specific 'domains': two such strategies were those for RAN ships and for Army B Vehicles.<sup>10</sup> The ships strategy has already run its course with only two ships disposed of—the ex-HMA Ships *Manoora* and *Kanimbla*—at a substantial cost to Defence. The B Vehicles strategy has returned funds, but there is no information on the costs incurred by Defence of managing the disposal.

24. Defence has not reported its performance in terms of the four 2011 reform priorities nor have measures or targets been set that would enable Defence to do so. The lack of financial data on major equipment disposals also hinders performance assessment against the priorities. The most significant insight from the initial round of reform is the need to take proper account of the relatively small scale of Defence equipment disposals, the additional costs which can arise due to Australia's distance from overseas markets, and a limited local market for these assets based on historical sales experience.

25. In response to recent reviews and investigations of disposal processes, Defence has pursued a further round of reforms. Key initiatives underway include the revision of Defence's disposals policy, the development of documented processes and templates to guide staff through disposal processes,

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9 At the time the primary source of concern about costs arose from the experience of disposing of two RAN ships, ex HMA Ships *Canberra* and *Adelaide*, as dive wrecks gifted to the states. This had cost Defence at least \$13 million and taken considerable administrative effort over an extended period.

10 B Vehicles comprise about 12 000 trucks, trailers and four and six-wheel drives.

and high-level planning for forthcoming disposals. However, there is currently no mechanism that allows Defence Disposals to track costs associated with a disposal project, and Defence should implement a monitoring and reporting mechanism that captures all significant costs. Substantial disposal costs can be incurred by disparate parts of the Defence Organisation, and while it may be challenging to keep track of them, monitoring can contribute to the effectiveness of Defence's management of SME disposals by highlighting escalating areas of expenditure, such as berthing costs relating to ship disposals.<sup>11</sup>

26. The potential benefits of recent reforms are likely to be eroded if Defence does not more clearly identify project management responsibility and establish structured consultation arrangements for major equipment disposals. At present, a large number of separate Defence groups may be involved in, or have expertise relevant to, disposal processes, highlighting the need for clearly defined and well-coordinated disposal processes, and consistent internal guidance. Further, in more complex or sensitive cases, there is a need for sufficient senior leadership involvement in major equipment disposals and key decisions, to contribute to the effective and timely identification, assessment and management of risks.

### **Major Case Studies—Boeing 707 and Caribou Aircraft, and Army B Vehicles (Chapter 4)**

27. The audit considered three case studies in detail, comprising the two disposals whose difficulties gave rise to the request for this audit, the Caribou and Boeing 707 (B707) aircraft fleets, and a more current disposal, B Vehicles.

#### *The Caribou aircraft case*

28. Defence sought to dispose of its last nine Caribou transport aircraft by sale, issuing a request-for-tender in October 2010. Two aircraft, earmarked for heritage purposes, were successfully sold to an historical aircraft society. However, the sale of the remaining seven aircraft proved troublesome. The preferred tenderer was replaced by another entity, and doubts arose over the latter's credibility and financial viability. While Defence proceeded with the disposal and the purchase of the aircraft by the replacement entity, which paid for the seven aircraft, Defence retained the aircraft until doubts about the

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11 Defence informed the ANAO that it was setting up a process to capture cost information associated with AMSO activities. However, many disposal costs are incurred outside AMSO and these other costs will need to be properly captured and attributed if disposal costs for SME are to be fully identified.

entity could be resolved. In January 2015, Defence informed the ANAO that the sale to this entity had been cancelled and Defence was considering alternative disposal options for the aircraft.

29. The Caribou disposal process demonstrated three key administrative shortcomings. Defence:

- did not observe that the original tenderer was being substituted by a separate entity and that the change was not merely a change of name;
- did not seek advice on the financial viability, background and integrity of the entity it was dealing with; and
- proceeded with the sale transaction (by issuing an invoice to the purchasing company) after becoming aware of concerns about the buyer. Not acting on available information exposed Defence and the Commonwealth to financial and reputational risk.

#### *The B707 aircraft case*

30. After first receiving an offer in mid-2007, Defence sold its B707 air-to-air refueller fleet to a private company based overseas, Omega Air, with an initial 2008 contract price of \$9.2 million. Selling the B707 aircraft fleet proved troublesome to Defence. The disposal process demonstrated three key administrative and contractual shortcomings. Defence:

- did not conduct adequate checks on the financial viability of the purchasing company—an issue which also arose in the Caribou aircraft case;
- agreed that the payment of \$3 million of the purchase price would be contingent upon US Federal Aviation Administration (FAA) certification of the aircraft, when it was known to Defence that this was unlikely. In effect, this approach provided the company with a price reduction; and
- allowed the purchasing company to remove the aircraft from Commonwealth premises before full payment had been received. This arrangement was contrary to advice received from the Department of Finance and Deregulation and left the Commonwealth with reduced capacity to secure payment.

31. During much of the period over which the B707 transaction took place, Defence hired air-to-air refuelling services from the purchasing company, at a

cost of over \$24 million. The refuelling arrangement was cancelled in 2013 on the advice of the Secretary.

32. The company ultimately paid Defence \$6.2 million for the B707 aircraft and related equipment. Defence did not receive the remaining \$3 million of the original contract price because FAA certification was not achieved by 31 December 2014.

### *The B Vehicles case*

33. B Vehicles comprise about 12 000 Army trucks, trailers and four and six-wheel drives, which are beyond their expected operating life. Defence has sought to dispose of the vehicles through an arrangement with an external company to detect and remediate asbestos in brake linings, and on-sell the vehicles to the public. This arrangement is expected to operate over some years as the vehicles are progressively withdrawn from service.

34. The B Vehicles disposal was arranged through a request-for-tender process which, following Defence's tender evaluation, drew a complaint from a non-preferred tenderer. Defence obtained several sets of internal advice about the tender evaluation process, some of it highly critical (and some of it contradictory), and twice sought urgent external advice.

35. The external advice noted that there had been a number of fairly significant concerns raised about the evaluation process by internal review teams within Defence, raising doubt about the defensibility of the evaluation outcome and process. The reputational risks for Defence included exposure to criticism, loss of industry confidence and doubt about the integrity of the tender process. However, the final external advice also noted that Defence would have a basis to defend its decision provided it demonstrated that the assessments undertaken (including financial assessments) were sound, factually correct and supported by reliable analysis.

36. Defence persisted with its original tender decision without acting on the final external advice to demonstrate that its assessments were sound. The delegate's decision to proceed with the preferred tenderer did not set out his reasons for not acting on the external advice. Given the sensitivities and potential risks involved in proceeding with the original tender decision, it would have been prudent to escalate the matter to more senior management,

for additional counsel, oversight or decision.<sup>12</sup> Defence records indicate that this course was not adopted.

### *Major case studies—common themes*

37. Each of the major case studies considered in this audit took place in an environment of disposals reform focused on reducing costs and maximising revenue. This environment was due, at least in part, to Defence's Strategic Reform Program (SRP)<sup>13</sup> and later reinforced by the disposals reform program announced mid-2011. A consistent theme in the case studies has been pursuit of the disposal option that promised to yield the greatest revenue.

38. The disposal of SME is a complex undertaking, requiring a broad understanding of the benefits, risks and costs of each disposal, and their effective management. The focus on revenue has not always been matched with appropriate consideration of disposal costs nor of risks of a non-financial kind, such as risks to reputation. Further, Defence did not monitor the net financial position—that is, revenue minus all significant costs incurred by the Commonwealth for each disposal—to help assess the overall benefit of its disposal strategies. Probity and financial checks and identifying non-financial risks also received either limited attention or were given reduced weight in decision-making.

39. Disposing of SME through an RFT process requires Defence to strike a balance between optimising sale proceeds and minimising the Commonwealth's overall costs and risks. To achieve an effective outcome, Defence must manage disposal activities, including any tender process, openly, fairly and equitably, and in a manner that will withstand scrutiny. Government and industry need to have confidence in the way Defence undertakes disposals, and the Defence Organisation needs to maintain fairness in its dealings with industry. Achieving these objectives necessarily requires a balanced assessment of risk and a broader, rather than narrower, view of Australian Government interests when planning and managing the disposal of SME.

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12 At the time of the decision to proceed to contract the Branch Head, Defence Disposals (Senior Executive Service (SES) Band 1), was acting Head, Commercial and Industry Programs Division (SES Band 2).

13 In 2009, Defence began a decade-long major reform of its business intended to generate savings to be reinvested within Defence. This was known as its 'Strategic Reform Program'.

## Managing hazardous substances in disposals (Chapter 5)

40. Hazardous substances, in particular, asbestos, have been used widely in the manufacture of Defence SME. Over the last decade, Defence has put substantial effort and resources into remediating asbestos in its inventory and its SME.

41. A major decision in the management of asbestos in disposals was the VCDF's clear directive to the Defence Organisation in October 2009: items that contain asbestos should be disposed of by sale or gift only where any asbestos contained within the item cannot be accessed by future users, and as such do not pose a health risk to those future users. A tension subsequently arose between the VCDF's directive and the approach within Defence to maximise revenue from major equipment disposal.

42. In several cases examined by the ANAO—in particular, the Caribou aircraft and B Vehicles fleet—Defence has struggled in its efforts to manage the risks posed by asbestos in equipment intended for disposal. In the case of the Caribou aircraft, equipment disposal was a trigger to cease asbestos remediation. The sale of the majority of the Caribou was not completed and asbestos components remain in place, and it is now a matter for Defence to decide a future course of action. The two aircraft sold to an historical aircraft society retained any asbestos items previously contained in them.

43. Defence has not always provided appropriate information to potential purchasers or recipients about the asbestos content of SME subject to disposal, notwithstanding legal advice to do so, senior leadership expectations and undertakings to government. This is the case, for example, with the B Vehicles.

44. The B Vehicles may contain accessible asbestos in various locations such as brake linings and gaskets. The vehicles are on-sold to the public by a private company engaged by Defence and established for this purpose. After receiving the B Vehicles, the company only reports back to Defence on the results of its checking for asbestos in the vehicle brakes, and remediating these components where necessary.<sup>14</sup> This disposal is ongoing.<sup>15</sup>

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14 Defence advised the then Minister for Defence Materiel in 2011 that 95 per cent of the B Vehicles were free of asbestos components. However, it has been unable to provide evidence for this estimate.

15 Defence advised the ANAO in January 2015 that, as a result of the findings of this performance audit, Defence had again reviewed the controls relating to B Vehicle disposal.



45. The F-111 aircraft disposal was largely managed by the DMO's Disposal and Aerial Targets Office. Defence's preference, given the use of asbestos throughout the aircraft, was to destroy most of them and retain only a few for Defence museums. Ministerial preferences led to a small number of aircraft also being retained for display outside Defence's direct control in private museums, but with ongoing Defence involvement in monitoring and reporting on risks. Defence has based its management of this arrangement on a professional assessment of the risks, but the costs of ongoing monitoring and reporting by Defence are yet to be assessed.

46. Defence's approach to some more recent disposals suggests that it has moved by increments from the VCDF's original position of allowing no accessible asbestos to be gifted or sold. Defence informed the ANAO during the audit that the directive remains in place.

47. The potential long-term risks of SME containing asbestos have been highlighted by a request for Australian Government assistance from an external organisation. The organisation was gifted a major item of Defence SME by the Australian Government several decades ago. The item has asbestos-containing material that is widespread through its structure and the organisation has advised Defence that the asbestos is now posing a hazard. While the SME is no longer owned by the Commonwealth and the issue of Defence or Commonwealth assistance is yet to be determined, it raises the question of whether other legacy cases exist and what action may be needed to address any risks posed.

48. In December 2014, DMO advised the then Minister for Defence that it was 'proposing to undertake a review of a number of past disposal activities to identify those items that contain hazardous substances, in particular asbestos containing material, that may give rise to potential future liabilities'. DMO did not indicate when that review was expected to be complete nor what action it proposes should the review identify further risks related to past disposal activities.

## **Gifting of Defence Specialist Military Equipment (Chapter 6)**

49. Gifting of public property was prohibited under the FMA Act except in certain defined circumstances, including where the Finance Minister had given written approval to the gift being made. The Finance Minister had sole ministerial authority over gifting, and had delegated that power to chief executives under the FMA (Finance Minister to Chief Executives) Delegation,



Part 17.<sup>16</sup> This instrument required delegates to observe specific conditions when considering making such a decision. These long-standing arrangements have largely continued under the *Public Governance, Performance and Accountability Act 2013* (PGPA Act).

50. The gifting rules have not been reflected accurately nor consistently in many instructions and guidelines for Defence staff. This may be due, in part, to the proliferation of such sets of instructions and guidelines. Defence should give prompt attention to the drafting of Defence instructions and guidelines to bring its documentation into alignment with the Australian Government's resource management framework.

51. The audit identified instances when Defence did not approve gifting of SME in accordance with applicable Commonwealth legislative and policy requirements. For example, when DMO recommended to the then Minister for Defence in 2005 that he write to state premiers and territory chief ministers offering the ex-HMAS *Canberra* as a gift for use as a dive wreck, DMO did not advise the Minister that he did not have the authority to make such a gift under long-standing legal arrangements<sup>17</sup>, nor of the requirements set out in the gifting delegation. Similarly, the Australian Defence Force's (ADF's) Leopard tanks were offered by the Minister for Defence as a gift to Returned and Services League (RSL) branches in 2007, before a request was made to the Finance Minister seeking formal approval of the gifting.

52. Invariably, when items of SME are to be withdrawn from service, Defence will offer early advice to the Minister for Defence on proposed disposal arrangements. In that context, where any options for gifting are to be contemplated, Defence should advise the Minister that the Minister does not have authority to approve a gift, and of the specific requirements of the Finance Minister's gifting delegation, including the requirement placed on the Finance Minister's delegate to adhere to the Commonwealth's general policy for the disposal of Commonwealth property, and to avoid establishing an undesirable precedent.

53. Further, experience has shown that gifting items of SME can involve substantial costs for Defence. For example, the disposal of the two RAN ships,

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16 The Finance Minister's delegation was to officials, not ministers.

17 Authority to gift Commonwealth assets lies with the Finance Minister, who has delegated it to the Defence Secretary. The Secretary has sub-delegated his authority to the Chief of the Defence Force and other members of the Defence Organisation.

ex-HMA Ships *Canberra* and *Adelaide* by gifting them to Victoria and New South Wales cost Defence at least \$13 million.

## Managing Other Risks (Chapter 7)

54. In addition to the matters considered above, a range of specific risks add to the complexity of managing SME disposals. The audit considered the following additional sources of risk:

- management of trailing obligations, specifically adherence to United States (US) International Trade in Arms Regulations (ITAR), which limit how Defence can dispose of US-sourced SME;
- perceived and actual conflicts of interest, which can arise for Defence personnel involved in disposals; and
- disposal of non-ADF SME, which has arisen in a small number of cases.

55. The US controls access to its defence technology through ITAR, making this a major consideration in many disposals because a large proportion of ADF SME is of US origin. Obtaining ITAR approval can take time and might not be granted. This can have cost or other consequences for a disposal. Defence has generally obtained ITAR approval where relevant for SME disposals over recent years. However, Defence has no centralised register of ITAR obligations in relation to existing SME, and could consider the cost-benefit of compiling a register to help manage its obligations.

56. A conflict of interest involves a conflict, which can be actual, potential or perceived, between a public official's duties and responsibilities in serving the public interest, and the public official's personal interests.<sup>18</sup> The audit observed a number of instances involving individuals working for Defence subsequently taking up related positions with external organisations doing business with Defence. In some cases, the individual had remained a Reservist with continued access to Defence resources.

57. Defence's post-separation employment policy requires ADF members and Defence Australian Public Service (APS) employees wishing to take up employment with private sector organisations to fully inform Defence of the situation. However, this does not always take place and has limited Defence's

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18 ANAO Audit Report No.47 2013–14, *Managing Conflicts of Interest in FMA Agencies*.

capacity to manage potential conflicts of interest.<sup>19</sup> Defence should reinforce its conflict of interest and post-separation policies to its ADF members and APS staff, particularly the need for transparency concerning any future private sector and Defence Reservist employment, and introduce practical measures to achieve consistent application of policy across the Defence Organisation. Defence could also provide illustrative examples of certain situations or behaviours requiring close management, including: related post-separation employment, Reservists undertaking private business with Defence, personal business interests and requests for favours.

58. From time-to-time Defence needs to dispose of non-ADF SME. While unusual and unpredictable, these instances impose a workload on Defence, and require planning and funding, in common with more conventional disposals. In the case of the Russian-made military helicopters flown to Australia in 1997<sup>20</sup>, Defence has been incurring some unquantified cost in storing them at Tindal for the better part of two decades. Greater awareness of such costs and the assignment of responsibility within Defence for disposal of SME that currently lacks a clear internal 'owner' would assist in effective disposal of such equipment.

## Entity response

59. Defence provided the following response to the proposed audit report:

Following a request from the Secretary of Defence and the Chief of the Defence Force to the Auditor-General in April 2013, Defence thanks the Auditor-General for recognising concerns around the management of major equipment disposal.

Defence welcomes the thoroughness of the review and agrees with the recommendations that will help to improve Defence's governance around disposal management.

Defence acknowledges that the disposal of military assets is an area of concern and that this important aspect of asset management appears to have not had the same level of attention relative to higher profile acquisition, sustainment

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19 Measures to manage conflicts of interest could include: allocating alternative duties; the restriction of the flow of information to the Defence member/employee; a review or audit of access that the Defence employee/member has, or has had, to specific information with relevance to their future employment; and restrictions on access by the Defence employee/member to information systems.

20 The helicopters were part of a shipment of equipment diverted to the Northern Territory in 1997. A United Kingdom-based private military company, Sandline International, had assembled the equipment for use under contract to the Papua New Guinea Government.

and operational activities. Defence appreciates the analysis provided by ANAO and will undertake to address the shortcomings in policy and performance.

The audit has highlighted the broad range of issues that must be considered in planning for disposal of major equipments. The audit report indicates that Defence does, for the most part, address the majority of these considerations, but that policy and guidance has been deficient which leads to the difficulty in achieving consistently high standards across the wide range of disposal types.

The report includes a chapter on the treatment of hazardous materials and draws attention to Defence's handling of asbestos containing material through the disposal process. Defence seeks to ensure that all hazardous materials are properly considered and managed, and that it complies with all of its legal obligations, when undertaking the disposal of Defence equipment.

Defence considers that the chapter overstates the risk associated with non-friable forms of asbestos that might still be in equipment subject to disposal.<sup>21</sup> Defence considers the residual risk posed by exposure to asbestos in the B-vehicles is no greater than that inherent in a wide range of vehicles of similar vintage which are also still saleable. However, Defence has taken steps to address the concerns raised in this report. Specifically, Defence has delayed the B-vehicles disposals to allow time to ensure Defence's asbestos management policies are both responsible and pragmatic.

The report validates Defence's concerns regarding cost implications for the Commonwealth and the potential for future liability arising from gifting of Defence assets, albeit with positive intent.

This report also rightly serves to remind Defence that there are broader considerations other than revenue that are important to the Commonwealth when planning the disposal of specialist military equipment.

**60.** The ANAO also sent extracts from the proposed report to the Department of Finance (Finance) and to three commercial parties whom the ANAO considered had a special interest in the content of those extracts. The two responses received, from Finance and Omega Air, are at Appendix 2.

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21 *ANAO comment:* Chapter 5 of this report considers the treatment of asbestos in disposal of major equipment having regard to the governance arrangements that Defence put in place in 2009 for managing asbestos (including the Directive by the VCDF—see paragraph 5.29). It is open to Defence to review the VCDF Directive in light of current legislative requirements and standards generally accepted in the community.

# Recommendations

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**Recommendation No. 1**  
**(paragraph 2.59)** To rationalise and simplify its existing framework of rules and guidelines for disposal of specialist military equipment, the ANAO recommends that Defence:

- (a) review and consolidate relevant existing guidance with a view to ensuring that it is concise, complete and correct; and
- (b) consult the Department of Finance in the course of this review, to maintain alignment with the wider resource management framework.

**Defence response:** *Agreed*

**Finance response:** *Supported*

**Recommendation No. 2**  
**(paragraph 3.93)** The ANAO recommends that, to improve the future management of the disposal of Defence specialist military equipment, Defence identifies, for each major disposal, a project manager with the authority, access to funding through appropriate protocols and responsibility for completing that disposal in accordance with Defence guidance and requirements.

**Defence response:** *Agreed*

**Recommendation No. 3**  
**(paragraph 3.95)** The ANAO recommends that, to improve the future management of the disposal of Defence specialist military equipment, Defence puts in place the arrangements necessary to identify all significant costs it incurs in each such disposal (including personnel costs, the costs of internal and external legal advice, management of unique spares and so on), and reports on these costs after each such disposal.

**Defence response:** *Agreed*

**Recommendation  
No. 4  
(paragraph 6.82)**

To bring its instructions and guidelines that address gifting of Defence assets into alignment with the requirements of the resource management framework, the ANAO recommends that Defence promptly review all such material. This could be undertaken as part of the review recommended in Recommendation No. 1.

**Defence response:** *Agreed*

**Recommendation  
No. 5  
(paragraph 7.39)**

The ANAO recommends that Defence:

- (a) reinforce its conflict of interest and post-separation policies to all ADF members and APS staff, particularly in relation to future private sector and Defence Reservist employment; and
- (b) introduce practical measures to achieve consistent application of the policies across the Defence Organisation.

**Defence response:** *Agreed*

## **Audit Findings**





# 1. Introduction

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*This chapter provides an overview of disposals of specialist military equipment in Defence. It also introduces the audit, including the audit objective, scope and approach.*

## An outline of Defence's asset disposals

### Defence assets

**1.1** Defence manages approximately \$75 billion of Commonwealth assets including about \$41 billion of specialist military equipment (SME).<sup>22</sup> Over the next 15 years Defence expects to replace or upgrade up to 85 per cent of its military equipment, including SME. During this time, Defence plans to dispose of up to 22 ships; 14 boats; 70 combat aircraft and 100 other aircraft; 110 helicopters; 470 armoured vehicles; 10 000 other vehicles; and a range of communications systems, weapons and explosive ordnance. This would be the biggest disposal of military equipment since World War II.

**1.2** The disposal of Defence SME is an integral part of managing the asset through its life cycle. Disposal is the final phase in that life cycle, and requires the appropriate assessment and treatment of risks relating to specific items of SME. An institutional risk is that within Defence, disposal may receive insufficient attention, as new capability and the transition to it attracts higher priority. However, this does not diminish Defence's responsibility for the proper management of public resources under its control.<sup>23</sup>

**1.3** When disposing of Defence assets, such as SME, Defence managers are required to seek the best outcome for the Commonwealth. That outcome might not be represented simply by revenue from sales. Decision makers need to take account of the costs of disposal (which can be substantial), any heritage aspects to the equipment being disposed of, restrictions on the disposal due to

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22 Net carrying value. Defence assets include: SME (including Repairable Items and Assets under Construction); general stores inventory; explosive ordnance; fuel; land, buildings and infrastructure; other plant and equipment; heritage and cultural assets; and intangibles (including intellectual property). Defence, *Annual Report 2013–14*, Vol. 2, p. 12.

23 This is an obligation which, during the period considered by this audit, was imposed until 30 June 2014 by s. 44 of the (former) *Financial Management and Accountability Act 1997* (FMA Act). Section 15 of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act), which took effect on 1 July 2014, imposes a similar duty to promote the proper use and management of public resources, while s. 16 imposes a further duty to establish and maintain appropriate systems of risk oversight, management and internal control.

international obligations or agreements with the original supplier, and a range of risks, including hazardous substances the equipment may contain and potential reputational risk to Defence and the Commonwealth.

**1.4** Defence withdraws SME from service because it is either surplus to, or no longer suitable for, its requirements. Assets that are no longer required may be:

- re-used within Defence for different purposes, for example, as training aids, for spares or components, for research, or as targets;
- retained by Defence for heritage or display purposes, for example, by transfer to Defence-managed museums and history units or as 'gate guards' outside Defence establishments;
- transferred to another Commonwealth Government entity, for example, the Australian War Memorial;
- gifted to Australian state or territory governments, foreign governments, or non-government heritage/community organisations;
- sold by tender, auction or private treaty as a going concern, for historical or display purposes, for spare parts or for scrap; or
- destroyed.

**1.5** Proper disposal of SME requires Defence to observe legislative and policy requirements, and to consider community interests and expectations, including:

- over the period under consideration, the financial framework requirements established under the *Financial Management and Accountability Act 1997* (FMA Act) and regulations under the Act<sup>24</sup>;
- military heritage interests and community expectations as to the availability of old military equipment for display;
- a need to deal with hazardous substances (such as asbestos) and workplace health and safety;

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24 The FMA Act, which was in effect until 30 June 2014, provided a framework for the proper management of public money and public property and contained rules about how public money and property were to be dealt with.

- Australian Defence export controls and, in particular, the requirements of the Standing Inter-Departmental Committee on Defence Exports;
- US ‘International Traffic in Arms Regulations’ (ITAR); and
- environmental compliance; for example, delays were incurred with scuttling of ex-HMAS *Adelaide*, where higher standards were imposed by the courts following environmental and community concerns.

## Defence’s organisational arrangements for disposals

**1.6** Disposal of the full range of Defence assets is handled by several Defence Groups:

- Joint Logistics Command (JLC) disposes of Defence inventory items, weapons and artillery;
- Chief Information Officer Group disposes of information technology equipment;
- Defence Support Group disposes of real estate;
- Munitions Branch and Guided Weapons Branch in the Defence Materiel Organisation (DMO) disposes of surplus explosive ordnance;
- Joint Fuels and Lubricants Agency in DMO disposes of fuels and lubricants;
- Land Systems Division in DMO disposes of commercial vehicles; and
- the Directorate of Disposals and Sales (DAS) in the Australian Military Sales Office (AMSO; a branch of DMO’s Defence Industry Division) has a co-ordinating role for the disposal of SME.

**1.7** SME disposals are complex. AMSO has identified that some 25 organisational areas across Defence (including DMO) can be stakeholders in the disposal of SME.<sup>25</sup>

## Development of organisational arrangements for SME disposals

**1.8** Defence first created a single point of reference for the development and promulgation of disposals policy in 1997. This occurred when it formed

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<sup>25</sup> This is based on the number of stakeholders identified for the Landing Craft Heavy (LCH) disposal project. The number of stakeholders will vary according to the project.

the internal ADF Disposals and Marketing Agency (ADF DMA), a tri-service organisation which amalgamated a number of functions.

**1.9** Since DMO was formed in July 2000, the SME disposals function has been moved several times internally. At the outset, ADF DMA was absorbed into DMO and managed under various organisational structures before being transferred to the Defence Asset and Inventory Management Branch, in DMO's Finance Division, in January 2008. ADF DMA was renamed 'Defence Disposals Agency' (DDA) in July 2008. In August 2010, DDA was moved to DMO's Acquisition and Sustainment Reform Division and then, in September 2011, to DMO's Financial Reporting and Policy Branch in Finance Division.

**1.10** On 1 June 2012, DDA was moved to AMSO in DMO's Commercial and Industry Programs Division. In November 2012 the agency was renamed 'Disposals and Sales' (DAS). On 1 July 2013, as part of the broader DMO Commercial Group restructure, AMSO became part of the new Defence Industry Division. To avoid confusion from the various changes, DAS and its predecessors are referred to as 'Defence Disposals' in this audit report.

**1.11** The then Minister for Defence Materiel announced major reforms to disposals in June 2011.<sup>26</sup> The reform objective was to generate revenue from Defence disposals, to be achieved by managing disposals as a commercially-focused major program.

**1.12** Defence's 2011–12 Annual Report identifies four priority areas for Defence Disposals:

- to reduce if not eliminate Defence major disposals cost;
- to return funding to the sustainment of current capability;
- to generate and then maximise revenue from the sale of Defence's military assets; and
- to ensure that Defence heritage, particularly war heritage, is appropriately recognised and preserved.<sup>27</sup>

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26 Minister for Defence Materiel, media release, 'Reforms to Disposal of Military Equipment', 29 June 2011.

27 Defence, *Annual Report 2011–12*, p. 216.

## Recent difficulties with Defence SME disposals

**1.13** Recently, Defence has experienced difficulties with two major disposals. One was Defence's sale of its fleet of Boeing 707 air-to-air refuelling aircraft and the other was Defence's sale of part of its fleet of Caribou aircraft. Both disposals led to reviews by DMO's legal counsel. The latter disposal also led to an investigation by the Inspector-General of Defence (IGD) and an internal audit by Defence's Chief Audit Executive.

**1.14** In July 2013, DMO commissioned a consultant to review its disposals function to identify the underlying problems for some specific disposals cases, including the two disposals mentioned above, and to inform an agenda for disposals reform. The consultant completed the report of the review in mid-October 2013. The report found 'a systematic shortcoming in the way in which major disposals have been conducted' and made six recommendations to improve disposal activities.

**1.15** DMO has made organisational and staffing changes, has been revising disposals policy, developing templates and documenting processes for disposals. This work was continuing during the audit.

## About the audit

**1.16** In April 2013, the Secretary of the Department of Defence and the then Chief of the Defence Force, in light of the difficulties mentioned above, wrote to the Auditor-General asking that the ANAO consider conducting a performance audit of Defence SME disposals during 2013–14. The Auditor-General agreed to commence a performance audit as part of the ANAO's 2013–14 work program. The audit began in November 2013.

**1.17** The audit objective was to assess the effectiveness of Defence's management of the disposal of specialist military equipment. The audit considered (i) whether Defence has conducted disposals in accordance with applicable Commonwealth legislative and policy requirements and Defence policies, guidelines and instructions; and (ii) where relevant rules have been departed from, the reasons and consequences. The audit examined Defence records of selected SME disposals that occurred over the last 15 years,<sup>28</sup>

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28 This performance audit focuses on disposals defined by Defence as 'Major disposals'. Major disposals comprise those items which are expected to recover more than \$1.0 million in revenue upon their disposal, or are capability platforms, weapon systems or items of significant public interest which require specialist disposal action and planning. See paragraph 2.27.

especially the period from 2005 to 2013, including actions in response to disposals not proceeding as intended.<sup>29</sup>

**1.18** The audit focuses upon Defence disposals from the point where a decision has been made to withdraw an item of Defence SME. That is, the audit is not concerned with the question of maintaining capability, which is one that must be foremost in the capability manager's mind when he or she sets a planned withdrawal date and decides to dispose of SME.

**1.19** Finally, the audit considered recent DMO reforms to the disposals process, including the agenda following the then Minister for Defence Materiel's announcement in 2011 about reform of disposals (paragraph 1.11). It also considered Defence's progress with this agenda, including efforts to obtain better value-for-money for the Commonwealth from SME disposals.

**1.20** The audit drew on the records held by Defence, including electronic records retained by Defence Disposals. Defence has no database, register or other systematic collection of records dedicated to tracking its SME disposals. Therefore, relevant material sometimes needed to be gathered from diverse locations. The audit also drew on some of the investigation work conducted by Defence before the audit commenced (paragraph 1.13). The auditors visited a small number of recipients of items of military equipment disposed of by Defence to gather their perspectives on the operation of disposals.

**1.21** The high-level criteria developed to assist in evaluating Defence's performance were:

- Defence policies and procedures governing disposals comply with all relevant Commonwealth legislation and policy;
- Defence disposal of SME is carried out effectively, in accordance with relevant legislation, policies and instructions; and
- recent reforms in the management of Defence disposals are suitably designed and progressing effectively.

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29 The audit did not encompass disposal of non-military items, real estate, ICT equipment, explosive ordnance, general consumable items nor Defence's management of its stocks and inventories.

**1.22** The audit was conducted in accordance with ANAO auditing standards at a cost to the ANAO of approximately \$571 000.

## Structure of the report

**1.23** The remainder of the report is arranged as follows:

Chapter	Content
2. Disposals Framework	Examines the Commonwealth and Defence frameworks for disposal of Defence SME.
3. Reform of Disposals	Considers the two initiatives in recent years to reform SME disposals in Defence.
4. Major Case Studies—Caribou and Boeing 707 Aircraft, and Army B Vehicles	Examines two major disposals that were troublesome for Defence and prompted this performance audit—the disposal of the Caribou and Boeing 707 aircraft. It also examines shortcomings in the more recent disposal of Army B Vehicles.
5. Managing Hazardous Substances in Disposals	Considers Defence’s management of hazardous substances in carrying out its disposal of SME, focusing on asbestos.
6. Gifting Defence Specialist Military Equipment	Examines the Australian Government’s gifting rules and how Defence has set about gifting SME assets that are no longer required.
7. Managing Other Risks	Considers Defence’s treatment of specific risks in managing certain disposals, including restrictions imposed on arms purchased from the US, conflict of interest risks, and disposal of non-ADF equipment.

## 2. Disposals Framework

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*This chapter examines the Commonwealth and Defence frameworks for disposal of Defence SME.*

### The framework for disposal of Defence assets

**2.1** Disposal of SME requires Defence to follow a range of legal and policy requirements relating to: the proper use of Commonwealth resources; dealing with hazardous substances; workplace health and safety; environmental issues such as those associated with the use of ships as dive wrecks; and restrictions on the re-transfer of military items, particularly those of US origin.

**2.2** The audit examined:

- the Commonwealth framework for the disposal of Defence SME over the period under consideration. For this period, the framework included the former FMA Act and the Finance Minister to Chief Executives gifting delegation made under the FMA Act;
- Defence's disposals policy framework. This comprised the Defence and DMO Chief Executives' Instructions made under the FMA Act and a range of internal policy and procedural documents; and
- difficulties with the existing framework.<sup>30</sup>

**2.3** The audit considers the rules for gifting Defence assets separately, as Defence guidance documents vary in their detail on this topic. This is set out in Chapter 6, with an analysis of specific examples of gifting Defence SME.

**2.4** Given the wide range of matters relevant to disposal of major Defence equipment, this chapter has not sought to catalogue all Commonwealth legislation or international arrangements that Defence must take into account. However, where these rules are relevant to particular disposals they are discussed in the appropriate chapter of this report. For example, Chapter 5 (which addresses management of hazardous substances) refers to legislation on asbestos management in Australia, and Chapter 7 (which deals with a range of disposal risks) discusses Defence's adherence to the US ITAR.

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30 Matters arising from the application of the framework (as contrasted with the framework itself) are addressed in subsequent chapters.



## The Commonwealth's disposals policy framework

**2.5** For the period under consideration, the FMA Act established the Commonwealth financial framework for the management of financial and other resources within the Australian Government. The FMA Act, therefore, also provided the relevant framework for disposal of Commonwealth assets.<sup>31</sup> Major disposals in Defence, more often than not, required consideration of the Act for two reasons: the asset is a Commonwealth resource; and the disposal process consumes Commonwealth resources, sometimes exceeding the value of the asset.

### Framework established by the FMA Act

**2.6** Under the FMA Act, responsibility for managing Commonwealth property rested with Commonwealth agency chief executives. This responsibility was governed by the principle-based requirements in the Act, in particular, the requirement to promote the proper use of Commonwealth resources (s. 44) and Part 6 of the Act, which dealt with the control and management of public property.<sup>32</sup>

**2.7** Section 44 of the FMA Act established a positive and personal obligation on each agency head to manage Commonwealth resources in a way that promoted their efficient, effective, economical and ethical use and was not inconsistent with the policies of the Commonwealth.<sup>33</sup> Section 44 was an overarching requirement applying to all aspects of an agency's resource management, including the management of 'public money' and 'public property', the administration of programs, the provision of grants, and procurement.

**2.8** In addition, there were several specific references to the disposal of Commonwealth assets within the FMA Act and in the associated FMA (Finance Minister to Chief Executives) Delegations, under which the Finance Minister delegated specific powers of the Finance Minister to Chief Executives.

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31 The main purpose of the FMA Act was 'to provide a framework for the proper management of public money and public property' and the Act contained rules about how public money and property were to be dealt with. On 1 July 2014, the PGPA Act replaced the FMA Act. The FMA Act was the extant legislation for the period covered by this ANAO performance audit.

32 The specific relevant sections were s. 41—Misapplication or improper use of public property, and s. 43—Gifts of public property.

33 Like the FMA Act, the PGPA Act requires the Accountable Authority (typically the Secretary, Chief Executive Officer, or governing body) of a Commonwealth entity to govern it in a way that promotes the proper use and management of public resources for which the entity is responsible.

One of these powers was the power to gift Commonwealth assets.<sup>34</sup> The delegation to Chief Executives included specific directions from the Finance Minister, with which delegates had to comply.

**2.9** The FMA Act, s. 41, required that ‘an official or Minister must not misapply public property or improperly dispose of, or improperly use, public property’.<sup>35</sup> Section 43 of the FMA Act explicitly prohibited disposal by gift, except in specific circumstances:

An official or Minister must not make a gift of public property unless:

- (a) the making of the gift is expressly authorised by law; or
- (b) the Finance Minister has given written approval to the gift being made; or
- (c) the Commonwealth acquired the property to use it as a gift.<sup>36</sup>

**2.10** The Commonwealth’s general policy for the disposal of public property was stated in the Finance Minister to Chief Executives gifting delegation made under the FMA Act. The policy was that, wherever it was economical to do so, the property should be disposed of at market price or transferred to another Commonwealth agency. Specifically, the property being disposed of should:

- (a) be sold at market price in order to maximise return to the Commonwealth; or
- (b) otherwise, should be transferred (with or without payment) to another Commonwealth Agency with a need for an asset of that kind.<sup>37</sup>

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34 FMA Act, s. 43, Gifts of public property.

35 FMA Act, s. 41, Misapplication or improper use of public property.

36 FMA Act, s. 43, Gifts of public property. The PGPA Act (s. 66) also prohibits the gifting of public property unless:

- (a) the property was acquired or produced to use as a gift; or
- (b) the making of the gift:
  - (i) is expressly authorised by law; or
  - (ii) is authorised by the Finance Minister in writing; or
  - (iii) is made in accordance with any requirements prescribed by the rules.

37 FMA (Finance Minister to Chief Executives) Delegation 2013, Part 17.2(1). The equivalent delegation under the PGPA Act sets requirements for gifting assets as follows:

When contemplating whether to authorise a gift of relevant property, a delegate must consider the overarching principles that, if appropriate to do so, the relevant property should be:

- (a) agreed to be transferred with or without payment to another government entity within Australia (including State or Territory governments); or
- (b) sold at market value, where it is economical to do so.

Source: PGPA (Finance Minister to Accountable Authorities of Non-Corporate Commonwealth Entities) Delegation 2014, Part 10.2(1).

**2.11** Further directions on gifting are set out in the delegation. These are discussed in Chapter 6, which considers both the gifting framework and how Defence has set about the gifting of SME assets that are no longer required.

## **Relevance of Commonwealth Procurement Guidelines and Rules**

**2.12** Under the FMA Act, Regulation 7 (1) allowed the Finance Minister to issue guidelines in relation to procurement and Regulation 7(3) required an official undertaking procurement to act in accordance with such guidelines.

**2.13** Until 2012, these guidelines took the form of the *Commonwealth Procurement Guidelines* (CPGs). The CPGs were replaced on 1 July 2012 by the *Commonwealth Procurement Rules* (CPRs). At their introduction the CPRs were presented as an instrument which ‘combines the requirements of Australia’s international trade obligations, government policy and good practice in procurement into a core set of rules which apply to Commonwealth procurement.’

**2.14** The applicability over the years of the CPGs/CPRs to disposals—as contrasted with procurement—has required clarification. FMA Regulation 7(1) has always included a reference ((d), below) to disposal of public property:

(1) The Finance Minister may issue guidelines in relation to procurement, including:

- (a) procurement policies and processes; and
- (b) requirements regarding the publication of procurement details; and
- (c) requirements regarding entering into procurement arrangements; and
- (d) requirements regarding the disposal of public property.

**2.15** While there have not been any separate guidelines issued by the Finance Minister in relation to disposal, the 2005 edition of the CPGs included the statement ‘Procurement also extends to the ultimate disposal of property at the end of its useful life.’ This reference appeared to extend the application of the CPGs to disposal action. However, a Finance Circular issued the following year provided a clarification which meant that:

the CPGs have no application to the disposal of public property. Rather, the management of disposals falls within the responsibilities of an agency’s Chief

Executive under s 44 of the FMA Act (promoting efficient, effective and ethical use of Commonwealth resources).<sup>38</sup>

**2.16** The CPGs became law on 1 July 2009 and were further amended when the CPRs replaced them in 2012. The CPRs were perceived as a clearer and more concise set of rules with no major differences from the CPGs except terminology. However, the CPRs introduced a minor revision to the definition of procurement:

Procurement continues through the processes of risk assessment, seeking and evaluating alternative solutions, the awarding of a contract, the delivery of and payment for the goods and services and, where relevant, the ongoing management of the contract and consideration of disposal of goods.

**2.17** As there is no explanation of the intended meaning of the words ‘consideration of disposal of goods’ and some Defence equipment is sold by tender, the intended effect of these changes on disposal practice is not clear in the wording. However, the CPRs state that procurement does not include (among other items) sales by tender.<sup>39</sup> Further, in October 2014, Finance confirmed to the ANAO that ‘the CPRs do require consideration of whole of life costs, including disposals, but only to the extent that it may or should affect decision making regarding the initial procurement.’<sup>40</sup>

**2.18** While the Australian Government’s procurement and grants frameworks are now well-developed, with consolidated whole-of-government guidance to support their application (in the form of the CPRs and Commonwealth Grant Guidelines), the disposals framework remains less well-developed. The only definitive statement of Commonwealth policy is that contained in the Finance Minister’s Delegation Part 17.2 (1), quoted above (paragraph 2.10), with no further elaboration above agency-level rules. These rules are considered in the following paragraphs.

## Defence’s disposals policy framework

**2.19** As the CPRs do not apply to disposals, the next level of guidance below the FMA Act is that produced by Defence. Defence has an extensive system of instructions, manuals and directives referred to as the ‘System of Defence

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38 Finance Circular 2006/02 Commonwealth Procurement Guidelines—Clarification.

39 Commonwealth Procurement Rules, paragraph 2.9(c).

40 Finance advice to the ANAO, 27 October 2014.

Instructions' (SoDI). The first to be considered are the former Chief Executive's Instructions (CEIs), issued under the FMA Act.<sup>41</sup>

## Defence and DMO Chief Executives' Instructions

**2.20** One way chief executives discharged their responsibility to promote the proper use of public resources under s. 44 of the FMA Act was by ensuring that their agencies had appropriate internal controls and guidance in place, such as CEIs and operational guidelines.

**2.21** The Department of Defence and DMO were separate agencies for the purposes of the FMA Act.<sup>42</sup> Each agency's Chief Executive issued CEIs applicable to their own agency.<sup>43</sup> Disposal of Defence SME assets is an activity that DMO carries out on behalf of Defence. Therefore, the DMO CEIs referred DMO officials responsible for disposing of Defence assets to Defence's policies and procedures for disposals. They required those DMO officials to:

- comply with Defence's CEIs and any other relevant CEI or policy and procedures relating to the disposal of public property; and
- not approve the disposal of Defence-controlled public property unless they hold a delegation under the relevant Defence delegation schedule issued by the Secretary of Defence [*that is, the Financial Delegations Manual (FINMAN 2)*].<sup>44</sup>

**2.22** Defence's CEIs also required assets to be disposed of in accordance with policies endorsed by the Secretary and/or the Chief of the Defence Force. They referred to Defence Instruction (General) LOG 4-3-008 *Disposal of Defence*

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41 Section 52 of the FMA Act stated that 'The regulations may authorise Chief Executives to give instructions to officials in their Agencies on any matter on which regulations may be made under this Act.' Regulation 6 of the *FMA Regulations 1997* (FMA Regulations) stated that 'The Chief Executive of an Agency is authorised to give instructions ... to officials in that Agency on any matter necessary or convenient for carrying out or giving effect to the Act or these Regulations, including instructions relating to the matters mentioned in paragraphs 65(2)(a) and (b) of the Act.'

42 The Department of Defence and DMO remain separate agencies under the PGPA Act.

43 CEIs were issued by the Secretary of the Department of Defence (for the Department of Defence) and the Chief Executive Officer DMO (CEO DMO). CEIs could be issued on matters listed in s. 65(2)(a)(iv) of the FMA Act, including 'using or disposing of public property.'

44 DMO CEIs, March 2010, Part 6—Public Property, 6.4—Disposal of Public Property, 6.4.3. The CEIs required Defence officials to comply with Defence's Financial Management Manual ('Finance Manual 5' (FINMAN 5)), the Financial Delegations Manual ('Finance Manual 2' (FINMAN 2)), relevant documents forming part of SoDI and other policy as specified in the CEIs.

*Assets* (the Disposal Instruction), discussed below, as the primary reference for direction and guidance on policy for effective and efficient asset disposal.<sup>45</sup>

## **Defence Instruction (General) LOG 4-3-008 Disposal of Defence Assets**

**2.23** The Disposal Instruction, issued in 2006, set out policy to be followed once a decision had been made to dispose of an asset. Despite being in need of updating it remained the primary source of mandatory policy for Defence during this audit.<sup>46</sup>

**2.24** Under the Disposal Instruction, the decision to dispose of assets rested with the relevant manager in Defence. For major platforms this is the capability manager (most often a Service Chief).<sup>47</sup>

**2.25** The Disposal Instruction established the following six mandatory policy directives that govern the disposal of Defence assets:

- disposals planning and management must be conducted as part of the lifecycle management process;
- all disposal activities are to be managed and conducted openly, fairly and equitably, and in a manner that will withstand government, public and international scrutiny;
- officials managing disposals are to optimise outcomes for Defence when implementing any disposal strategy<sup>48</sup>;
- when disposing or gifting public property it is mandatory to comply with the FMA Act; Defence and DMO policy on asset management

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45 The Secretary and CDF jointly issue each DI(G) pursuant to s. 9a of the *Defence Act 1903*. The Secretary authorises DIs(G) under the *Public Service Act 1999* and they are enforceable under that Act. The CDF issues DIs(G) under the *Defence Act 1903* and they are enforceable under the *Defence Force Discipline Act 1982*.

46 This DI(G) was cancelled in December 2014, towards the end of the audit, and replaced by a new chapter of the Defence Logistics Manual ('DEFLOGMAN'). Note that the DI(G) did not apply to disposal of all types of Defence assets. It excluded disposal of land, buildings, infrastructure and non-deployable property, plant and equipment; the sale of assets currently in use and inventory; disposal of explosive ordnance; and the disposal of some controlled Defence and strategic equipment. These assets are covered by other Defence instructions.

47 The Disposal Instruction does not identify the 'relevant manager'. However, paragraph 23 of the Instruction refers the reader to the Defence Supply Chain Manual for further detail. The Defence Supply Chain Manual (July 2003) was replaced in July 2010 with the Electronic Supply Chain Manual (ESCM), which is part of the Defence Logistics Manual Series. The ESCM, Volume 4, Chapter 7, paragraph 42, identifies the capability manager as the relevant manager for capability platforms generally, subject to the relevant delegations for the disposal of assets issued under the CEIs.

48 ANAO comment: The Disposal Instruction states that the optimum outcome 'may not be limited to monetary return, as there is a number of options for consideration when determining a disposal strategy'.

and financial management delegation schedules; and International Treaty obligations;

- weapons are not to be gifted, sold or transferred without the appropriate approval; and
- all weapons not gifted, sold or transferred to other organisations are to be disposed of, or destroyed, in a manner appropriate to the type of weapon.<sup>49</sup>

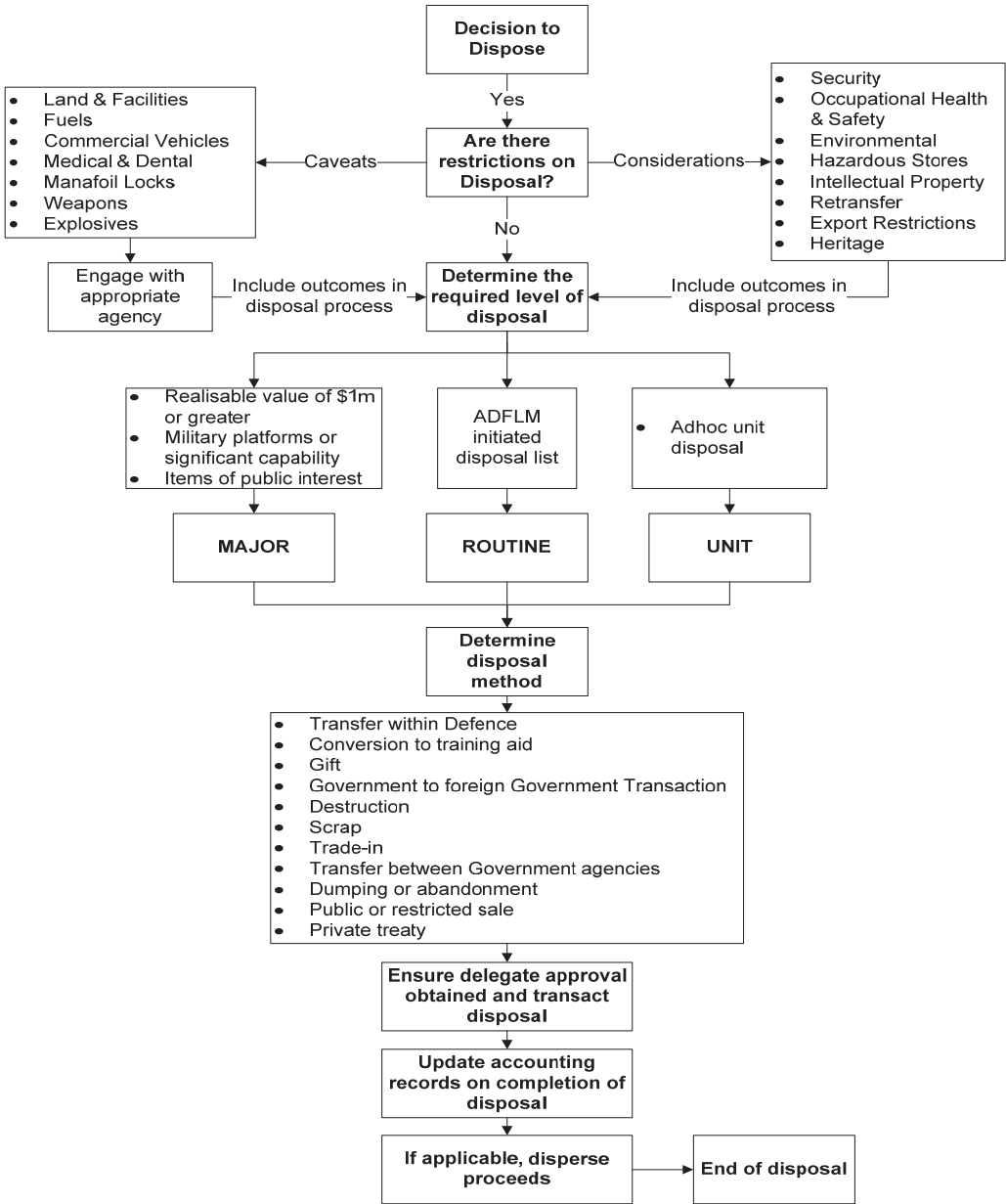
**2.26** The Disposal Instruction also required that auditable records of disposals be maintained and retained to demonstrate adherence to Defence logistics governance processes, and that disposal records be signed original documents that allowed the content to be traced to the primary asset management system.

**2.27** As Figure 2.1 illustrates, there are three levels of disposal in Defence, Major, Routine and Unit. This performance audit focuses on disposals defined by Defence as ‘Major disposals’, that is: those items which are expected to recover more than \$1.0 million in revenue upon their disposal, or are capability platforms, weapon systems or items of significant public interest which require specialist disposal action and planning.

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49 Defence Instruction (General) LOG 4-3-008 Disposal of Defence Assets, October 2006.

**Figure 2.1: Defence Disposals Flowchart**



Source: Adapted from Defence, DI(G) LOG 4-3-008 Disposal of Defence Assets. The flowchart is reproduced in the Electronic Supply Chain Manual (ESCM) Volume 4, s. 7, Chapter 1.

Note: ADFLM = Australian Defence Force Logistics Manager.



## Other Defence manuals

**2.28** Other Defence and DMO manuals contain further guidance relevant to disposals over the period considered by the audit. These include:

- the Defence Logistics Manual (DEFLOGMAN) Series (including Part 2, Volume 5, Defence Inventory and Assets Manual<sup>50</sup> and Part 3, the Electronic Supply Chain Manual (ESCM));
- the DMO Acquisition and Sustainment Manual; and
- the DMO standard operating procedure for managing disposals (SOP (FD) 01-0-073).<sup>51</sup>

## Other directives

**2.29** From time to time, senior Defence managers issue directives to address new or emerging issues that affect disposals, adding to the rules Defence Disposals must follow. An example is the directive by the Vice Chief of the Defence Force (VCDF) in October 2009 prohibiting the sale or gifting of Defence equipment containing asbestos that would be accessible to future users, and which would be a potential health risk. Implementation of this directive is considered in Chapter 5.

## Difficulties with the existing framework

**2.30** The audit observed a number of difficulties with the existing Defence disposals framework, relating to:

- the structure, consistency and completeness of the guidance;
- a lack of rigour in disposal tender evaluations;
- cases where disposals become procurements; and
- the clarity of guidance relating to approvals for disposal activity.

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50 The ANAO initially found that the chapter of this manual intended to cover inventory and asset disposals was empty. In the course of this audit a revised draft of the chapter was endorsed by the Defence Logistics Committee in March 2014 and approved by the Vice Chief of the Defence Force (VCDF) in September 2014. Defence informed the ANAO that it had been published in December 2014.

51 Standard Operating Procedure, Finance Division, Manage Major Disposals, SOP (FD) 01-0-073, Version 2.2, 24 November 2010. DMO informed the ANAO that some DMO Divisions/System Program Offices (SPOs) have also issued their own standard operating procedures.

**2.31** Chapter 3 examines the lack of clarity in management responsibility for SME disposals in Defence policy and guidance. In addition, difficulties relating to varying interpretations of the gifting rules are examined in Chapter 6.

### **The structure, consistency and completeness of the guidance**

**2.32** Instructions and guidance to Defence staff on disposal action lie in an extensive range of documents, of varying vintage and completeness. This may be due in part to the number of separate parts of a large organisation which have a legitimate interest. However, having multiple points of reference may not be necessary or helpful. It is more resource-intensive to update, provides a potential source of error and inconsistency, and creates challenges for personnel seeking to keep abreast of requirements.

**2.33** Some of the existing guidance is inconsistent across different sources and possibly incorrect. This has been analysed for the rules on gifting, and this analysis is set out separately in Chapter 6 (paragraph 6.5 forward).

**2.34** The most challenging aspect of this framework for disposals is that, notwithstanding the apparent proliferation of sources of guidance, there is little practical guidance on the interpretation of the policy principles. This was the view, for example, of the Chief Contracting Officer at Richmond on relevant policies regarding disposal of assets in November 2012:

There's a Defence Instruction General that I read at the time, a DI(G). ... And I think there was also a Disposals Manual or something like that I looked at at the time. But when I looked at those policies, they were all very high-level policies and quite vague about the actual governance of the mechanics of a disposal by sale activity.

**2.35** Similarly, when asked about the 'the mandated or stipulated processes, policies, instructions regarding disposals' the former branch head responsible for Defence Disposals said, in December 2012:

Well, there are none or there are none that I would say would be contemporary or relevant, and that's where we were moving to, to come up with a business process ... that we thought was relevant and would work, then our aim was to actually drive ... some of the business process and business policy change.<sup>52</sup>

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52 This statement was made in December 2012 in a formal discussion within Defence reviewing the failure of the Caribou disposal. That disposal is examined in Chapter 4.

**2.36** Defence Disposals obtained external advice on policies applicable to asset disposal in mid-2011. That advice noted that: ‘there appears to be very little guidance for personnel involved in disposal of assets which explains the policies and processes that should be followed, and issues and factors that should be considered, in a way that the [*Defence Procurement Policy Manual*] does for procurement.’

*Example of incomplete guidance*

**2.37** An example of incomplete guidance relates to the cost-effectiveness of disposals. Policy Directive 3 in the Disposal Instruction requires officials to optimise the outcome for Defence when implementing any disposal strategy. The Instruction explains that ‘this may not be limited to monetary return, as there is a number of options for consideration when determining a disposal strategy.’ However, the Instruction provides neither an explanation nor examples of what is meant by ‘not limited to monetary return’, nor any guidance as to how the monetary return itself is to be estimated and an overall assessment made. It references the Defence Supply Chain Manual<sup>53</sup> and the Defence Procurement Policy Manual for further guidance on selecting a method of disposal.<sup>54</sup>

**2.38** In contrast, the ESCM usefully points out that estimates of both costs and revenue from the disposal must be taken into account when selecting a disposal method:

When considering disposal options, the full anticipated sale value is to be used. This is the estimate of the market value less cost of sale. It provides a comparative basis to determine the most cost-effective means of disposal.

**2.39** However, the ESCM provides no guidance on how to estimate costs or which items should be considered for inclusion in the costing.

**2.40** The DMO standard operating procedure does not help on this point, largely re-stating the desirability of taking into account the cost-effectiveness of the disposal method:

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<sup>53</sup> This reference in the Disposal Instruction is out-of-date. The Defence Supply Chain Manual was replaced by the Electronic Supply Chain Manual (ESCM) in 2010. The ESCM, authorised jointly by the Secretary of Defence and the Chief of the Defence Force, was first issued in 2010, and is updated regularly. The relevant chapter is the Department of Defence, Electronic Supply Chain Manual, Volume 4, s. 7, Disposal of Defence Assets.

<sup>54</sup> The Defence Procurement Policy Manual primarily refers readers back to the DI(G) LOG 4-3-008.

Once assets are identified for disposal, the most appropriate means of disposal needs to be identified taking into account cost effectiveness and any known restrictions on disposal including export and on-selling limitations and the heritage value of the item.

**2.41** In practice, there are many elements that need to be considered in estimating the cost-effectiveness of a method of disposal, including elements with a non-financial character, such as the equipment's perceived merit for heritage and display. The key elements with financial implications include:

- the expected revenue from sale. This will depend on the condition of the equipment and its potential uses. The revenue may also be sensitive to market conditions (and, therefore, timing of sale), including the availability of similar items from other countries;
- the cost of preparing items for sale (demilitarisation, remediation, hazardous substance removal, repainting);
- storage/mooring/accommodation costs (or other scarce Defence resources) until disposal takes place;
- transport/towing/delivery costs, particularly if specialist services are required;
- destruction costs (dismantling, explosive demolition, burying, sinking);
- identification, collection and disposal of unique spares associated with the equipment (these may be distributed widely among Defence facilities);
- legal costs (internal and external)<sup>55</sup>;
- sales costs, for example, where an agent or other party is involved in arrangements to sell assets on to a third party and attracts a portion of the payment received from that third party;
- the expected time taken to obtain ITAR approval. Although not a cost in itself, the delay can cause increases in other costs, such as storage/mooring costs and, potentially, a delay can lead to the transaction taking place in different market conditions;

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55 The audit has observed that Defence frequently seeks legal advice in support of disposals.

- residual maintenance costs. It will be important to make a sound and timely judgement as to when to cease maintenance on the equipment and the depth of any further maintenance before disposal<sup>56</sup>; and
- personnel costs (including salary and overheads) in all of the above activities, including for the relevant Systems Program Office (SPO) and disposals personnel. Personnel costs are less visible to the managers involved but, nevertheless, need to be taken into account.

**2.42** Awareness of these costs could also reveal matters needing active internal management within Defence during the disposal. For example, a disposal manager may need to manage expectations as to how long a request-for-offer process or obtaining ITAR approval may take, as this may have cost implications for the SPO with custody of the equipment to be disposed of.<sup>57</sup>

### *DMO Disposals Review*

**2.43** The 2013 DMO Disposals Review also emphasised the lack of lower-level policy and procedural guidelines:

While [*Defence*] Disposals personnel appear to be aware of the requirements of [*the*] legislation and policy framework, a number of disposal activities appear to have suffered from a failure to comply with policy and due process—resulting in internal and external criticisms of those activities.

These failures appear to have resulted from two primary issues—first, a lack of detailed and consistent policy guidance and ‘checkpoints’ for disposal processes, and second, a historical culture of focusing on achieving outcomes (as approved by the Minister), rather than following due process.

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56 This may involve terminating contracts with outside parties. The decision will need to take account of whether the equipment is to continue to operate, to be used as a static display or scrapped.

57 The DMO Disposals Review (conducted by an external consultant for DMO, October 2013) stated (p. 17):

the relationship between SPOs as ‘custodians’ of assets and [*Defence*] Disposals as the disposal body has been strained. This may, in part, have been driven by the fact that SPOs need to seek funding for costs associated with holding and preserving assets while Disposals undertook disposal activities, resulting in capability managers/owners bearing additional costs where disposal processes were protracted.

**2.44** The review acknowledged that considerable work had been done but there was still significant outstanding work to implement a comprehensive suite of disposals processes and procedures.<sup>58</sup>

**2.45** The Disposals Review's first recommendation was that Defence review in detail the legislation and policy applicable to disposals, and develop a single guidance document to set out clearly the applicable legislative and policy framework. In December 2013, DMO engaged the consultant who undertook the Disposals Review to draft such a document. The consultant had, by April 2014, provided two draft 'deliverables'. In late April 2014, Defence informed the ANAO that:

AMSO has provided initial feedback to [*the consultant*] indicating that the draft deliverables do not meet our requirements and will provide more guidance.

Separately, [*the consultant*] and AGS (who was involved in providing legal advice in the lead up to the establishment of AMSO) will be invited to attend a planning workshop to support the legislation policy review and to assist in proposing remediation actions.<sup>59</sup>

#### ***Lack of rigour in disposal tender evaluations***

**2.46** Lack of rigour in the Defence disposals framework also arose in the project in 2012 to dispose of Defence's older fleets of Army B Vehicles.<sup>60</sup> This came to light following a complaint about Defence's selection process for a company or entity to help it dispose of these vehicles.<sup>61</sup>

**2.47** The complaint concerned Defence's evaluation of the tenders it received. Defence then instigated a range of reviews and obtained legal advice. The advice pointed out that:

It is noteworthy in this regard, that the legislative and policy environment in which disposals are conducted is generally less detailed and rigorous than that applicable to procurements—so, for example, the Commonwealth's obligations/commitments under the [*Defence Procurement Policy Manual*] and CPRs do not apply to disposals in the same way they apply to procurements.

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58 Among the previous work identified by this ANAO audit was the drafting of procedures and probity guidelines by the Australian Government Solicitor (AGS) in mid-2012. The draft AGS material was annotated to indicate that it was contingent on the cancellation of DI(G) LOG 4-3-008 *Disposal of Defence Assets*. That DI(G) was cancelled in December 2014, towards the end of the audit.

59 In October 2014, Defence informed the ANAO that this work was still in progress.

60 B Vehicles comprise about 12 000 trucks, trailers and four and six-wheel drives, which are beyond their expected operating life.

61 A more detailed analysis of Defence's Army B Vehicles tender process is set out in Chapter 4.

### *Failure to conduct adequate financial checks on purchasers*

**2.48** An absence of guidance within the Defence disposals framework also contributed to the difficulties Defence had with obtaining payment from the purchaser of its B707 aircraft and associated equipment (see Chapter 4). Defence did not carry out adequate checks on the financial viability of the purchasing company which, even before the sale contract had been executed, claimed to be experiencing financial difficulties.

### **Recognition of a need for a rigorous disposal policy and process**

**2.49** DMO has recognised the desirability of introducing greater rigour in disposals and improving consistency between disposals policy and the procurement framework established by the CPRs. Following the difficulties DMO experienced with the Caribou sale, in March 2012 the Secretary of Defence expressed surprise when informed that it was not standard practice to make probity checks on commercial bidders for ex-military aircraft, whereas probity checks are a normal feature of procurement processes. Subsequently, the Deputy Chief Executive Officer DMO stated (March 2012):

Noting the current major disposals program—and the lack of a Commonwealth policy framework around disposals (disposals are not covered by the Commonwealth Procurement Guidelines, for example), I think we have been a little too *laissez faire* in our approach to date, and we are now remediating this. In principle, we will now apply the usual procurement policy and practice rigour to disposals, notwithstanding that the CPGs do not apply.<sup>62</sup>

**2.50** Later, he instructed DMO officers to ensure that the relevant DI(G), which was under review, be aligned with the financial management and accountability framework and related guidance.<sup>63</sup>

### **Where a disposal becomes a procurement**

**2.51** Ordinarily, it might seem that procurement and disposal are distinct processes, but this has not always been so for Defence SME. Defence wanted to dispose of the ex-HMA Ships *Manoora* and *Kanimbla* by sale. However, it

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62 Defence internal correspondence, Deputy CEO DMO to Chief of Staff to the Secretary of Defence and Director-General of Defence Disposals, March 2012.

63 The development of any policy for disposals at the Commonwealth level—as a counterpart to the CPRs—would require action by the responsible department, the Department of Finance.



became apparent that the only likely sale was for recycling as scrap.<sup>64</sup> Moreover, any purchaser of the ships would charge more for removing them than it would pay for the scrap. In the event, Defence paid \$4.17 million to have the ships towed away and received \$1.67 million for the scrap.<sup>65</sup> Thus, this asset disposal became a procurement of services, costing the Commonwealth (with other charges) a net \$2.56 million.

**2.52** Professional advice obtained by Defence in November 2012 set out the essence of the argument for this business transaction becoming a procurement:

the question of whether an activity is properly categorised as a procurement or a disposal (and treated accordingly from a legislative and policy perspective) really turns on the substance of the transaction ... a disposal activity which involves substantial costs (such that the disposal/sale really becomes a secondary activity) is, in our view, more properly categorised as a procurement activity—i.e. when viewed properly, the Commonwealth is procuring the services of a third party to dispose of an asset, rather than selling an asset.

**2.53** The change of classification from disposal to procurement raised concerns as to whether the disposal process—now a procurement—might be flawed when viewed from this new perspective, and might need to be cancelled. Defence obtained assurance that if it were able to confirm and document a range of matters (including that the process could and would now continue in a manner consistent with the CPRs) then there would be grounds to defend a decision to continue with the process, which it did.

**2.54** This turn of events highlights the importance of focusing on the substance of a transaction, which may change in the course of a disposal. In this case an attempt at disposal by sale failed to attract sufficient revenue to meet disposal costs, giving rise to a procurement. While the Department of Finance has, since 2009, highlighted the need to classify transactions carefully

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64 In April 2012, the then Minister for Defence Materiel approved the release of a request-for-tender to companies which would undertake the work in Australia. The contract for disposal was signed in May 2013.

65 Defence records indicate that the net cost to Defence of disposing of the two ships for scrap in Australia would have been between \$8 million and \$10 million.



in the grants context<sup>66</sup>, there is a lack of whole-of-government advice relating to classification at the interface of disposal and procurement activity.

## Ministerial approval of disposal strategy

**2.55** As discussed in paragraphs 2.6 to 2.10, under the FMA Act (and now the PGPA Act), the power (delegated from the Finance Minister) to approve the disposal of public property other than at market price rests with the Secretary of Defence and the Chief Executive Officer of the DMO (CEO DMO). They have delegated this power to holders of specific positions within Defence and the DMO.<sup>67</sup> However, the Disposal Instruction states:

Any disposal strategy that could reasonably be expected to attract heightened political or public interest may require Ministerial approval. In such instances the disposal strategy must be submitted by the appropriate Australian Defence Force Logistics Manager, to the ADF Disposals and Marketing Agency (ADF DMA) [*Defence Disposals*] for its advice prior to submission to the appropriate Minister or Delegate for approval.<sup>68</sup>

**2.56** While a careful reading of this key paragraph in the Disposal Instruction indicates that it refers to ministerial approval of the disposal strategy, rather than the actual decision to dispose of materiel, its wording is not sufficiently clear to distinguish between these two activities. The Disposal Instruction does not clearly or explicitly distinguish between a Minister's understandable interest in the disposal of major assets in his or her portfolio and the proposed strategy, and the formal authority under the law to make gifting decisions, which is the responsibility of the Finance Minister and his or her official delegates, including the Secretary of Defence.<sup>69</sup> Defence's policy and guidance in this area needs to be explicit to support the proper operation of the gifting delegation. A particular risk, examined in Chapter 6, is that the Defence Minister has not always been clearly advised on the operation of the gifting delegation.

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66 Finance emphasised the importance of focusing on the substance of a financial transaction when categorising Commonwealth activity and determining the appropriate legal and policy framework to apply. See Finance, 'Grants, Procurements and other Financial Arrangements', Finance Circular No. 2013/01, paragraph 2 forward. This circular was preceded by Finance Circular 2009/03 'Grants and other common financial arrangements'.

67 The delegation involves the disposal of public property by sale, trade-in, swap/exchange, transfer, dumping, destruction or abandoning. This includes the disposal of public property that is surplus, unserviceable or obsolete, including property which has a value of nil.

68 Defence Instruction (General) LOG 4-3-008 Disposal of Defence Assets, paragraph 25.

69 This is a long-standing feature of the Australian Government's financial management framework.

## Conclusion—disposals framework

**2.57** Disposal of Defence SME is governed by a framework of legislation, policy and procedure which, for the period under review, was established by the FMA Act. The FMA framework placed an obligation on each chief executive officer to manage agency affairs in a way that promoted proper use of Commonwealth resources.<sup>70</sup> The Australian Government's general disposals policy was stated indirectly in the gifting delegation provided by the Finance Minister to chief executives: that the property being disposed of should be sold at market price or transferred to another Commonwealth agency. While the Commonwealth Procurement Rules (CPRs) provide a whole-of-government framework for procurement, they do not extend to disposal and there is not, and has not been, a counterpart to the CPRs for the disposal part of the asset life cycle. In the absence of an explicit Commonwealth policy, Defence developed internal procedures and processes for its disposal activities.

**2.58** Within Defence there is a range of policy and guidance on disposals, some of which is inconsistent and requires review. Notwithstanding the proliferation of material, Defence's policy and guidance is cast at too high a level of generality and lacks a practical procedural focus. For instance, Defence offers no direction in how to estimate and capture the full costs of a disposal project; and guidance does not include a requirement to verify the identity, financial viability or business purposes of a party to whom Defence may be considering selling its surplus SME. These practical issues arose more than once in the case studies examined in this audit, affecting the successful conduct of SME disposals.<sup>71</sup> Another shortcoming in Defence's current disposals framework is the absence of well-defined and robust disposal tender processes, resulting in one tender examined in this audit attracting criticism from both internal and external advisers.<sup>72</sup> Sound guidance for the conduct of an SME disposal has been lacking for some years and, although DMO has been working on developing new policy and guidelines, these are not yet in place. Overall, Defence's disposals framework remains immature, particularly given the nature of Defence materiel subject to disposal, and the associated risks.

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70 'Proper use' was defined as efficient, effective, economical and ethical use not inconsistent with Commonwealth policies. Comparable high-level obligations are currently placed on accountable authorities (such as a departmental secretary) and officials by s.15 of the PGPA Act 2013.

71 See, for example, paragraphs 4.56 and 4.85.

72 See paragraphs 4.118 – 4.127.

## Recommendation No.1

**2.59** To rationalise and simplify its existing framework of rules and guidelines for disposal of specialist military equipment, the ANAO recommends that Defence:

- (a) review and consolidate relevant existing guidance with a view to ensuring that it is concise, complete and correct; and
- (b) consult the Department of Finance in the course of this review, to maintain alignment with the wider resource management framework.

**Defence response:** *Agreed*

**Finance response:** *Supported*

## 3. Reform of Disposals

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*This chapter considers the two initiatives in recent years to reform SME disposals in Defence.*

### Recent initiatives to reform disposals

**3.1** There have been two major initiatives in recent years to reform Defence disposals practice for SME:

- the then Minister for Defence Materiel<sup>73</sup> announced the first major reform in 2011; and
- Defence initiated a new round of reform in 2013, following difficulties with the Caribou and Boeing 707 aircraft disposals.

**3.2** In June 2011, in announcing the first round of reform, the then Minister for Defence Materiel stated that he was ‘reforming Australia’s system of military disposals—to reduce costs, generate potential revenue and provide opportunities for Defence industry involvement.’ The major feature was to turn SME disposals from a loss-making function into a net revenue-producing function. In advancing this proposal, Defence highlighted relevant developments in the United Kingdom (UK) as a model for Australia.

**3.3** This chapter considers this first round of reform and examines:

- the impetus for the reform, including events leading to their announcement;
- the announcement of the reform and the objectives and expectations set; and
- progress with implementation and achievement of objectives.

**3.4** The second, further round of reform was under way at the time of the audit. Hence, only limited comment can be made on that here, focusing on arrangements for future disposals management.

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73 The Minister for Defence Materiel at that time was the Hon. Jason Clare MP.

## The impetus for the 2011 reform

3.5 Reform of the disposal of major equipment has occurred in the context of other major activities within Defence. The following are relevant, in particular, to understanding the disposal reform announced in 2011:

- *Accelerated Disposals Program (ADP)*—on 27 November 2007, the VCDF asked that the CEO DMO review items of inventory that were potentially surplus to Defence requirements. Defence then began the ADP for obsolete and surplus inventory. While this program did not include SME, it gave equipment disposal and related problems, such as substances with hazardous properties, greater profile.<sup>74</sup>
- *Disposal of the ex-HMA Ships Canberra and Adelaide*—disposal of these two ships from planned decommissioning of the first ship in late 2005 to scuttling of the second in 2011 was prolonged, problematic and expensive.<sup>75</sup> Further, disposal of former naval ships and boats over a decade or more had been costly to Defence (see Table 3.1).
- *Strategic Reform Program (SRP)*—in 2009, Defence began a decade-long major reform of its business intended to generate savings to be reinvested within Defence. This set a strong imperative to seek opportunities to save funds by improving practices.<sup>76</sup>

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74 Defence initiated its ADP to identify efficiency improvements and generate savings. This was directed at the many hundreds of thousands of types of item (comprising many millions of individual items) held in Defence warehouses under the control of Defence's JLC. At this time, it was accepted that disposals was 'not something that Defence has done well in the past but there is now a determination to fix this issue and to harness all the benefits to be generated from undertaking this important activity.' Source: Defence, internal correspondence, Director General Supply Chain Branch, JLC, 7 December 2008.

75 The disposal of these ships is discussed in more detail in Chapter 6.

76 The *2008 Audit of the Defence Budget* (the Pappas Review, 3 April 2009), which underpinned the SRP, focused on opportunities to improve on the management of general inventory—and commented on the progress then being made. However, it did not identify SME disposals as an opportunity.

**Table 3.1: Disposal of Royal Australian Navy ships, 1997–2010**

Year	Name	Fate and revenue	Additional cost to Commonwealth <sup>A</sup>
1997	<i>Swan</i>	Scuttled at Geographe Bay, W.A.	Not known
1998	<i>Ovens</i>	Gifted to Western Australian Museum	Not known
1999	<i>Torrens</i>	Sunk in deep water off W.A. coast as live-fire exercise	Not known
1999	<i>Moresby</i>	Sold at public auction for \$580 000	Not known
2000	<i>Bermagui</i>	Sold at public auction for \$584 000	Not known
2000	<i>Kooraga</i>	Sold at public auction for \$584 000	Not known
2001	<i>Ardent</i>	Sold by private treaty for \$150 000	Not known
2001	<i>Shoalwater</i>	Sold by public tender for \$160 000	Not known
2001	<i>Rushcutter</i>	Sold by public tender for \$180 000	Not known
2001	<i>Perth</i>	Gifted to Western Australia—scuttled at Albany, W.A.	Not known
2001	<i>Otama</i>	Sold to Western Port Oberon Association for \$55 000	\$500 000 Federation Grant
2002	<i>Hobart</i>	Gifted to South Australia—scuttled off Yankalilla Bay	Not known
2003	<i>Brolga</i>	Sold at public auction for \$255 000	Not known
2005	<i>Brisbane</i>	Gifted to Queensland—scuttled off Mooloolaba	\$3 million
2006	<i>Westralia</i>	Sold following request-for-proposal for \$2.75 million	Not known
2006	<i>Orion</i>	Scrapped in Henderson, W.A.	\$3.2 million
2006	<i>Cessnock</i>	Scrapped in Darwin	\$400 000
2006	<i>Whyalla</i>	Scrapped in Darwin	\$400 000
2006–07	<i>Bunbury</i>	Scrapped in Darwin	\$450 000
2006–07	<i>Geraldton</i>	Scrapped in Darwin	\$450 000
2006–07	<i>Fremantle</i>	Scrapped in Darwin	\$450 000
2006–07	<i>Geelong</i>	Scrapped in Darwin	\$450 000
2006–07	<i>Launceston</i>	Scrapped in Darwin	\$450 000
2006–07	<i>Bendigo</i>	Scrapped in Darwin	\$450 000
2006–07	<i>Ipswich</i>	Scrapped in Darwin	\$450 000

Year	Name	Fate and revenue	Additional cost to Commonwealth <sup>A</sup>
2006–07	<i>Dubbo</i>	Scrapped in Darwin	\$450 000
2006–07	<i>Warrnambool</i>	Scrapped in Darwin	\$450 000
2007	<i>Wollongong</i>	Scrapped in Port Macquarie	\$400 000
2007	<i>Gladstone</i>	Gifted to the Gladstone Maritime Museum	Not known
2007	<i>Townsville</i>	Gifted to the Townsville Maritime Historical Society	\$200 000 grant
2008–09	<i>Canberra</i>	Gifted to Victoria—scuttled off Barwon Heads	\$7 million payment to state
2008–10	<i>Adelaide</i>	Gifted to New South Wales—scuttled off Terrigal	\$6 million payment to state
2011–12	<i>Manoora</i>	Sold for scrap in Texas: \$1.5 million revenue	\$4.17 million removal fee
2011–12	<i>Kanimbla</i>		

Sources: Defence, Ministerial Submission 'Disposal of Navy Ships 2011 to 2019', November 2010, and Source Evaluation Report for disposal of HMA Ships *Manoora* and *Kanimbla*.

Note A: Represents Defence estimates of budgeted direct costs to Defence for the disposal. Does not include indirect costs associated with contracting, legal advice, advertising, sale agents' fees, and valuations.

**3.6** The ex-HMA Ships *Canberra* and *Adelaide* were gifted to the states of Victoria and New South Wales to be scuttled as dive wrecks. In each case, managing the disposal, including the selection of a suitable site, preparing the ship and addressing environmental and other concerns, turned out to be lengthy and complex and, in the New South Wales case, involved court action. Defence Disposals invested extensive administrative effort, including in working with state government bodies. Defence has estimated that, taken together, the two disposals cost the Commonwealth about \$13 million in funding provided by Defence to the states, primarily to prepare the ships for scuttling.<sup>77</sup>

**3.7** By way of background, an earlier Minister for Defence<sup>78</sup> had offered to meet the costs of preparing the ex-HMAS *Brisbane* for use as a dive wreck over

77 Defence informed the ANAO that funds to meet these costs were obtained from allocations within Defence for naval sustainment. However, Commonwealth funding may not have met all the scuttling costs. For example, one account states that 'The NSW Government originally committed \$0.25m to the project, as well as in-kind contributions, but had to meet significant additional costs to complete the project.' Source: C Cole and C Abbs 2011, Catchments & Lands, Department of Primary Industries, Newcastle, NSW, 'Scuttling the ex-HMAS *Adelaide* as an artificial reef and recreational dive site: A case study in complexity', available at: <http://www.coastalconference.com/2011/papers2011/Cathy%20Cole%20Full%20Paper.pdf>, [accessed August 2014].

78 The Hon. Peter Reith MP.

a decade ago. Even though this offer had been capped at \$3 million by a later minister<sup>79</sup>, an expectation of similar funding had been created for later offers of ships as dive wrecks. This precedent<sup>80</sup> and its consequences for the disposal of ex-HMA Ships *Canberra* and *Adelaide* are discussed in Chapter 6 (from paragraph 6.31).

## **Ships Disposal Strategy 2011–19**

**3.8** In June 2010, Defence began work on a ships disposal strategy for the following decade, the remaining period of the SRP. The strategy was to address a substantial program of ship disposals over that period. Defence expected to decommission up to two dozen ships, including HMA Ships *Tobruk*, *Kanimbla*, *Manoora*, *Darwin*, *Newcastle*, *Sydney* and *Melbourne*. Defence wanted to avoid incurring similar costs to those incurred when it disposed of the ex-HMA Ships *Canberra* and *Adelaide*.

**3.9** Moreover, on the basis of Defence's understanding of the experience of the UK Ministry of Defence (in particular, with former Royal Navy ship ex-HMS *Fearless*), Defence identified a potential for funds to be returned to the Commonwealth from ship disposals, as a contribution to the SRP, by recycling a high proportion of the constituent material. Defence believed it could not only avoid the previous losses but earn revenue, if only from scrap. Defence internal estimates at that point, for example, showed that had the ex-HMAS *Adelaide* been sold for scrap, it could have returned revenue of \$3 million.

**3.10** Defence Disposals then developed a strategy to enable ship recyclers to compete against other interested parties (including dive wreck/artificial reef proponents) on a value-for-money basis. Defence first drafted a ministerial submission proposing the strategy in July 2010. This was finalised and put to the then Minister for Defence Materiel<sup>81</sup> in November 2010.

**3.11** In essence, the strategy pointed out that Defence had incurred costs in recent years from ships gifted as dive wrecks. Since it would dispose of a large number of ships during the remainder of the SRP period, it estimated the cost to Defence of continuing past practices to be up to \$40 million. However, Defence had formed a view, based on reports of UK experience, that ship

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79 Senator the Hon. Robert Hill.

80 As discussed in Chapter 6 (paragraph 6.11), the Finance Minister's Delegation for gifting public property alerts delegates to the potential risks posed by precedents.

81 The Hon. Jason Clare MP.



disposal could be more effective and profitable, citing, in particular, examples centred on dismantling, recycling and recovery of materials.

**3.12** The strategy Defence developed was to release a global request-for-proposal (RFP) to seek options for the disposal of up to 17 ships and associated equipment, encompassing methods such as: sale or export as a going concern; dismantling and recycling; dive wrecks; and museum exhibits. Defence envisaged successful respondents could form a panel of prospective tenderers, with tenders assessed on a ship-by-ship basis.

**3.13** The Minister for Defence Materiel did not immediately approve the proposal but sought further advice on the potential for involvement of the Australian shipbuilding industry.<sup>82</sup> After consulting a range of Australian companies, Defence responded to the Minister with a further submission on 5 April 2011. Defence had concluded from its consultations that there was sufficient industry interest to proceed with the proposed RFP. Defence then sought ‘priority consideration’ of the ships disposal strategy, which the Minister approved on 7 April 2011.

**3.14** In June 2011, shortly after the strategy was approved, Defence further advised the Minister on the timing and structure of the RFP. This followed the decommissioning of the HMAS *Manoora* on 27 May 2011—earlier than expected. The RFP would now be in two parts, one for the ex-HMAS *Manoora* (and potentially HMAS *Kanimbla*, should it also be decommissioned early) and the other for the remaining ships to be decommissioned through to 2019.

### **Other ‘domain solutions’**

**3.15** From about October 2010, Defence began to develop further longer-term disposal strategies similar to that for Navy ships. The next such strategy was to be a ten-year vehicle disposal strategy, enduring for the remainder of the SRP period and modelled on the ships strategy. Following vehicles, it expected to develop aerospace and helicopter strategies to complete the set.

**3.16** In early 2011, DMO’s acting Head of Acquisition and Sustainment Reform Division (HASRD) stated that his ongoing strategic review of the 2011–20 disposal environment showed that Defence would be undertaking its largest disposals program since World War II. This would test Defence (and Defence Disposals) in terms of resources, and also industry capacity. However,

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82 The Minister’s response was perceived within Defence as an initial rejection of the strategy.

in developing 'domain solutions' (such as the ships and vehicles strategies), Defence Disposals expected to be in a well-informed position to develop a business case for more internal resources if required.

## Proposal and announcement of the reform

**3.17** The major reform proposal put to the Minister for Defence Materiel in May 2011 by the CEO DMO set out two key points:

- first, the large scope of military equipment disposals over the coming decade (representing 54 per cent of Defence's specialist military equipment<sup>83</sup>); and
- second, that 'managing disposals as a commercially-focused major program' presented a financial opportunity.

**3.18** Defence advised the Minister that Defence Disposals had begun a range of measures to deal with imminent disposals. These comprised the F-111C disposal strategy, the ships strategy (then recently approved by the Minister), and a forthcoming vehicles strategy. Defence's advice drew a particular contrast between the high disposals revenue obtained by the UK since 1997 (£650 million) and the losses made by Australia (\$19 million). Defence based this advice on information on UK disposals that had come to hand in early 2011.

**3.19** Defence attributed the difference in performance to:

- a. a reactive [Australian] disposals process, where disposals have been undertaken on an asset by asset basis, with detailed planning not occurring until late in an asset's life;
- b. utilising military assets to establish State tourism infrastructure, e.g. ex-HMA Ships *Perth*, *Hobart*, *Brisbane*, *Canberra*, *Adelaide* being gifted (in some cases with cash contributions) for use as artificial reefs/dive wrecks; and
- c. the lack of a commercial focus for disposals, encompassing planning, target setting, market analysis, product development, industry partnering, etc.

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83 This, according to the ministerial submission, is in terms of the equipment's original acquisition cost and includes supporting inventory.

**3.20** The submission stated that the CEO DMO had asked Defence Disposals to develop further initiatives which would reduce and eliminate disposal costs, return funds to sustainment, and generate and maximise revenue for both Defence and the Commonwealth. The submission noted that a number of complexities would need to be addressed to realise these objectives and manage disposals as a major program, including ITAR, occupational health and safety and heritage issues.<sup>84</sup> The next initiative, however, would be international benchmarking focused on the UK, US and Canada. A comprehensive program plan was promised to follow.

## Announcement

**3.21** The Minister for Defence Materiel announced the reform to military equipment disposal on 29 June 2011.<sup>85</sup> The announcement emphasised the large scope of expected disposals over coming years and the contrast between the substantial revenue generated by the British Government from their military disposals since 1997 and the costs incurred by Australia. The rationale for reform was ‘to reduce costs, generate potential revenue and provide opportunities for Defence industry involvement’.

**3.22** The announcement stated that the ships disposal strategy would be the first initiative under the reform and that this would seek proposals in two parts: first, disposing of HMAS *Manoora* and, second, all other ships. The plan to dispose of up to 12 000 Army B Vehicles had also been approved by this point, and was included in the Minister’s announcement.

**3.23** Consistent with the Minister’s announcement, Defence’s 2011–12 Annual Report identified four key priority areas for Defence disposals:

- to reduce if not eliminate Defence major disposals cost;
- to return funding to the sustainment of current capability;
- to generate and then maximise revenue from the sale of Defence’s military assets; and

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<sup>84</sup> On the question of generating revenue for Defence, one threshold issue not addressed in the submission related to Defence’s ability to retain receipts from the disposal program. Under s.31 of the FMA Act and FMA Regulation 15, there were defined circumstances in which FMA Act agencies could do so. Receipts not of a type listed in the Regulations would go to consolidated revenue.

<sup>85</sup> The Hon. Jason Clare MP, Minister for Defence Materiel, press release, ‘Reforms to Disposal of Military Equipment’, 29 June 2011.

- to ensure that Defence heritage, particularly war heritage, is appropriately recognised and preserved.<sup>86</sup>

## Organisational support

**3.24** To implement the reform, a proposal was formulated in May 2011 for consideration by the CEO DMO to create an ‘enhanced’ Defence Disposals unit. This would require additional resources of 15 full-time equivalent positions plus operating expenses.<sup>87</sup> The basis for the proposal was the size and complexity of the reform program. The reform program was referred to by Defence Disposals during the remainder of 2011 as the ‘Strategic Divestment Program’.

## Progress with implementing reform

**3.25** On the question of its progress with the reform announced by the Minister in June 2011, Defence informed the ANAO:

Two key activities in financial year 2011–12 aimed at reducing cost and maximising revenue to Defence were progressing of the Navy ships disposal Request for Proposal (RFP) released in July 2011 and the Army non-combat vehicles disposal RFP released in August 2011.

**3.26** Taking account of these and the other items identified above, the audit assessed progress with:

- the ships disposal strategy;
- the vehicles disposal strategy;
- Defence’s international benchmarking of disposals;
- the tracking of both disposal costs and revenue; and
- the comprehensive program plan promised by the CEO DMO to the Minister.

**3.27** Each of these is discussed in the following paragraphs (3.28 to 3.64).<sup>88</sup>

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<sup>86</sup> Defence, *Annual Report 2011–12*, p. 216.

<sup>87</sup> The proposal did not include an estimate of the costs.

<sup>88</sup> A further initiative, which had already been underway but could be considered part of this round of reform, was a proposed Blanket Demilitarisation and Disposal Agreement (BDDA) with the US. This relates to US ITAR and is considered in Chapter 7.

## **Ships disposal strategy**

**3.28** In November 2011, five months after the ministerial announcement discussed in paragraphs 3.21 to 3.23, Defence ministers issued a progress report on the full range of Defence reform then underway (including much that is well beyond equipment disposals). The progress report noted that the RFP for ship disposals closed on 14 October 2011 and responses were being evaluated. A decade-long ship disposal solution was expected to be finalised and in place during 2013, with the focus for 2011 and 2012 being cost-effective disposal of the ex-HMA Ships *Manoora* and *Kanimbla*.

**3.29** In December 2011, the evaluation report on the proposals expressed disappointment with the 17 proposals received:

the Commonwealth sought innovative solutions from the industry on the disposal options for the fleet of [Navy] obsolete vessels over the coming decade. The responses were disappointing as no innovative solutions were provided. Each of the respondent proposals would incur a cost to the Commonwealth and in some cases this cost would be ongoing with the risk of some costs escalating over the proposed ten year disposal period.

**3.30** The evaluation report also considered options proposed for the ex-HMAS *Manoora*<sup>89</sup> and ex-HMAS *Kanimbla* (which had then just been decommissioned). The report observed:

the overwhelming response for the disposal option for *Manoora* and *Kanimbla* has been that of recycling at Commonwealth expense. Most of [the] proposals assessed incurred a cost to the Commonwealth. Of the few proposals that suggested a return to the Commonwealth when further assessed also incurred costs to the Commonwealth in the form of towing and transportation of the vessel to the recycling facility overseas.

**3.31** The fate of the ex-HMA Ships *Manoora* and *Kanimbla* was thereafter settled as a separate matter from the overarching ships disposal strategy.

### ***Disposal of the ex-HMA Ships Manoora and Kanimbla***

**3.32** Defence advised the Minister for Defence Materiel in March 2012 that ‘evaluation of the RFP responses [to the ships strategy] was underway.’<sup>90</sup> The

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<sup>89</sup> The disposal of the ex-HMAS *Manoora* formed a separate part to the RFP as the Navy wished to expedite it.

advice stated that, following the earlier than expected decommissioning of the ex-HMA Ships *Manoora* and *Kanimbla*, Defence now held sufficient market knowledge to recommend an immediate disposal strategy. There had been neither industry interest in the sale of the ships as going concerns nor any interest from foreign navies. There were no viable responses either to use the ships as dive wrecks nor as museum exhibits. Defence now proposed to release a restricted request-for-tender (RFT) to selected companies for the sale of the ships for recycling.

**3.33** Defence's ministerial advice noted separate expressions of interest from areas such as the Queensland Gold Coast and Sunshine Coast, and the New South Wales Illawarra region, for use of the ships as dive wrecks. The advice counselled against such options, noting that:

- those responses received to the RFP that had offered dive wrecks as a proposal were considered deficient and the respondents expected Commonwealth funding; and
- even a robust, funded proposal would meet opposition on environmental grounds with potential for protracted litigation.

**3.34** Following a meeting between the Minister and Defence officials on 30 May 2012, the Minister asked for further advice on recycling the ships within Australia and overseas; use of a vessel by State governments as a dive wreck; and their possible disposal as a live-fire target. The Minister, who had received representations from state and federal members of parliament seeking to have a decommissioned RAN ship sunk off the Queensland coast as a dive wreck, also sought a draft letter of offer to the Queensland Government.

**3.35** On 6 June 2012, Defence provided the advice and draft letter the Minister had requested. Defence recommended that one or both ships be offered to the Queensland Government for use as a dive wreck:

on an "as is, where is" basis, with the immediate removal of the ship(s) from Sydney Harbour, and all costs and expenses in the removal, preparation for scuttling, legal and environmental compliance or any activity associated with this transaction to be borne by the Queensland State Government.

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90 Evaluation of the RFP responses had been underway since November 2011, as indicated in the Minister's press release at that time on progress of Defence reforms. The ministerial submission of March 2012, which was focused on the disposal of the ex-HMA Ships *Manoora* and *Kanimbla*, does not explain why so much time had elapsed on this task.

**3.36** Should the offer be declined, Defence proposed that the ships be made available for recycling through a select tender process.

**3.37** The Minister wrote to the Queensland Government in June 2012 offering a ship as a dive wreck, and advising that it would cost a minimum of \$10 million to sink one ship for this purpose. The Queensland Government declined and Defence issued the RFT on 10 July 2012. However, discussions continued with a view to the New South Wales Government using one of the ships for the same purpose. On 28 September 2012, it also declined a similar offer. Defence then proceeded with the RFT for sale of the ships for recycling.

**3.38** When Defence began evaluating responses to its RFT it found that:

the sale contract released in the RFT has hit a snag. None of our tenderers can provide an ‘in the black’ sale price. That is, they are prepared to offer a sale price but either due to the cost of the removal or the cost of the recycling it would still come at a cost to the Commonwealth.

**3.39** Defence ultimately signed the contract with the successful tenderer on 20 May 2013 and the ships were later taken to the US to be broken up. As mentioned earlier (paragraph 2.51), the contract involved a net cost to the Commonwealth of about \$2.5 million. This was because the cost to the Commonwealth of removing the ships from Sydney and towing them to the breaker’s yard in Brownsville, Texas, was considerably higher than the price paid to the Commonwealth for them.<sup>91</sup>

**3.40** The full cost of the disposal, however, is much higher.<sup>92</sup> The ships had to be removed from Garden Island in Sydney to allow for repairs to facilities in preparation for the International Fleet Review. Defence then had to meet mooring costs for the ships until 4 July 2013, when the ships were transferred to the disposal contractor. DMO obtained commercial mooring for them at Glebe Island, which cost some \$3.25 million.

**3.41** Although the revenue returned from the scrap can be identified, the ANAO has found no evidence that Defence monitored the costs of the entire

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91 Defence records indicate that the net cost to Defence of disposing of the two ships for scrap in Australia would have been between \$8 million and \$10 million.

92 Some of the costs incurred in disposing of HMA Ships *Manoora* and *Kanimbla* can be attributed in part to the delay in Defence obtaining ITAR approval from the US. However, on this occasion, Defence added to this delay through its own administrative error. When it was conducting final negotiations with the two preferred tenderers, it submitted an ITAR approval application for one tenderer on 15 January 2013 but omitted to submit one for the other (ultimately successful) tenderer until 13 March 2013.



disposal of the ex-HMA Ships *Manoora* and *Kanimbla* to inform future disposals, nor did it document the process for learning, education or accountability purposes.

### *Fate of the ships disposal strategy*

**3.42** Ultimately, Defence took up none of the proposals received in response to the ships disposal RFP. Defence informed the ANAO that, nevertheless, the ‘RFP did provide important information to help guide future ship disposal planning.’ However, Defence did not identify the nature of this information nor how it will guide that planning.

**3.43** One reasonable conclusion from this work is that a stream of revenue from this source is unlikely to be realised and that Navy ship disposal in the foreseeable future is more likely to generate net costs to the Commonwealth. Transport costs, in particular, are high for ship disposals overseas, and additional costs can mount quickly if delays occur.

**3.44** Aside from the disposal of ex-HMA Ships *Manoora* and *Kanimbla*, the ships disposal strategy appears to have run its course without result. Defence has not indicated how this turn of events has been acquitted with ministers or the Parliament, who may have expectations based on earlier announcements.

**3.45** The experience of the ships disposal strategy highlights the need for key strategies to be strongly grounded in an understanding of the operating context or historical experience, and supported by analysis.<sup>93</sup> As indicated in Table 3.1, in the decade before the strategy, disposal of ships had generally come at a cost to the Commonwealth. The step change envisaged in ship disposal outcomes now looks too optimistic.

## **Vehicles disposal strategy**

**3.46** On 21 June 2011, the Minister for Defence Materiel approved Defence’s recommended strategy for the disposal of about 12 000 Army B Vehicles over 10 years (2011–20). However, it took Defence until November 2012 to sign a contract to give effect to the strategy. The audit examined the development of these arrangements as a case study (Chapter 4) and in relation to hazardous substances (Chapter 5).

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93 As discussed, Defence’s thinking was informed by recent UK experience. However, it is necessary to assess differences in circumstance, such as the likely transport costs arising from Australia’s distance from overseas recyclers compared to those faced by the UK.



**3.47** Defence informed the ANAO that:

the Army non-combat vehicles RFP aimed to give industry the opportunity to propose disposal solutions which would reduce Defence's cost and return net funding to sustainment of current Defence capability. This RFP ultimately led in 2012 to the contract with [*the successful contractor*] for the B Vehicles disposal, which is an innovative commercial approach that has led to over \$9 million in revenue being returned to Defence [*in calendar year 2013*].

**3.48** However, Defence's internal project tracking report for the B Vehicles disposal indicated that, as at May 2014, the 'project health' was of 'concern' due to Defence's own slow release of surplus vehicles to the contractor. As a result, Defence has agreed to reduce, substantially, the Commonwealth's share of the revenue. Under a complex revenue-sharing formula, Defence's share was originally set at an effective 64 per cent of the proceeds from sale of the vehicles. For 2014–15, Defence has agreed to drop this share to 24 per cent. Thus, the revenue Defence gains from this arrangement in 2014–15 will be a smaller proportion of a lower than anticipated revenue stream.

### **International benchmarking**

**3.49** Defence's undertaking to the Minister in May 2011 was that its next initiative would be further international benchmarking, encompassing both departmental and industry activities and outcomes in the UK, US and Canada.<sup>94</sup> The term 'benchmarking' can be used to refer to any process of comparison, but it also has a more technical meaning, implying specific steps and structured procedures designed to identify and replicate best practice. The audit sought to identify where, on the continuum between general comparison and structured analysis, Defence Disposals' benchmarking work lies.

**3.50** Defence Disposals reported to the CEO DMO, in September 2011, that the outcome of international benchmarking for disposals would be a paper on the future structure and operation of disposals in Defence. This paper, prepared in October 2011, sought to create an 'enhanced Defence Disposals Agency', including by raising the Defence Disposals staff level from 13 APS full-time-equivalent staff to 21 and by creating a single organisational unit by combining staff from JLC and Defence Disposals.<sup>95</sup>

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<sup>94</sup> See paragraph 3.20.

<sup>95</sup> The earlier proposal to increase the size of Defence Disposals to support the disposals reform program (see paragraph 3.24) had not succeeded.

**3.51** In relation to the benchmarking work done by Defence Disposals, the October 2011 paper stated:

The business models used by allied nations have shown that this model works and can generate significant revenue in an area where Defence has traditionally expended budget allocation. In particular, the model used by the UK MoD [*Ministry of Defence*] has a large number of contracts covering the sale of B Vehicles, helicopters, military spares, scrap metal, rubber goods, etc. There are very few items disposed of by the MoD which result in a cost, and this is the business model which will be adopted by [*Defence Disposals*].<sup>96</sup>

**3.52** It is not clear how far this proposal advanced, but it is apparent that it did not succeed as a funding/establishment request. However, elements of the business model (such as the B Vehicles disposal) have proceeded.

**3.53** Defence has not identified any other material output from the benchmarking work or the undertaking made to the Minister in May 2011.

#### *Benchmarking against the UK*

**3.54** Reference to the UK experience in disposals became more voluble within Defence in 2011. DMO officials had observed, in mid-April 2011, a report in a UK magazine<sup>97</sup> stating that the Ministry of Defence (MoD) had earned revenue of £650 million since 1997 from the sale of defence equipment.<sup>98</sup>

**3.55** Defence promptly provided a comparison in disposals revenue performance to ministers' offices and to the CEO DMO, pointing out that, in the same period that the MoD had obtained this revenue, Australian Defence disposals had cost the Commonwealth about \$20 million. This comparison was also prominent in the subsequent ministerial submission proposing reform to the disposals program as a whole.

**3.56** In late April 2011, after submitting its advice to ministers' offices and the CEO DMO, Defence Disposals became aware of important further detail of the MoD arrangement. Closer scrutiny of the source material (the answer to a

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96 The audit has not found any evidence drawn upon by Defence to support the statement 'There are very few items disposed of by the MoD which result in a cost'.

97 The report was in the March 2011 edition of the UK Ministry of Defence magazine 'Desider', which characterises itself as 'the monthly corporate magazine for [UK] Defence Equipment and Support (DE&S). It is aimed at readers across DE&S, the wider MoD, armed forces and industry, and has stories and features about support to operations, equipment acquisition and support.'

98 This article was based on an answer provided to a Parliamentary question in the House of Commons, a copy of which Defence subsequently obtained from the Internet.

Parliamentary question) showed that the revenue of £650 million represented the total of the return to both the private contractors involved and the MoD. Each would receive only a proportion of that gross figure, which also included payments to the private partners for 'collection, storage, accounting, upgrade and sale' of the stores and equipment.

**3.57** This suggests that Defence Disposals had misunderstood the magnitude of the revenue obtained by the UK Government on its sale of MoD equipment. There is no evidence that this caveat was transmitted to more senior Defence management or ministers' offices, who may have been left with the impression that the UK Government had earned more revenue than in fact it had from disposal of military equipment.

**3.58** Defence records provide no analytical evidence of serious benchmarking effort to compare the Australian disposals performance with that of the UK or the other countries mentioned in the May 2011 submission to the then Minister. Defence's proposal for a new approach based on the UK model seems to have been based on a general understanding of the industry partnership model it had adopted and a superficial comparison of reported gross sales revenue. Further, during the audit, Defence informed the ANAO that:

some research was undertaken to benchmark Defence's disposals with overseas countries; however, there is no evidence that DMO provided further written advice to the minister regarding the benchmarking outcomes.

**3.59** Further, there is no evidence of assessment by Defence Disposals of how the UK industry partnership model would translate to Australian circumstances or what factors the model might be sensitive to. For example, factors that could have been considered in any such analysis might be:

- the likely large number and variety of MoD equipment disposed of and the proximity of these assets to the substantial European market; and
- the relatively smaller scale of Defence equipment disposals, the distance from overseas markets, and an apparently limited local market for these assets based on historical sales experience.

## **Revenue and costs**

**3.60** One of the main objectives of the reform to disposals as announced by the Minister in June 2011 was to reduce costs and increase revenues.

**3.61** To manage and track disposals, and assess progress with cost reduction and increasing revenues, Defence needs appropriate business procedures, including a mechanism that draws together all of the expenditures and revenues associated with each disposal. This would allow Defence to work out the net position for each disposal, report progress against undertakings to the Minister and, potentially, identify lessons from particular disposals so as to manage future disposals more effectively. Such a mechanism would be a fundamental requirement in a ‘commercially-focused major program’ seen as presenting a financial opportunity (paragraph 3.17).

**3.62** As mentioned in Chapter 1 (paragraph 1.20), Defence has no database, register or other systematic method to manage or collect records for its major equipment disposals. Moreover, Defence did not put business processes in place to track financial or other progress of the reform. Thus it is not clear how Defence expected thereafter to manage the initiative or report its performance other than on an ad hoc basis (for example, by undertaking data collection on each occasion that performance information was required).

**3.63** Within Defence, concern had developed at the costs associated with gifting naval ships for use as dive wrecks. During 2011 these costs became a focus for Defence in considering options for reducing the cost of disposals. However, as discussed in Chapter 2 (see paragraph 2.41), there are many other sources of expenditure which can contribute to the costs of a disposal, including personnel, hazardous substances, storage, accommodation and towing costs, and legal costs. These costs are borne by different parts of Defence and there seems not to have been any means to draw them together to present a full record of the costs and revenues for SME disposals.

### **Comprehensive program plan**

**3.64** In the reform proposal to the Minister in May 2011, the CEO DMO undertook to provide a comprehensive program plan to support the reform initiative. Defence records indicate that no program plan was prepared as part of the reform initiative, and any attempt at comprehensive planning for disposals awaited a further round of reform from 2013 onwards.

## Conclusion—initial round of disposals reform

**3.65** Defence initiated a first round of reform of SME disposals in 2011 with four priority areas: to reduce if not eliminate Defence major disposals cost<sup>99</sup>; to return funding to the sustainment of current capability; to generate and then maximise revenue from the sale of Defence’s military assets; and to appropriately recognise and preserve Defence heritage, particularly war heritage.

**3.66** Defence based this reform on comparison with overseas experience. However, the reform proposal was not underpinned by sufficient analysis or research to support the expectation of generating revenue from SME disposals. Defence set about implementing the reform primarily through establishing long-term strategies for the disposal of SME in specific ‘domains’: two such strategies were those for RAN ships and for Army B Vehicles.<sup>100</sup> The ships strategy has already run its course with only two ships disposed of—the ex-HMA Ships *Manoora* and *Kanimbla*—at a substantial cost to Defence. The B Vehicles strategy has returned funds, but there is no information on the costs incurred by Defence in managing the disposal.

**3.67** Defence has not reported its performance in terms of the four 2011 reform priorities nor have measures or targets been set that would enable Defence to do so. The lack of financial data on major equipment disposals also hinders performance assessment against the priorities. The most significant insight from the initial round of reform is the need to take proper account of the relatively small scale of Defence equipment disposals, the additional costs which can arise due to Australia’s distance from overseas markets, and a limited local market for these assets based on historical sales experience.

## Further reform of Defence disposals

**3.68** In response to the recent reviews and investigations of disposal processes, Defence has:

- made a number of organisational and staffing changes;

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99 At the time the primary source of concern about costs arose from the experience of disposing of two RAN ships, ex HMA Ships *Canberra* and *Adelaide*, as dive wrecks gifted to the states. This had cost Defence at least \$13 million and taken considerable administrative effort over an extended period.

100 B Vehicles comprise about 12 000 trucks, trailers and four and six-wheel drives.

- identified forthcoming disposals by reference to the Key Defence Asset Register (KDAR);
- set out a general disposals plan in a spreadsheet; and
- set about revising departmental disposals policy, developing templates and documenting disposals processes.

**3.69** Defence has also recently developed a formal monitoring and reporting mechanism for individual disposals. The new reports for individual disposals available to date mainly provide a commentary on the progress of the disposal and do not generally identify a total budget for the disposal, nor track expenditure and revenue.<sup>101</sup> However, this work is ongoing.<sup>102</sup>

**3.70** The most substantial recent review of disposals was instigated in mid-2013, when Defence obtained the services of external consultants to review the operation of Defence Disposals. The consultant stated its task thus:

The review was ... established to provide DMO stakeholders with an understanding of the issues that may have given rise to past problems.<sup>103</sup>

**3.71** The DMO Disposals Review was completed on 16 October 2013 and provided to Defence. It gave particular focus to four case study disposals: Caribou aircraft; B707 aircraft; B Vehicles; and Landing Platform Amphibious ships (ex-HMA Ships *Manoora* and *Kanimbla*), all of which have been examined in this audit.

**3.72** The review made six recommendations and Defence accepted them all. The recommendations (which are set out in Appendix 1) address: legislation and policy review; delegation framework clarification; the disposals governance framework; risk analysis, disposals templates, processes and instructions; and training and resourcing. In April 2014, Defence developed a plan to implement these recommendations by December 2014 and to assess progress in the period January to June 2015.

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101 In several cases, the reports observed stated that no specific project budget had been allocated.

102 In October 2014, Defence informed the ANAO that, from July 2014, an additional level of reporting detail has been added to Defence's financial management system to enable AMSO to monitor its expenditure associated with each disposal project. However, AMSO does not have visibility of expenditure related to SME disposals incurred by other areas in Defence, where major disposal costs may be incurred.

103 Defence, DMO Disposals Review, 16 October 2013, p. 3.

**3.73** Some major issues raised in the review's recommendations are also discussed in this audit report (for example, matters relating to legislation and delegation are considered in Chapters 2 and 6). However, one aspect highlighted by the review warrants further consideration here: the overall management of the disposals function in Defence. The following matters were considered by this audit:

- responsibility for major equipment disposals; and
- senior leadership involvement in disposal processes.

## **Responsibility for disposals**

**3.74** DMO is responsible for the disposal of Defence major military equipment as part of the sustainment phase of the asset lifecycle, which includes disposal. Sustainment of the equipment is administered through Materiel Sustainment Agreement (MSA) arrangements<sup>104</sup>, whereby DMO is funded by Defence to sustain Defence equipment.

**3.75** Defence records indicate that the former DDA<sup>105</sup> saw itself as having the project management role: for example, in presentations given in 2011 it stated that: 'Defence Disposals Agency manages the disposal of major items.' Frequent direct correspondence between the Minister's office and DDA (including by email) is consistent with DDA being perceived as having prime management responsibility.

**3.76** When the AMSO was established within DMO in July 2012, it subsumed the DDA. DDA was subsequently renamed 'Disposals and Sales' (DAS) in November 2012. Current Defence guidance identifies that DAS is now the single point of contact within the DMO for guidance and support on SME disposal policies, processes and procedures:

In the context of disposals, AMSO-DAS is responsible for provision of guidance and support to DMO System Program Offices (SPO) in the disposal

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104 The ANAO is conducting an audit of Defence's MSAs. The objective of the audit is to examine the contribution made by Defence's MSAs to the effective sustainment of SME.

105 See paragraphs 1.9 and 1.10 for a description of the various organisational changes to Defence Disposals.



of Defence capability platforms, major disposal programs and items of significant interest.<sup>106,107</sup>

**3.77** Notably, the function carried out within AMSO is described in Defence guidance as providing advice, support and guidance, but not management of the disposal: 'DAS has been resourced to provide SPOs with the advice and support necessary to successfully plan and conduct Major Disposals'.<sup>108</sup> The ostensible reason is that 'DAS is not funded to conduct disposals or to manage assets inventory'.<sup>109</sup> These recent statements indicate that AMSO seems to have taken a step back from 'managing' and being 'responsible for' the disposal of major items (the position in 2011) to 'facilitating', 'supporting' and 'providing guidance' for disposals work.

**3.78** As noted above, relevant funding is allocated to DMO SPOs through MSAs. SPOs are responsible for the ongoing sustainment (including disposal) of capital assets and therefore, unlike DAS, notionally control the funding allocated by the capability manager for meeting disposal costs through Defence's MSA arrangements.

*Other instructions and guidelines unclear on management responsibility*

**3.79** The lack of clarity in management responsibility for SME disposals is exacerbated by other current Defence instructions and guidelines, which are inconsistent. Defence's policy documents that address the disposal of major Defence assets present a confused picture of who is responsible for what when it comes to the disposal of these assets, with the allocation of responsibilities differing between documents, and in some cases, within the same document.

**3.80** New templates, accountability matrices and guidance being developed within AMSO should help as a roadmap through the complicated disposals landscape. Nevertheless, there is a risk this material will have limited effectiveness if the accountabilities and responsibilities for disposals are not

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106 Defence defines capability platforms as those assets designed to provide Defence with a military capability, either individually or collectively. These assets will generally be land vehicles, ships, aircraft or submarines and will be listed in the Key Defence Asset Register (KDAR). Defence defines a major disposal as relating to those items which are expected to recover more than \$1 million in revenue upon disposal, or are capability platforms, weapon systems or 'items of significant public interest which require specialist disposal action and planning'. Source: DI(G) LOG4-3-008 Disposal of Defence Assets.

107 Defence, DEFGRAM No. 197/2013, Management of Major Platform and Inventory Disposals, 8 April 2013.

108 Defence, Disposals and Sales Disposal Guide, version 1.0, May 2013, p. 9.

109 *ibid*, p. 11.



made clear to, and accepted by all stakeholders, and supported through appropriate management structures. That is, in concert with devising any new guidance there is also a need to more clearly identify who should have overall management responsibility and authority for disposal activity below the level of the CEO DMO. Management responsibility and authority should be clearly and consistently reflected in all policy and guidance documents, and supported through appropriate organisational arrangements.

**3.81** It needs to be borne in mind that Defence SME disposal is a process rather than a single event. SME disposal can be costly, complex and involve multiple organisations within, and external to, Defence. Without clear lines of accountability and responsibility accompanied by appropriate guidance and levels of resourcing, Defence increases the risk of poor outcomes in respect of cost, capability, public safety, the environment and its reputation from these types of disposals.

*Multiple spheres of expertise*

**3.82** Major equipment disposals are complex projects with many spheres of expertise likely to be involved in any one disposal. These include: technical expertise in the equipment; contracting expertise; legal advice; logistics (JLC may have relevant responsibility for associated inventory); sales and marketing proficiency; knowledge of hazardous substances; and knowledge of export and related controls. Some disposal projects will not call on all of these types of expertise. However, since there will be many organisational units involved in each major disposal, identifying and providing appropriate authority to a project manager would enhance the prospect of successful management of a disposal.

**3.83** Consultation arrangements involving the various organisational units responsible for different aspects of a disposal process currently lack any defined structure comparable, for example, to the structures employed at the opposite end of the lifecycle, in capability development. In reviewing the extensive documentation in the course of the audit there was little evidence of formal consultation during disposal processes. Managing disposals with informal consultation arrangements—‘knowing whom to talk to’—may introduce risks, particularly as experienced staff members move on and informal organisational connections and knowledge are lost.

**3.84** The DMO Disposals Review also identified coordination weaknesses:

While there are various bodies that are acknowledged as having a role in the disposal process (including Integrated Disposal Project Teams), it appears that these bodies have relied on informal working relationships which do not always result in the views of each stakeholder organisation being taken into account in the disposal process.<sup>110</sup>

**3.85** The current organisational structure, management arrangements and departmental guidance for major equipment disposals are fragmented, with Defence in effect relying on a form of collective responsibility across organisational boundaries. This fragmented approach introduces additional risks for the Commonwealth in disposal of SME. The challenge for Defence is to ensure adequate consultation takes place when managing disposals without creating unwieldy committees, or alternative management arrangements, that may be prone to dispersed or unfocused responsibility.

**3.86** In reviewing the case studies examined in this audit, tensions have been apparent between Defence Disposals and other organisational units (for example, with JLC in relation to the disposal of the B Vehicles—see Chapter 4). Again, this was identified by the Disposals Review:

the relationship between Disposals and key stakeholders such as JLC and [*Defence's Chief Finance Officer Group*] has been, in some cases, strained—primarily as a result of a lack of clarity regarding responsibility for disposal of particular assets, and how funds incurred/received through a disposal process should be handled.<sup>111</sup>

**3.87** Competition among organisational units over the expected financial returns from disposals is unlikely to assist in the effective and efficient disposal of major military equipment, and there would also be benefit in clarifying this aspect of the disposals process.

## **Senior leadership involvement in disposal processes**

**3.88** The 2013 Disposals Review report indicates that it had become the practice for the DMO section handling major military equipment disposals to draft its preferred approach to a disposal, obtain ministerial approval, and

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110 Defence, DMO Disposals Review, 16 October 2013, p. 18.

111 Defence, DMO Disposals Review, 16 October 2013, p. 17.

then assume that the authority of that approval would over-ride any other procedural consideration:

it appears that Disposals (in particular DDA) has in the past had a very close working relationship (ie a “direct line”) to the Minister and has sought Ministerial endorsement of disposal strategies in most cases ...

it appears that Disposals sought, and obtained, Ministerial approval of Disposals’ proposed course of conduct for most disposals and that this, in turn, was seen to override any competing views given by stakeholders. This also appears to have created a culture focused on implementing the Minister’s approved strategies, with less than full consultation and co-operation with other Defence organisations.<sup>112</sup>

**3.89** A fortnightly report to the CEO DMO in July 2011 referred to the ‘ever increasing Ministerial involvement in disposals’ and the view within Defence Disposals in late 2012 was that, over the previous five years, ‘ministerial advice, notings and requirements for approvals have increased significantly.’ A former Director of Defence Disposals reported in December 2012 that his focus had been ‘disproportionately aimed at keeping the minister’s office happy’. His key function in that role as director:

ending up being very much a liaison role I suppose with the minister’s office. As much as that probably shouldn’t have been the main game, that really ended up being the priority customer.<sup>113</sup>

**3.90** The level of ministerial involvement in an activity is a matter for the minister and government of the day. Where a minister does wish to be closely involved in a particular issue, it is appropriate that senior management also become involved and advise Defence leadership as necessary. However, based on the ANAO’s review of Defence’s records for disposals over recent years, there is little record of involvement of senior leadership above the branch head level. Appropriate engagement with senior leadership, particularly at key points of significant disposals, would help Defence identify and manage the relevant risks when disposing of SME.

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<sup>112</sup> *ibid.*, pp. 18–19.

<sup>113</sup> Defence, internal records, December 2012.

## Conclusion—recent round of disposals reform

**3.91** In response to recent reviews and investigations of disposal processes, Defence has pursued a further round of reform. Key initiatives underway include the revision of Defence's disposals policy, the development of documented processes and templates to guide staff through disposal processes and high-level planning for forthcoming disposals. However, there is currently no mechanism that allows Defence Disposals to track costs associated with a disposal project, and Defence should implement a monitoring and reporting mechanism that captures all significant costs. Substantial disposal costs can be incurred by disparate parts of the Defence Organisation, and while it may be challenging to keep track of them, monitoring can contribute to the effectiveness of Defence's management of SME disposals by highlighting escalating areas of expenditure, such as berthing costs relating to ship disposals.<sup>114</sup>

**3.92** The potential benefits of recent reform are likely to be eroded if Defence does not more clearly identify project management responsibility and establish structured consultation arrangements for major equipment disposals. At present, a large number of separate Defence groups may be involved in, or have expertise relevant to, disposal processes, highlighting the need for clearly defined and well-coordinated disposal processes, and consistent internal guidance. Further, in more complex or sensitive cases, there is a need for sufficient senior leadership involvement in major equipment disposals and key decisions, to contribute to the effective and timely identification, assessment and management of risks.

## Recommendation No.2

**3.93** The ANAO recommends that, to improve the future management of the disposal of Defence specialist military equipment, Defence identifies, for each major disposal, a project manager with the authority, access to funding through appropriate protocols and responsibility for completing that disposal in accordance with Defence guidance and requirements.

**3.94** **Defence response:** *Agreed*

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<sup>114</sup> Defence informed the ANAO that it was setting up a process to capture cost information associated with AMSO activities. However, many disposal costs are incurred outside AMSO and these other costs will need to be captured and attributed if disposal costs for SME are to be fully identified.

## Recommendation No.3

3.95 The ANAO recommends that, to improve the future management of the disposal of Defence specialist military equipment, Defence puts in place the arrangements necessary to identify all significant costs it incurs in each such disposal (including personnel costs, the costs of internal and external legal advice, management of unique spares and so on), and reports on these costs after each such disposal.

3.96 **Defence response:** *Agreed*

3.97 As an initial step, Defence could incorporate guidance on which items to take account of in costing an SME disposal in the revision of its existing framework of rules and guidelines for SME disposal (see Recommendation 1).

## 4. Major Case Studies—Caribou and Boeing 707 Aircraft, and Army B Vehicles

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*This chapter examines two major disposals that were troublesome for Defence and prompted this performance audit—the disposal of the Caribou and Boeing 707 aircraft. It also examines shortcomings in the more recent disposal of Army B Vehicles.*

### Selection of major case studies

**4.1** As noted in Chapter 1, the failed disposal of the Caribou aircraft and the troubled disposal of the Boeing 707 (B707) aircraft, each through a commercial sale process, were the projects that prompted the request by the Secretary of Defence and CDF for this audit.

**4.2** Both of these disposals have been analysed and reviewed internally by Defence, generating extensive documentation, particularly in the case of the Caribou disposal. However, the main focus of this earlier work has been on legal matters or identifying possible misbehaviour by particular parties and individuals. The focus in this chapter is on the administrative aspects of the disposals and identifying weaknesses that could have contributed to the difficulties experienced in each case.

**4.3** Defence suggested the B Vehicles disposal to the ANAO as an example of a more recent disposal, and one which it viewed as successful. Review of the project during the audit has revealed shortcomings in some aspects of the disposal.

### Caribou aircraft

#### Withdrawal of the Caribou fleet

**4.4** The Caribou is a Canadian-designed light tactical transport aircraft capable of operating from unprepared airfields. It can function as an air-bridge or as a platform for paradrop and airdrop operations and is suited to aerial re-supply to remote areas. The RAAF took delivery of its first of 29 Caribou

aircraft in 1964. The first project to replace the Caribou began in 1978, with planned withdrawal extended many times thereafter, ultimately to 2010.<sup>115</sup>

**4.5** A brief in January 2008 advised the Chief of Air Force (CAF) that Caribou availability was satisfactory but there was doubt about future Caribou viability due to asbestos within the aircraft. Within nine months, Defence became more dissatisfied with Caribou availability. The CDF informed the then Minister in September 2008 of his intention to examine the option to withdraw the ADF's remaining fleet of 14 Caribou aircraft by the end of 2009.<sup>116</sup> This proposed withdrawal was attributed to the Caribou being beyond the end of its economic life, and suffering from reduced availability due to fatigue, corrosion, obsolescence and the need for increased maintenance. Although the advice to the Minister at this time did not mention asbestos, when the Minister announced the earlier-than-planned retirement of the Caribou aircraft on 19 February 2009, he cited asbestos, corrosion, fatigue and obsolescence as reasons.<sup>117</sup>

**4.6** Caribou aircraft contain asbestos in the airframe and in some replaceable parts. Under Australian law, the use of all types of asbestos was effectively banned from 31 December 2003 (the use of some types of asbestos was banned much earlier) subject to a very limited range of exemptions. Defence had been granted exemptions for continued use of Caribou parts, though the exemptions were due to expire at the end of 2009.<sup>118</sup>

## **Allocation of Caribou aircraft to museums**

**4.7** On 9 March 2009, the Minister announced that two Caribou aircraft would be preserved for historic purposes. One was to go to the RAAF Museum at Point Cook and the other to the Australian War Memorial. By October 2009,

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115 ANAO Audit Report No.3, 2013–14, *AIR 8000 Phase 2 — C-27J Spartan Battlefield Airlift Aircraft* assessed the adequacy of Defence's processes to select the Caribou aircraft replacement, the C-27J Spartan Battlefield Airlift Aircraft.

116 In fact, Defence had 13 aircraft to dispose of as one had been written off following a crash in Papua New Guinea in September 2008. Since 1964, Defence's original fleet of 29 Caribou aircraft had been reduced to 13 through attrition. Some were badly damaged or destroyed in crashes and others retired from service.

117 The Minister stated his determination to 'weed out' asbestos from the ADF. Minister for Defence, 'Retirement of the DHC-4 Caribou', 19 Feb 2009. The Minister specifically directed that his media release, drafted by Defence, address the fact that the Caribou aircraft contained asbestos.

118 Defence's management of asbestos in disposals, including a case study on the Caribou, is examined in Chapter 5, 'Managing hazardous substances in disposals'.

Defence had decided that a total of six of the Caribou fleet of 13 aircraft should be retained for historic purposes:

- three aircraft at RAAF bases;
- one at the Australian War Memorial; and
- two to non-Defence historical aircraft organisations.

**4.8** Defence subsequently decided to allocate the two aircraft for historical organisations through the 2011 RFT process. As part of that process, the remaining nine Caribou aircraft—that is, those not to be retained by Defence or transferred to the Australian War Memorial—were to be offered for sale.

### **Defence received numerous expressions of interest in the Caribou aircraft**

**4.9** Following the Minister’s announcement of the retirement of the Caribou aircraft, Defence received numerous expressions of interest from individuals and organisations seeking Caribou spare parts, the complete aircraft for display, or to purchase the aircraft as a going concern. One expression of interest, on 5 May 2009, came from an individual purporting to represent an unnamed resource development group with interests in Papua New Guinea (PNG), Liberia, Mali and Alaska. The group wanted to purchase seven or eight Caribou aircraft, four for use in these countries and three or four to help communities in which the organisation operated.<sup>119</sup>

**4.10** Once Defence called for tenders, the same individual prepared a tender response submitted to Defence in March 2011 for the most significant proportion of the Caribou aircraft offered for sale. Defence eventually selected this tender response in May 2011 as the preferred response for the seven aircraft offered for sale as going concerns (paragraphs 4.16 – 4.20).

### **Approval of the Caribou disposal strategy (December 2009)**

**4.11** In December 2009, the then Minister for Defence Personnel, Materiel and Science approved Defence’s disposal strategy to sell nine aircraft with support packages. Specifically, Defence had proposed:

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<sup>119</sup> Around the same time Defence also received an expression of interest from Omega Air, the purchaser of the RAAF’s B707 aircraft fleet discussed later in this chapter.



- Two aircraft and support packages would be offered for sale to Australian entities that could demonstrate the capacity and intention to preserve the aircraft in flying condition as items of military heritage; and demonstrate compliance with relevant legislation, in particular the replacement of maintenance parts that contain asbestos.<sup>120</sup>
- Seven remaining aircraft, support packages and associated unique and surplus common equipment would be offered for:
  - [sale for] export as going concerns<sup>121</sup>;
  - sale within Australia for eventual use as going concerns noting that the prospective recipients would be required to identify and source asbestos-free replacement components; or
  - sale as exhibits for static display on the condition that the prospective recipients undertake to pay for work involved in preparing the items for display on a cost-recovery basis.
- Those items that could not be sold would be scrapped or recycled.

#### *Asbestos in the Caribou*

**4.12** In its December 2009 submission, Defence advised the Minister that the Caribou airframe contained in situ asbestos<sup>122</sup>, and a number of replaceable parts containing asbestos.<sup>123</sup> It also advised that the estimated cost of removing the known and suspected asbestos-containing material within the Caribou aircraft, and to design and install replacement panels and sections was more than \$500 000 per aircraft.

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120 To this end, Defence informed the Minister that entities would be required to demonstrate how asbestos-containing material parts would be replaced or contained if required so the aircraft could be legally flown in Australia. Defence's subsequent assessment of this requirement in the tender evaluation was based solely on the tenderers' assertions in their responses. The tender evaluation report contains no evidence that Defence made any independent assessment of those claims to assure itself that tenderers had that capacity.

121 Defence informed the Minister that the Canadian manufacturer of the aircraft had expressed interest in acquiring them and that a sale to the manufacturer was a likely outcome. The manufacturer did not submit a bid in response to the RFT.

122 In situ, in relation to a product that contains asbestos, means that, 'the product is fixed or installed:  
(a) in:  
(i) a building or any other structure that forms a workplace; or  
(ii) a plant, a vehicle or any other thing that is for use at a workplace; and  
(b) in a way that does not constitute a risk to users until the asbestos contained in the product is disturbed.'

Source: OHS Regulations 1994, Part 6, Regulation 6.3.

123 These parts were in brakes, propellers, engine seals, gaskets and linings.

**4.13** External legal advice received by Defence in October 2010 noted Defence's intention that the successful tenderer(s) would assume all responsibility for the management of asbestos and other hazardous substances in the Caribou aircraft. The legal advice stated that to transfer this compliance burden effectively, Defence would need to carefully assess, and make available to tenderers, all information relevant to asbestos and other hazardous substances contained in the Caribou. The legal advice also noted that there was a risk that interested tenderers may be discouraged by the costs associated with asbestos remediation and other obligations such as removing the aircraft from Defence premises. Defence's management of asbestos in the Caribou disposal is examined in more detail in Chapter 5 'Managing hazardous substances in disposals'.

### **The Request-for-Tender (October 2010)**

**4.14** Approximately 10 months after the Minister approved the Caribou disposal strategy, on 28 October 2010, Defence Disposals released an RFT for the sale of the aircraft, spares packages, spare engines and other items such as propellers, with some items to be made available only to heritage organisations. By the time the RFT closed four months later, on 1 March 2011, Defence had received 17 tenders.<sup>124</sup>

#### *Selection of tenderers (May and June 2011)*

**4.15** On 11 May 2011, Defence's Tender Evaluation Board (TEB) for the disposal decided that a bid from the Historical Aircraft Restoration Society (HARS) was the preferred bid for the two aircraft intended to be preserved as items of military heritage. A bid from ZIAS Cultural Enhancement Foundation (ZCEF) was the preferred bid for the seven aircraft (plus spares packages) that Defence sought to sell as going concerns. The discussion that follows relates only to the ZCEF tender, as this is the part of the disposal that continues to be problematic for Defence, nearly four years later.

#### *Evaluation of the ZCEF tender*

**4.16** The ZCEF tender submission was prepared by the same individual who had expressed interest in the Caribou fleet, in May 2009, on behalf of an unnamed resource development group with interests in PNG, Liberia, Mali and

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<sup>124</sup> Two tenders were received after the closing date making the total number of tenders 19. One of these was received 24 hours late and accepted into the assessment process.

Alaska.<sup>125</sup> However, the ZCEF tender submission, received on 1 March 2011, made no reference to resource-related activities or any operations in Africa or Alaska. Rather, it stated that ZCEF was an Australian-owned charitable foundation whose purpose was to provide humanitarian assistance to PNG, Pacific Islands and ‘Australian Aboriginal cultural groups in those regions’.

**4.17** ZCEF offered Defence a total of \$540 000 for all seven aircraft and six spare parts packages. According to Defence’s tender evaluation report, the only other offer received by Defence that included all seven aircraft and six spare parts packages was an offer of \$150 000. ZCEF’s tender submission contained claims as to the organisation’s aspirations for the aircraft, including its intention to upgrade the aircraft to ‘form the basis of a humanitarian aid delivery capability for use in Australia, PNG and surrounding countries’.<sup>126</sup>

**4.18** The ZCEF tender submission did not contain any financial information about the organisation, beyond a hand-written note stating ‘financial details available on request’. Defence Disposals staff subsequently requested further information from the representatives of ZCEF to verify the company’s financial capacity to complete the tender. On 18 April 2011, Defence received an email from another consultant containing a document purporting to be a trust certificate from a bank registered in Bougainville, PNG. The certificate stated that the bank held \$1.5 million on behalf of ZCEF for the purposes of the purchase of the seven Caribou aircraft. Further, the certificate included a statement that the funds were ‘clean, clear, freely available funds of trustworthy (non-criminal) origin, generated from commercial business transactions’.

**4.19** Defence’s Financial Investigation Service staff examined the certificate. On 21 April 2011, they expressed concern to Defence Disposals staff about the credibility of the bank, the trust certificate and, therefore, ZCEF’s financial capacity to meet, not only the initial purchase price, but the Commonwealth’s

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125 See paragraph 4.9.

126 The tender submission also claimed that the organisation planned to establish a training facility for ground crew, technicians, and eventually, pilots; and that PNG and Aboriginal trainees would be accommodated in Brisbane while they were undergoing training. The tender submission indicated that the foundation planned to establish emergency relief depots in Australia, PNG and adjacent countries and that the aircraft would be available to provide assistance for disaster relief in Australia. Further, the tender submission included the suggestion that the ADF could hire the aircraft back for parachute training or troop transport.

requirement in the tender that the aircraft be properly maintained.<sup>127</sup> Defence's Financial Investigation Service staff suggested that the risk to Defence would be reduced by receipt of full payment from the proposed purchaser before release of the assets.<sup>128</sup> However, further information was needed to make any assessment of the company's financial position. No further checks were conducted at this time.

**4.20** On 7 June 2011, the then Minister for Defence agreed to Defence's recommendation that Defence commence contract negotiations with ZCEF.

### **Successful tenderer withdraws and is substituted (June 2011)**

**4.21** On 21 June 2011, Defence received an email from a purported representative of ZCEF stating that the CEO of ZCEF had instructed him to advise Defence that, effective immediately, ZCEF had no interest, financial or otherwise, in the above tender and that ZCEF was withdrawing from the tender. Additionally, Defence was advised that:

[ZCEF] understands and acknowledges that the Tender will continue post its withdrawal with another humanitarian-focused organisation utilising alternate funding sources.

It is clearly understood that in the continued utilisation of the existing Tender documentation and any and all other information provided in support thereof, is undertaken strictly on the basis that no liability, direct, contingent, current or future, will accrue against [ZCEF].

[ZCEF] hereby authorises the ADF to retain and utilise, for its internal purposes only, copies of the original Tender and other documents which clearly refer to the Foundation, notwithstanding the Tender will continue under a name not related to, or associated with, [ZCEF].

**4.22** This advice provided Defence with a clear statement that ZCEF had withdrawn from the tender process and that ZCEF recognised that the tender might continue with another humanitarian organisation. Further, it clearly

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127 An internal Defence investigation later determined that ZCEF did not have any accounts or funds held with the Commercial Development Bank, let alone possess \$1 500 000. ZCEF had only one bank account, being located at the ANZ Morayfield Branch, Queensland, and which only contained a maximum amount of \$250 at any one time.

128 The advice provided by a Defence Financial Investigation Service Price and Cost analyst to Defence Disposals stated that 'It will be a lot less risky if you are able to request all the funds upfront before the Commonwealth hands over the aircraft'.

stated that ZCEF had no relationship with any future entities that might have an interest in taking over the tender.

**4.23** On 21 June 2011, Defence also received an email from a person purporting to be the 'Lead Consultant for a new Humanitarian Fund currently being established ... by the AMRock Group—as yet unnamed officially' (Amrock). This individual had also been making representations to Defence purportedly for and on behalf of ZCEF.

**4.24** In the email, the consultant claimed that Amrock had obtained the 'security deposit' (trust certificate) for ZCEF that was submitted to Defence during the tender process. Further, he stated that Amrock would take over the tender with 'no material change to the stated Asset Use Plan or the commitment to the Disaster Response Depots and the humanitarian endeavours/activities and disaster relief activities'. The consultant then recommended to Defence that the tender continue because the only change to the tender was a change in the purchaser's name.

**4.25** Nine days later, on 30 June 2011, Defence received another email from the consultant to Amrock<sup>129</sup>, providing further reasons, including PNG cultural issues, for the purported name change (from 'ZCEF' to 'Amrock'). This advice was in contrast to the 21 June 2011 advice that the two entities were unrelated (see paragraph 4.21).

### **Contract signed (September 2011)**

**4.26** Defence proceeded with contract negotiations with Amrock, based on the tender submitted in May 2011 by ZCEF and the apparent assumption that there had been a change only in the organisation's name. Defence staff did not make any independent inquiries or seek any advice on the bona fides of either company or any individual involved in the tender.

**4.27** On 15 September 2011, the Minister for Defence Materiel announced the outcome of the RFT process. Defence signed a contract of sale with Amrock on 23 September 2011 based on the tender submitted in May 2011 by ZCEF.

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129 The consultant referred to 'recent telephone conversations' between himself and the Defence Disposals staff member responsible for managing the disposal. Defence's internal investigation into the disposal later determined that 'inadequate records (or no records) of telephone conversations were made' by this Defence Disposals staff member and 'therefore it was not clear what discussions had taken place.'

## Concerns raised, invoice issued and paid (October 2011)

**4.28** In October 2011, following a request from Defence Disposals to raise the invoice for the sale, Defence's Finance Business Centre raised concerns with the then Branch Head of Defence Disposals about the financial viability of the buyer and the authenticity of the 'bank guarantee' provided to Defence.

**4.29** On 4 October 2011, at the request of Defence's Finance Business Centre, Defence's Financial Investigation Service carried out further checks on Amrock. These checks, completed on 6 October 2011, revealed that:

- Amrock was registered on 24 June 2011, just days after being presented to Defence as the company to replace ZCEF as the successful tenderer for the Caribou aircraft and associated spares.<sup>130</sup>
- One of the directors of Amrock had the same name as the General Manager of the Commercial Development Bank of Bougainville who signed the \$1.5 million trust funds certificate previously presented to Defence as evidence of ZCEF's financial viability.
- The Melbourne address of the Commercial Development Bank of Bougainville was the same address as the registered office of Amrock and the premises were being used for the operations of another business.
- The other director of Amrock was also a director of a number of other companies that had been deregistered, suspended from the Australian Stock Exchange, or had received a qualified audit opinion on their financial statements as proper financial records were not maintained.

**4.30** Financial Investigation Service staff expressed concern about the validity of the Commercial Development Bank documentation, the capacity of Amrock to honour the sale agreement and, given the financial and reputational risks involved, recommended further investigations. Defence's Finance Business Centre then sought the assistance of the Reserve Bank of Australia (RBA) to verify the legitimacy of the Commercial Development Bank of Bougainville through the Bank of PNG. The RBA advised Defence that this could take some time.

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130 The company had \$100 total paid share capital issued and the sole shareholder resided in Hong Kong.

**4.31** The then Branch Head of Defence Disposals requested the invoice be issued regardless of the concerns about Amrock because, as he explained later, failure by the buyer to pay the invoice would be the simplest way to terminate the contract.<sup>131</sup> This preferred approach suggests that key Defence staff were not alert to the reputational risks for the Commonwealth of selling ex-military aircraft to an organisation which appeared to have made misrepresentations to Defence. The only risk that was evidently given serious consideration was the financial risk of non-payment of the invoice and Defence's consequent failure to realise the expected revenue.<sup>132</sup>

**4.32** Defence issued the invoice to Amrock on 13 October 2011 and received payment in full on 27 October 2011.

### **Advice from Reserve Bank of Australia (October 2011)**

**4.33** On 14 October 2011, the day after Defence issued the invoice to Amrock, Defence's Finance Business Centre received the following advice from the Bank of PNG via the RBA:

Please be advised that the Central Bank is sole authority in PNG responsible for licensing of deposit-taking institutions. The bank has no records, past or present of a bank by the name of 'Commercial Development Bank, Bougainville', therefore it is not a legitimate institution.

**4.34** The RBA representative also noted in her email advice that an Internet search on the director of the bank indicated that 'it appears he may be a charlatan'.

**4.35** The Finance Business Centre passed this information promptly to Defence Disposals. The Branch Head, Defence Disposals, responded to the advice by advising the Finance Business Centre that:

we have a signed contract and in the first instance will seek contract performance whilst also investigating associated issues such as this. Failure by Amrock to pay is the simplest way for me to repudiate the contract.

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131 The audit has found no evidence that this decision was considered by any more senior management before being made.

132 Defence's subsequent Inspector-General's investigation found that the conduct of a number of staff involved in the process was less than satisfactory, including the withholding of some critical information on the preferred tenderer from others responsible for giving advice and making decisions in the process. While the investigation found no evidence or cause to suspect any criminal conduct, it did identify that the efforts of one individual in particular were focused on ensuring the continuation of the tender process over all other considerations.



**4.36** The Branch Head, Defence Disposals, advised his superiors of the situation later that day.<sup>133</sup>

**4.37** On 18 October 2011, a representative of the Inspector-General of Defence (IGD) approached Defence Disposals, having been alerted by the Defence Finance Business Centre to possible irregularities associated with the Commercial Development Bank. The Branch Head, Defence Disposals, responded that: 'My initial thought is that we hold off on instituting formal notifications etc until, the due date of the ARI [*invoice*], when we can determine if Amrock have paid'. This response is consistent with a perception that the primary risk facing Defence was that of non-payment.

### **Ongoing management of the transaction by Defence**

**4.38** Late on 20 November 2011, the CEO DMO sought advice from the Branch Head, Defence Disposals, as to the status of the Caribou disposal. Early the following morning, he was advised:

Current status is that Zia (now Amrock Aviation) have paid, the funds are clear and Amrock are arranging to take delivery of the aircraft. It is expected that the aircraft will be removed before Christmas.

**4.39** Later that day (21 November 2011), the CEO DMO directed that the disposal be halted until more was known about the buyers. The Deputy CEO explained to the Branch Head, Defence Disposals as follows:

[*The CEO's*] issue is not the money; it is understanding who we are actually selling ex-Military assets to. If Amrock Aviation is simply a front for another organisation, then we need to know the end recipient of the asset.

A name like 'Zia' (think Pakistan) should at least raise the flag to undertake further inquiries to look behind the corporate veil to determine the ultimate owner.

In any event, a full probity check of the successful bidder, including directors, shareholders and other related parties **MUST** be a core part of any evaluation, at least where the company is not well known to us.

**4.40** On 12 December 2011, a member of the public contacted the office of the Minister for Defence Materiel alleging that the individuals involved in Amrock were of ill repute.<sup>134</sup> On the same day, Defence was made aware of the

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133 These were the Chief Finance Officer, DMO and the Deputy Chief Executive Officer, DMO.

134 The contact was prompted by the person seeing mention of Amrock in the Minister's press release.



complaint and allegations. During Defence's investigation into the disposal, additional allegations were made about the individuals and the source of the funds used to purchase the aircraft. On 22 December 2011, Defence informed the Minister for Defence Materiel's office by email that Defence would retain possession of the assets until the matter was resolved.

**4.41** Despite the CEO DMO's direction that the disposal be halted, Defence allowed Amrock representatives to collect the Caribou aircraft documentation from an RAAF base on 4 January 2012.<sup>135</sup> While this audit found no evidence that the CEO's instruction was deliberately disregarded, there had been sufficient time, since November 2011, to provide the necessary information within Defence.

**4.42** Further, on 6 February 2012, Amrock representatives collected 21 Caribou batteries and six spare cells from another RAAF base. It appears that some Defence Disposals staff remained uninformed about the CEO DMO's directive even at this point, with one staff member informing the then Branch Head of Defence Disposals on 8 February 2012 by email that 'we will proceed with arranging the asset removal, and coordinating with [*the relevant SPO*] ... until we are advised to halt'.<sup>136</sup>

## Current situation

**4.43** Defence informed the ANAO in October 2014 that it was still in possession of the aircraft and the funds received for the purchase of the aircraft. Defence has received demands from Amrock, and their legal representatives, to release the aircraft in accordance with the disposal contract. As at January 2015, Defence advised that the sale to Amrock had been cancelled and other disposal options for the aircraft were being considered.

**4.44** Defence further informed the ANAO that as at August 2014, the cost of external legal advice for the Caribou disposal was \$99 335. The cost incurred by the SPO responsible for the Caribou over the period since the disposal process commenced to 30 June 2014, including in preparing for the disposal, was estimated to be \$743 000.

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135 This aircraft documentation is, according to Defence, critical for anyone purchasing aircraft to obtain the relevant clearances from the Civil Aviation Safety Authority.

136 The then Branch Head responded stating that he was happy to continue to engage with Amrock to prepare for removal. However, 'that said, I have instructed that no removal is to take place without my express approval'.

## **Defence reviews of the administration of the Caribou disposal**

**4.45** The Caribou disposal has been the subject of four internal Defence reviews, specifically:

- a 'Quick Assessment', by DMO's internal legal area, completed in September 2012<sup>137</sup>;
- an investigation by Defence's IGD, completed in August 2013<sup>138</sup>;
- an internal audit by Defence's Audit and Fraud Control Division, completed in November 2013<sup>139</sup>; and
- a discussion paper prepared by the IGD for DMO's internal legal area, completed in August 2013.

**4.46** Collectively these reviews found that Defence management deficiencies contributed to the difficulties with the disposal, including that:

- Defence's mandatory disposals policy was deficient and that reform efforts had stalled;
- the conduct of certain Defence staff involved in the Caribou disposal process was below par;
- the Caribou disposal process was conducted in accordance with historical practice that did not always reflect or comply with official policy and process;
- the records for the Caribou disposal were in a 'parlous state' with poorly maintained files, and important meetings and conversations not documented resulting in an insufficient audit trail of the disposal; and
- there were shortcomings in the administration and oversight of the tender evaluation particularly with regard to the lack of probity checks on the preferred tenderer.

**4.47** Of particular note, the reviews identified that executive involvement in disposals was at the strategic oversight level and that the disposals function

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137 The purpose of this review was to establish a chronology of key events, identify any probity or ethical issues, and to provide a brief analysis of key issues.

138 The primary purpose of this investigation was to determine whether the conduct of any Defence personnel associated with the disposal of the Caribou aircraft was unsatisfactory or deficient.

139 The primary purpose of the internal audit was to determine whether the disposal of the Caribou aircraft was conducted in accordance with Defence policies and procedures.

did not have appropriately skilled staff with sufficient resources. Additionally, the geographic separation of Defence Disposals (based in Sydney) from central oversight, management and control (based in Canberra) needed to be addressed. The disposals function has since been substantially (but not wholly) moved to Canberra.

**4.48** Defence's internal review to determine whether there was any misleading or deceptive conduct on the part of the successful tenderers observed that it was not reasonable to expect that the Defence staff involved in the tender assessment could have identified all of the issues uncovered by the IGD investigation, which was conducted by professional investigators over a period of almost 12 months. However, aspects of ZCEF's tender submission and certain events throughout the tender evaluation process, discussed above, should have prompted a more cautious approach to the transaction by Defence Disposals staff before contract signature in September 2011. Further, some aspects of the tender evaluation represented key points of failure in the disposal process and, if handled differently, may have given Defence an opportunity to recover the situation. These are considered below.

### **Shortcomings in Defence's administration of the Caribou tender**

#### *Connection between the 2009 expression of interest and ZCEF tender*

**4.49** As noted in paragraph 4.9, in May 2009 Defence received an expression of interest from an individual purporting to represent an unnamed resource development group with interests in PNG, Liberia, Mali and Alaska. This same individual was responsible for preparing the ultimately successful tender response for ZCEF for most of the Caribou aircraft. The available evidence indicates that Defence Disposals staff either did not notice or did not make the connection between the May 2009 expression of interest and the subsequent tender process.

**4.50** Had that link been made and given the capabilities of the aircraft<sup>140</sup>, even in its demilitarised state, it would not be unreasonable to expect a more cautious approach to be adopted by Defence staff when dealing with an unknown organisation with an interest in obtaining Caribou aircraft for operations in remote areas. Further, had that link been made, the fact that the eventual tender submission focused solely on humanitarian use for the aircraft

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140 The Caribou aircraft can operate from short and rudimentary airstrips; a capability of value for a range of legal and illegal activities.

within Australia and the South Pacific, should have elicited a more circumspect approach to the assessment of the tender.

*Tender submission inadequacies and shortcomings of Defence's assessment*

**4.51** Defence's internal investigation into the Caribou disposal determined that the ZCEF tender submission did not provide sufficient information to meet the tender criteria related to the tenderer's apparent technical ability and financial capacity to implement its proposed plans for the use of the aircraft.

**4.52** As noted in paragraph 4.18, the ZCEF tender submission did not contain any financial information about the organisation to support its claimed ability to pay for the aircraft, only a handwritten note stating 'financial details available on request'. When Defence eventually received the purported trust certificate from the 'bank' registered in Bougainville, PNG, neither Defence Disposals staff nor the staff from Defence's Financial Investigation Service made further enquiries about the credibility of the bank or its officials named on the certificate.<sup>141</sup> At the very least, a basic Internet search of the names of these officials could have provided some information about the nature of their business dealings and interest in the Caribou aircraft. The lack of further enquiries exposed the Commonwealth to risk.

**4.53** In October 2010, Defence's internal legal team had recommended to Defence Disposals staff that a full financial check be done on any prospective tenderers to avoid a repeat of non-payment issues it had experienced in the B707 aircraft disposal (paragraph 4.68 – 4.83). Despite this earlier experience and explicit internal legal advice, Defence Disposals did no full financial check during the tender process. Defence's internal investigations later concluded that a more complete check of ZCEF's finances would have revealed that it had no funds.

**4.54** Defence Disposals staff also accepted at face value information and claims contained in the ZCEF tender submission, including assertions about its humanitarian role, its intention to upgrade the aircraft, establish technical training facilities in Brisbane and emergency aid depots in the region

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141 As mentioned in paragraph 4.19, staff from Defence's Financial Investigation Service did express concern to Defence Disposals staff about the credibility of the bank, the trust certificate and therefore ZCEF's financial capacity to meet, not only the initial purchase price, but the Commonwealth's requirement contained in the tender that the aircraft be properly maintained. They also suggested that the receipt of full payment from the proposed purchaser before release of the assets may reduce the risk to Defence and advised Defence Disposals staff that additional information was needed to make any assessment of the company's financial position.

(including in Australia and PNG—see paragraph 4.17), and the possibility of the ADF hiring the aircraft back for parachute training or troop transport. To support its claimed technical ability to maintain the aircraft, ZCEF's tender submission listed the job titles of staff supposedly working for the organisation, without any details of who these staff members were, or relevant experience or qualifications.<sup>142</sup> Defence's IGD investigation determined that Defence Disposals staff did not seek any further assurance on the question of ZCEF's purported technical abilities.

**4.55** Defence's source evaluation report used to support the decision to select the successful tenderer was of poor quality. The report provided an unclear assessment of the tenderers' claims against the assessment criteria and, in selecting ZCEF, relied solely on the claims made in the submission about the capacity of the preferred tenderer without any verification.<sup>143</sup> Further, as identified during Defence's IGD investigation into the disposal, the evaluation report did not include all the relevant advice received by Defence Disposals staff from Defence's Financial Investigation Service.

*Withdrawal and substitution of the preferred tenderer*

**4.56** The June 2011 email advice to Defence about the withdrawal of the successful tenderer (on whom no checks were done) was accompanied by the proposal to replace that tenderer with another (refer to paragraph 4.21). The substitution should have prompted a closer look at the entities involved. The Defence Procurement Policy Manual offers the following advice on substitution of tenderers:

This situation poses many risks to Defence and accordingly a thorough analysis should be undertaken of the new company's management, relevant experience and financial capacity to undertake the contractual requirements adequately before approval for substitution is given.<sup>144</sup>

**4.57** Defence did not analyse Amrock's corporate structure or management to verify that the change from ZCEF to Amrock was in fact a change in name only. Defence proceeded to contract with Amrock rather than ZCEF on the

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142 Defence's internal investigation concluded that the company did not employ any staff.

143 For example, the source evaluation report states that evidence of the tenderer's 'technical ability to maintain the aircraft has also been supplied and includes experience in maintaining and operating Caribou aircraft exceeding 50 years.' This statement is apparently based solely on an unsubstantiated claim in the tender submission.

144 Defence Procurement Policy Manual, 2014, Chapter 5.6, p. 16.

assumption this was only a change of name. However, the IGD investigation into the disposal found it possible that collusion between Defence Disposals staff and parties external to Defence had led to characterisation of the change from ZCEF to Amrock as only a name-change, rather than a substitution of one corporate entity for another, unrelated one.<sup>145</sup>

**4.58** Further, as shown by Defence's Financial Investigation Service (paragraph 4.29) and the RBA (paragraph 4.34), the Governor of the Commercial Development Bank was potentially connected to Amrock. This information could have come to attention from a rudimentary Internet search and could have prompted Defence staff to conduct additional inquiries.

*Focus on payment risk obscures other risks*

**4.59** On the face of it, the primary focus of Defence Disposals staff, including at senior executive level, was on the risk of non-payment. This attention to payment risk allowed other risks, such as the risk to reputation resulting from not knowing the nature of the other entity, to go unnoticed until later in the transaction.<sup>146</sup>

**4.60** Defence Disposals' decision to issue the invoice and seek payment, despite concerns from elsewhere within Defence about the organisations with which Defence was dealing (see paragraphs 4.28 to 4.32), suggests a lack of appreciation of the risks to Defence and government other than the risk of not being paid. The following statements from Defence Disposals staff about the Caribou disposal, appearing in Defence documents, also support this view:

I mean, you know, in sheer marketing terms I think most in [*Defence Disposals*]*—I think everybody in [Defence Disposals] would prefer just to get the biggest buck, you know.*

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145 The internal (to Defence) probity advisor, who was responsible for advising Defence Disposals staff on the integrity of the process, believed the assertion made by Defence Disposals staff that there had been a change in name only to the existing entity rather than a change in entities. Nevertheless, had the probity adviser been required to independently verify such claims (as was done once internal investigations and reviews were underway) rather than rely on assertions, the fact that Amrock and ZCEF were two separate legal entities under different ownership would have come to light well in advance of Defence entering into the contract of sale.

146 While concerns had been raised about the validity of the Commercial Development Bank and the capacity of Amrock to honour the sale agreement, the nature of the organisation with which Defence was dealing and their purpose in acquiring the aircraft was not specifically considered until November 2011. It was at this time that the CEO DMO expressed concern based on the organisation's name which, in his view, warranted further investigation into the organisation. However, this was not until after Defence had received payment for the aircraft, complicating matters for Defence.

[*probity checks*] have never been required as part of the commercial sale process ... Besides why would you chase your customers away from a sale contract?

## **Other weaknesses in the Caribou disposal process**

### *Gauging market interest*

**4.61** Expert external advice received by DMO in October 2010 on the Caribou disposal suggests Defence had not thought through all of the commercial aspects of the disposal strategy (that is, for example, valuing the aircraft at below \$150 000 while at the same time estimating the cost of removing asbestos to be about \$500 000). In addition, the cost of removing the aircraft in accordance with contractual requirements, such as a requirement to maintain appropriate liability insurance when removing the aircraft, was expected to impose further costs on successful tenderers. The advice received suggested to Defence that, as part of the planning and RFT development process, Defence would have to consider how to balance the need for appropriate contractual protections and requirements with the likely cost impacts to industry (and therefore, impacts on industry's interest in the process). This was considered to be 'key to the commerciality of the disposal strategy'.

### *Management of Caribou unique spares in the SME disposal process*

**4.62** Defence generally acquires large numbers of spare parts for every major weapons system or platform it acquires. These spares are often widely dispersed.<sup>147</sup>

**4.63** A sound disposal process ideally requires knowledge of the type and number of spare parts being disposed of.<sup>148</sup> This helps to determine whether there is a market for the assets in question and informs disposal decisions. Accurate information is also important because the spares may contain hazardous substances such as radioactive material or asbestos.<sup>149</sup>

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147 Ministers have, on occasions, been surprised at the numbers of items held in stock. For example, in 2010, the then Minister for Defence asked the department 'given the long, known ramp-down and disposal of the F-111s, why are there so many items (3.8 million items) held in stock?'

148 The required knowledge also includes an understanding about the estimated market value of the goods to be disposed of and the legislation and subsidiary rules governing disposal.

149 Where an item contains radioactive material, Defence is required to obtain prior approval from the Australian Radiation Protection and Nuclear Safety Agency (ARPANSA) before disposal. Defence's compliance with ARPANSA requirements and management of asbestos in major disposals is examined in Chapter 5, 'Managing hazardous substances in disposals'. See also ANAO Audit Report No. 29, 2013–14, *Regulation of Commonwealth Nuclear and Radiation Activities*.



**4.64** Spares often form a large part of a major SME disposal and, in some cases, can be a larger potential source of revenue than the major item itself. Additionally, the disposal of a major piece of SME and associated spares is a complex and resource intensive process.

**4.65** In the case of the Caribou, Defence did not have a complete understanding of the spares inventory at the time of disposal. Taking stock of unique spares required considerable effort involving items in 116 separate warehouses around Australia recorded in multiple inventory systems. This activity was still in process in mid-2012, nearly two years after the RFT and nearly one year from the signing of the contract. Defence estimates the cost of identifying unique Caribou spares at about \$242 000, of which about \$226 000 was paid to Defence contractors during financial year 2012–13 to identify and pack Caribou spares.<sup>150</sup>

**4.66** Defence did not receive acceptable bids for some of the Caribou spares offered in the October 2010 request-for-tender. In October 2014, these remained in containers in storage at Macrossan Stores Depot in North Queensland.

**4.67** Despite the significant cost and effort involved in preparing the inventory of spares for the disposal, Defence has subsequently discovered a further 35 containers not specifically contemplated nor included in the Caribou aircraft sale contracts. This suggests that Defence's inventory records for the Caribou were unreliable.

## Boeing 707 air-to-air refuelling aircraft disposal

### History and early disposals

**4.68** From 1978 to 1988, Defence purchased seven B707 aircraft that had previously been operated by commercial airlines. One was to be used for spare parts, leaving Defence with six aircraft. Between 1988 and 1992, Defence converted four of the remaining aircraft for use in air-to-air refuelling and transport.<sup>151</sup> From 2000, when the Government announced that it was considering replacing the B707 aircraft, Defence received several expressions of

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<sup>150</sup> Defence informed the ANAO that as at February 2014, the estimated SPO related costs for the disposal of the Caribou were approximately \$743 000, not including any internal staffing costs or legal costs associated with the sale. These costs were expected to reach approximately \$750 000 by the end of financial year 2013–14 and \$772 000 by the end of financial year 2014–15 due to ongoing storage costs for the aircraft.

<sup>151</sup> One aircraft crashed in 1991, leaving Defence with a total of five.



interest in acquiring them. A company called ‘Omega Air’ approached Defence in 2003 with a view to acquiring one B707 aircraft. However, Defence subsequently decided to retain this aircraft for spares.<sup>152</sup>

**4.69** In November 2005, Defence decided to withdraw its fleet of B707 aircraft from service on 1 July 2008 (together with a flight simulator, the remains of a B707 aircraft that had been used for spares since February 2001, a range of spare parts, ground support equipment and aircraft documentation). Defence based its withdrawal decision on the aircraft no longer being cost effective and an expectation that the capability provided by the B707 aircraft would be replaced by multi-role transport and tanker (MRTT) aircraft from 2009.<sup>153</sup> Maintenance of the B707 fleet had been costing the RAAF around \$38 million a year.

**4.70** At the time that Defence decided to withdraw the B707 aircraft, it expected a capability gap of about 18 months, which the then Chief of Air Force (CAF) had expected to fill using tanker aircraft from various sources:

I have reviewed the planned transition from the B707 tanker aircraft to the new A330 aircraft with the aim of determining the ideal PWD [*planned withdrawal date*]. In order to prepare for a smooth transition to the new aircraft, a period of about 18 months will be required between the B707 withdrawal and achieving the A330 initial operating capability (of two fully mission capable aircraft and the necessary crews). The first A330 aircraft is planned to arrive in Australia in December 2008, and the aircraft will become progressively available initially for airlift, and subsequently for tanking tasks.

During the interim period I plan to maintain air combat proficiency in air to air refuelling by using tanker aircraft from a variety of sources including USAF or Singaporean tanker aircraft, and if necessary, leased civilian tanker aircraft. As a result I intend to withdraw the B707 from RAAF service on 1 July 2008 ...<sup>154</sup>

**4.71** In early 2007, a key member of Defence’s MRTT project team joined Omega Air as its Director of Australian Operations and, thereafter, represented Omega Air in many of its dealings with Defence in the B707 aircraft matter.

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152 In 2006, Defence transferred its single remaining non-converted B707 aircraft to a commercial company in exchange for B707 aircraft spare parts.

153 The Government approved the Multi-role Tanker Transport aircraft – Air-to-Air Refuelling Capability project (project AIR 5402) in May 2003, with delivery of the aircraft expected to commence in 2009. This has been a project of concern since December 2010. In February 2013, the then Defence Minister announced that the Multi-role Tanker Transport (MRTT) aircraft had reached Initial Operational Capability (IOC).

154 Minute from the Chief Air Force to the CDF and Secretary, 1 November 2005.

## Commercial sale of the B707 aircraft (2008)

**4.72** On 11 May 2007, Omega Air wrote to Defence expressing interest in purchasing the B707 aircraft subject to Omega Air's representatives being able to inspect the aircraft.<sup>155</sup> In early July 2007, Defence facilitated a visit by Omega Air representatives to RAAF Base Richmond to inspect the aircraft in preparation for a potential offer for purchase. From this point forward Defence's planning activities for the disposal of the B707 aircraft focused on a sole-source sale to Omega Air.

**4.73** On 30 July 2007, Omega Air made an unsolicited offer to Defence to purchase three B707 aircraft, spares, a flight simulator and documentation for \$10.5 million.<sup>156</sup>

**4.74** By October 2007, Defence was aware that delivery of the replacement capability—the MRTT aircraft—would be delayed and that the disposal of the B707 aircraft would result in a longer capability gap. To address this gap, on 3 March 2008, Defence entered into a five-year US Foreign Military Sales (FMS) agreement through which Defence paid for air-to-air refuelling services provided by Omega Air.<sup>157</sup> In accordance with Defence's request to the US Government of 21 December 2007, the FMS agreement specifically required that Omega Air provide the air-to-air refuelling services.<sup>158</sup> Defence informed the ANAO in December 2014 that it had specified Omega Air because it was both less expensive and more flexible than the other option available under the FMS arrangement.

**4.75** In February 2008, Omega Air wrote to Defence requesting a reduction to the price it had offered in July 2007 for the purchase of three B707 aircraft, spares, a flight simulator and documentation and, in March 2008, the parties

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155 Omega Air stated that, subject to inspection of the aircraft by Omega Air representatives, it would be willing to pay Defence between USD \$6 million and \$9 million (at the time, approximately AUD \$7.2 million to \$10.8 million) for the three B707 aircraft plus a further amount for the spares which was to be determined once the value of the available spares was known.

156 The offer comprised \$6.6 million for the three B707 aircraft plus spares and documentation and, if Defence was prepared to sell the B707 flight simulator to Omega Air as part of the package rather than disposing of it through sale by open tender, a total of \$10.5 million for the total package. The offer included three payment options: (i) Omega Air to pay the \$10.5 million to Defence (ii) Omega Air to provide Defence with \$10.5 million of air-to-air refuelling services; or (iii) a mix of options (i) and (ii).

157 Omega Air provides air-to-air refuelling services for the US Navy and Marine Corps.

158 As a result, Defence received services from Omega Air using at least one of the B707 aircraft it had provided to Omega Air. As Omega Air had not yet paid for the aircraft, Defence was, in effect, hiring its own property on occasions between October 2011, when Omega Air took control of the aircraft (see paragraph 4.95) until Defence placed an embargo on its use of refuelling services from the Omega Group around April 2013 (see paragraph 4.108).

agreed to a reduced price of \$9.5 million. In October 2008, Defence entered into a sole-source contract, to sell, for \$9.5 million (excluding GST)<sup>159</sup>, three B707 aircraft, a flight simulator, spares, training material and documentation to Omega Air.

**4.76** Defence has not provided any reason for entering into a sole-source contract rather than, for example, using an open tender to help ensure it obtained value-for-money from the disposal. However, at the time, Defence was of the view that Omega Air's offer was far in excess of any offer it could expect from other sources. The response received by Defence to a subsequent B707 aircraft tender process (see paragraph 4.86) supports this conclusion. It is not clear whether Defence gave any consideration as to why the Omega Air offer was so high.

*Offer of services in-lieu of payment*

**4.77** In July 2008, before a contract was signed, Omega Air wrote to Defence to advise that it was experiencing financial difficulties. Defence did not conduct any checks on the financial viability of Omega Air at this time. However, shortly afterwards, in September 2008, Defence considered a proposal from Omega Air to amend the proposed purchase contract to allow Defence to accept up to \$6.2 million in air-to-air refuelling services from the company in lieu of a cash payment for the aircraft.

**4.78** Defence originally viewed Omega Air's September 2008 proposal favourably. It saw this approach as potentially supplementing its budget by obtaining some \$6.2 million in services that, if received in cash, would have to be returned to consolidated revenue rather than being retained by Defence. The proposal would also address its looming capability gap. Defence eventually decided not to proceed with this arrangement when it ascertained that if it were to receive services in lieu of payment it would still have to return an equivalent value from its budget allocation to consolidated revenue. Thus, there would be no net benefit to Defence regardless of whether the proceeds from sale were received in cash or in kind. That is, the total sale value of

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159 At the time there was considerable uncertainty around the application of GST to the transaction. Defence eventually determined that GST did in fact apply to the transaction. In April 2013, Defence issued invoices to Omega Air totalling \$620 000 for GST on the transaction that had not previously been charged. Omega Air eventually paid the GST in early 2014.

\$9.5 million amount would flow to consolidated revenue regardless of the payment method.<sup>160</sup>

**4.79** Under the terms and conditions of the October 2008 contract, Omega Air was to pay amounts at intervals to Defence over the period to mid-2009 (see Table 4.1). All amounts were to be paid before removal of the items from Defence premises. Omega Air paid the \$0.5 million security deposit on 27 October 2008 and \$1.8 million for the consolidated spares, training material and documentation on 30 March 2009.

**Table 4.1: Payment schedule for B707 aircraft, October 2008 contract**

Item	Price and Timing
Security deposit	\$0.5 million (to be paid within 10 working days of contract execution)
Consolidated B707 aircraft spares, training material and documentation	\$1.8 million (to be paid within 50 days after the delivery* of the item but before its removal from Defence premises) Expected delivery date—28 February 2009
B707 flight simulator	\$1.8 million (to be paid within 50 days after the delivery of the item but before its removal from Defence premises) Expected delivery date—30 April 2009
3 x B707 aircraft	\$1.8 million each (to be paid within 50 days after the delivery of the item but before its removal from Defence premises) Expected delivery dates: 31 May 2009 15 June 2009 30 June 2009

Source: Defence documents.

\* Under the contract of sale for the aircraft, delivery of an item is defined as when access is given to the purchaser for the purpose of removal.

### *Purchaser requests delays*

**4.80** On 9 April 2009, Omega Air requested that the delivery (access) date for the three aircraft and flight simulator be delayed to 30 September 2009. In June 2009, Defence and Omega Air agreed to a contract change (signed by Defence on 30 June 2009 and by the Omega Air representative on 6 July 2009). The contract change revised the delivery (access) dates for the B707 aircraft and the flight simulator to 30 September 2009 and, consequently, the due date for

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<sup>160</sup> Defence came to this conclusion based on advice it received from the then Department of Finance and Deregulation (DoFD), which indicated that Defence would be required to transfer funds, equivalent to the value of the in-kind air-to-air refuelling services, to consolidated revenue.

payment to 19 November 2009 (being 50 days after the delivery date, though still before the removal of the assets from Defence premises). Further, an additional security deposit of \$500 000 was to be paid by Omega Air, which it paid on 24 August 2009.<sup>161</sup>

**4.81** On 27 June 2009, when the then CEO DMO was informed by DMO officials of Omega Air's request, he expressed concern and sought advice on the security that had been obtained and directed that the disposal transaction be actively risk managed to 'avoid a SAFF-type problem'.<sup>162</sup> On 3 July 2009, Defence Disposals informed the CEO DMO that the situation was not in any way similar to the SAFF issue as the contract required payment in full by Omega Air before collection of any equipment and noted that prior payment was a requirement under the Disposal Instruction.

**4.82** On 23 September 2009, Omega Air sought a further three-month extension of the delivery (access) date because it had been unable to obtain relevant US Federal Aviation Administration (FAA) approvals. Defence rejected this request on 30 September 2009. In October 2009, Defence offered Omega Air an extension to 29 January 2010 provided it paid an additional \$1 million non-refundable security deposit. Omega Air did not accept this offer.

**4.83** Subsequent extensive negotiations between Defence and Omega Air during February 2010 failed and, during that month, the parties entered into formal mediation, which did not resolve the dispute. Legal advice obtained during the February 2010 negotiations and mediation recommended that Defence seek further information about Omega Air's financial status and corporate structure. Defence did not act on this recommendation.

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161 This contract change proposal also reduced the purchase price of the flight simulator from \$1.8 million to \$1.3 million.

162 The then CEO DMO was referring to the disposal by sale of contaminated fuel to the South Australian Farmers Federation (SAFF) between June 2001 and June 2008 by Defence's Joint Fuels and Lubricants Agency. The Agency had managed four major sales of fuel to SAFF, each with a value over \$1.0 million. SAFF defaulted on payments in all four transactions, requiring lengthy and expensive legal action to recover the debts. The fourth sale, worth over \$3.9 million, was the subject of a Defence internal investigation in 2009. The Joint Fuels and Lubricants Agency was the subject of ANAO Audit Report No.44, 2001–02, *Australian Defence Force Fuel Management*.

## **Contract terminated, parties in dispute, new request-for-tender issued (2010)**

**4.84** Defence terminated the Omega Air contract on 1 April 2010 with a view to seeking damages for the company's breaches of the contract.<sup>163</sup> At this point Omega Air had paid Defence a total of \$2.8 million (excluding GST) and taken possession of the B707 aircraft spares and documentation.<sup>164</sup>

**4.85** After cancelling the contract, Defence conducted a limited review into the financial status of the Omega Air group of companies. Defence chose not to conduct further investigations into Omega Air's financial viability although it continued negotiations with the company after cancelling the contract.

### ***Request-for-tender***

**4.86** On 1 October 2010, Defence issued a new request-for-tender (RFT) for the re-sale of the remaining B707 assets, which closed on 10 November 2010. It received four responses with offers ranging from a best offer of \$90 000 to a net cost to Defence of \$900 000.

**4.87** There was a marked difference between the best offer received by Defence in response to the 2010 RFT (\$90 000) and the contracted purchase price with Omega Air of \$9.5 million. The difference may be explained in part by the fact that the B707 assets<sup>165</sup> were offered for sale without any spares, training material and aircraft documentation. These items had already been sold to Omega Air in early 2009 upon payment of the instalment of \$1.8 million (see paragraph 4.79).

**4.88** In parallel with these activities, on 5 November 2010, Defence received a letter of offer from Omega Air to settle the dispute. The offer was open until 10 November 2010—the closing date of the tender. On 18 November, Omega Air extended this offer to 25 November 2010.

**4.89** By mid-November 2010, Defence was doubtful of the merits of pursuing legal action against Omega Air to recover damages, for reasons including the potential ongoing financial costs of legal action. The company's financial position was still unknown to Defence.

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163 Omega Air denied this claim and counter-claimed that the Commonwealth was in breach and had wrongly terminated the contract.

164 Omega Air had not taken possession of any ex-RAAF B707 aircraft at this point.

165 The remaining B707 assets comprised three B707 aircraft, one B707 flight simulator and one incomplete B707 airframe.



**4.90** Defence decided not to continue with the tender it had commenced in October 2010. Defence and Omega Air continued negotiations throughout 2010 both directly, and through their respective legal advisers.

### **Dispute settled (January 2011)**

**4.91** The dispute between Defence and Omega Air was settled on 31 January 2011. The settlement was effected through a Deed of Release, Deed of Guarantee and Indemnity, and Deed of Charge. The Deed of Charge was intended to provide the Commonwealth with security over the aircraft in the event that Omega Air did not meet its payment obligations under the contract. However, as discussed in paragraph 4.98, this instrument was ineffective.

**4.92** Under the settlement, the purchase price was reduced to between \$6.2 million and \$9.2 million (excluding GST). Omega Air's payment of the \$3 million difference was conditional upon it obtaining certain US Federal Aviation Administration (FAA) certifications for the three B707 aircraft before 31 December 2014.<sup>166</sup>

**4.93** In September 2009, Omega Air had cited its inability to obtain relevant FAA approvals as justification for an extension of the delivery date and, hence, the payment date, under the contract. Additionally, during negotiations with Defence in February 2010, Omega Air claimed it was unlikely that it would ever obtain the necessary approvals. Further, Omega Air stated it was impossible for the aircraft to be certified in the US as the modifications for the purposes of equipping the aircraft with air-to-air refuelling capability had not been done in accordance with FAA regulations. These factors indicate that Omega Air was unlikely to obtain the FAA certifications and be required to pay the remaining \$3 million to Defence.

**4.94** Notwithstanding the history of non-payment, Defence did not conduct any further checks into the company's financial situation before settling the contractual dispute. At this juncture, Defence's external legal advisor expressed a 'strong preference to obtain specialist advice from [its] Banking and Finance team to inform the settlement negotiations'. However, the legal adviser was instructed by the then Branch Head for Defence Disposals not to obtain such advice.

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166 The certification is a Supplemental Type Certificate (STC) and relates to the RAAF modifications to the aircraft for the purposes of equipping the aircraft with air-to-air refuelling capability (see paragraph 4.68).

## **Ownership and possession transfers without full payment for assets (2011)**

**4.95** The terms of the January 2011 settlement allowed Omega Air to take possession of the B707 aircraft and flight simulator without paying the Commonwealth in full for the assets. On 3 February 2011, Omega Air paid Defence the \$1.4 million (excluding GST) required for the settlement to take effect and for title to the three aircraft and the simulator to pass to Omega Air.<sup>167</sup> The three aircraft left Australia under Omega Air's control between 23 and 25 October 2011. The company took possession of the simulator in November 2011.

**4.96** Allowing Omega Air to take possession of the aircraft without the Commonwealth first receiving payment in full is inconsistent with:

- advice Defence received from the then Department of Finance and Deregulation (DoFD) in 2008<sup>168</sup> that the assets could not be released until payment had been received in full; and
- the requirements of Defence's Disposal Instruction, which requires that the Commonwealth receive payment in full before the purchaser takes delivery of the assets.

**4.97** The arrangement also removed the primary risk treatment Defence had in place to address the risk of non-payment and is contrary to the July 2009 assurances provided by DMO officials to the then CEO DMO (see paragraph 4.81).

**4.98** In Defence's view, the January 2011 Deed of Charge contained a lien that was intended to protect the Commonwealth from the risk of any default on payments due to the Commonwealth under the settlement arrangement. To give effect to this arrangement, Omega Air was required to register the Deed of Charge with: the US Federal Aviation Administration (FAA); and

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<sup>167</sup> Omega Air had by this stage paid a total of \$4.2 million for the B707 assets including the \$1.8 million paid for the spares, training material and documentation in 2009. The full contract price was \$9.5 million including the \$3 million contingent on Omega Air obtaining FAA certifications. These amounts are exclusive of GST.

<sup>168</sup> In August 2008, in discussions concerning the proposed B707 sale, Defence Disposals staff noted specific Department of Finance advice that the assets could not be passed over until the contract was concluded.



‘internationally under the Cape Town Convention’.<sup>169</sup> However, Defence made no attempt to follow up Omega Air’s obligation to register the Deed of Charge with the relevant authorities until early 2013. In April 2013, Defence Disposals obtained confirmation from the FAA that Omega Air had not registered the Deed of Charge with the FAA. Further, in August 2013, Defence received advice from the FAA, via Omega Air, that the Deed of Charge was not valid. In November 2014, Defence informed the ANAO that it does not believe the Deed of Charge was registered under the Cape Town Convention either.

### **Proposal for deferral of payment (2013)**

**4.99** In February 2013, Omega Air requested that the due date for the next payment of \$1 million (which had been due in January 2013) be deferred one year until 1 February 2014 and then be payable by instalments of \$250 000 a month from 1 February 2014 to 1 May 2014.

**4.100** Within Defence, the delegation to approve a proposal for payment by instalments of a debt of this magnitude rests with the Secretary, CDF or Chief Finance Officer (CFO).<sup>170</sup> As a consequence, Defence’s CFO Group became involved and inquired further into Omega Air’s financial situation. This revealed that the company was not then able to settle the debt.

**4.101** On 1 May 2013, Defence’s CFO rejected Omega Air’s request.<sup>171</sup> Negotiations continued between Defence and Omega Air in the months that followed. Defence continued to insist on payment in full and in October 2013, advised Omega Air that an embargo that Defence had placed on its use of refuelling services from the Omega Group would continue until Omega Air met its obligations in full.<sup>172</sup>

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169 In email correspondence with Defence Disposals staff on 26 January 2011, Omega Air stated that it would register the lien before the aircraft departed Australia. This undertaking was not reflected in the 31 January 2011 settlement.

170 The authority to approve the payment of a debt to the Commonwealth by instalments has been delegated from the Finance Minister to the Secretary. The Secretary has, in turn, delegated the authority to various positions within Defence with only the CDF and CFO having the authority to approve the repayment of a debt of this magnitude by instalments.

171 A subsequent offer to pay by instalments was rejected by Defence on 16 October 2013.

172 At this point, the five-year FMS contract signed in March 2008 had expired. Defence’s embargo on Omega Air’s refuelling services is discussed at paragraph 4.108.

## **Further payments received (September 2013 to February 2014)**

**4.102** Between September 2013 and February 2014, Omega Air paid the remaining \$2.62 million (including GST) invoiced by, and owed to the Commonwealth. Although there was no agreement by Defence for Omega Air to pay by instalments, Omega Air initiated instalment payments and, by 28 February 2014, had paid the total reduced purchase price of \$6.2 million.

**4.103** In July 2014, Defence informed the ANAO that the contractual provisions for payment to the Commonwealth remained relevant until the sunset date of 31 December 2014. Therefore, if Omega obtained the relevant FAA certifications by 31 December 2014, Omega Air would be liable to pay the Commonwealth \$1 million (excluding GST) for each certified aircraft.

**4.104** In February 2014, Air Force's Technical Airworthiness Regulator noted that Omega Air could continue to operate the B707 aircraft without the relevant FAA certification. Further, following discussions with Omega Air, Defence Disposals formed the view that the company had little incentive to seek certification and did not intend to do so.<sup>173</sup> In the event, Defence did not receive the remaining \$3 million of the original contract price because FAA certification was not achieved by 31 December 2014.

## **Cost of external legal advice for the B707 aircraft disposal**

**4.105** Defence informed the ANAO that it had spent \$282 239 on external legal fees on the B707 aircraft disposal. Defence was unable to provide an estimate of the cost of internal legal advice.

## **Addressing the capability gap after B707 aircraft withdrawal**

**4.106** As discussed earlier, following the withdrawal of the B707 aircraft fleet, the RAAF's replacement air-to-air refuelling capability was to be provided through the MRTT project. However, this project did not deliver the expected capability from 2008 as scheduled and, as a result, a lengthy capability gap arose.<sup>174</sup>

**4.107** Defence was aware when it decided to withdraw the B707 aircraft that it would face a capability gap. In the event, to address the capability gap, from March 2008, Defence paid Omega Air for air-to-air refuelling services. Defence

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<sup>173</sup> See footnote 166.

<sup>174</sup> Initial capability for the MRTT project was delivered in 2013.

did this through the five-year US Foreign Military Sales (FMS) agreement, with Omega Air specifically named as the provider of the services to Defence in accordance with Defence's request (see paragraph 4.74).<sup>175</sup> As discussed in paragraph 4.74, Defence advised the ANAO that it had specified Omega Air because it was both a less expensive and more flexible option than the other option available under the FMS arrangement.

**4.108** Defence estimated that, as at 10 April 2013, it had paid Omega Air \$24.04 million for these services (not including the cost of the fuel); at times receiving services from Omega Air using one its own B707 aircraft.<sup>176</sup> However, Defence advised the ANAO that it had received liquidated damages because of the delays in the new MRTT capability coming into service. This had the effect of reimbursing Defence for the cost of hiring commercial air refuelling services. In April 2013, the Secretary of Defence indicated to the RAAF that the FMS arrangement should cease given Omega Air's then failure to pay the remaining amounts under the contract.

## Army B Vehicle fleet

**4.109** The Army's B Vehicle fleet (B Vehicles) comprises about 12 000 trucks, trailers, motorbikes, quad bikes, and four and six-wheel drive sedans. Defence acquired the fleet progressively between 1959 and 1994. By 2008, Army had determined that 98 per cent of the fleet had exceeded its expected operating life and was increasingly costly to maintain, repair and operate.

### Disposal strategy approved (June 2011)

**4.110** In July 2010, the then Deputy Chief of Army began a program to reduce the size of the Army's B Vehicle fleet because of obsolescence, a lack of maintenance funding, and its expected replacement through the major capital acquisition project 'LAND 121'. On 21 June 2011, the then Minister for Defence Materiel approved Defence's proposal for the sale by tender of approximately 12 000 B Vehicles expected to become surplus over the period 2011–20, and the sale for dismantling and recycling of remaining vehicles that could not be sold viably as working vehicles. Defence informed the Minister that the net proceeds from the sale of the vehicles would be invested in vehicle simulators for Army.

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<sup>175</sup> Omega Air provides air-to-air refuelling services for the US Navy and Marine Corps.

<sup>176</sup> See footnote 158.

**4.111** Defence further informed the Minister that the potential revenue from the B Vehicles disposal would be about \$70 million.<sup>177</sup> However, Defence noted that under its sale proposal, any potential revenue would be ‘impacted by costs incurred by the Prime Contractor, such as in remediating hazardous materials such as asbestos that may be contained within the vehicles.’

### **Evaluating the tender—Army B Vehicles (2012)**

**4.112** Following an Army B Vehicles request-for-proposal process in the latter half of 2011, Defence invited seven companies to respond to a limited RFT which opened on 8 March 2012 and closed on 14 May 2012. Defence received three responses. A tender evaluation board that included nominees from Defence Disposals and Joint Logistics Command (JLC) evaluated responses.

**4.113** By mid-2012, Defence’s estimate of the revenue to be raised through B Vehicle sales was in the range of \$100 million to \$150 million. There is evidence of differing views within Defence as to whether such revenue could be retained by Defence for its own purposes—rather than being returned to consolidated revenue—and, if so, what that purpose should be:

- An arrangement had been in place in Defence earlier to allow JLC to retain revenue from its disposals to fund its Accelerated Disposals Program (ADP). JLC developed an expectation that some or all the revenue from B Vehicle disposals would be used to fund the ADP.
- With Defence Disposals’ assistance, Army had sought agreement to retain revenue from the disposal to meet its own funding pressures. This ultimately resulted in a proposal to use the revenue to acquire vehicle simulators to improve efficiency of driver training for Army.

**4.114** Ultimately, the choice in selection of a tenderer was between a company JLC had previously done business with and another, newer participant in the vehicles disposal business. Before the source evaluation report recommending the preferred tenderer was completed, a senior JLC member (not part of the tender evaluation board) expressed doubts to Defence Disposals as to the capacity of the newer participant—which became, ultimately, the preferred tenderer—to discharge the work under the contract successfully. The JLC nominee on the tender evaluation board ultimately

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177 This was based on the earlier sale by Defence of small numbers of B Vehicles at auction.

dissented from the board's conclusions and recommendations and did not sign its report.

**4.115** The source evaluation report was considered and approved by the Head, Commercial and Industry Programs Division (HCIP) on 30 August 2012.

**4.116** Subsequent to the tender evaluation, the delegate for contract signature confirmed to the ANAO that, in his view, 'JLC representatives at the time had a very sceptical view about going down a tender process at all for the B Vehicles disposal.'

**4.117** In October 2012, one of the non-preferred tenderers wrote to Defence expressing concern about the conduct and potential outcome of the tender evaluation. At the time, Defence had not advised any of the non-preferred tenderers of the outcome. However, the letter showed that the tenderer was aware of details of the tender process which Defence thought should have been protected by its 'commercial-in-confidence' nature.

**4.118** In response, DMO's Contracting Services Branch conducted an administrative review (known as a 'Quick Assessment' (QA)<sup>178</sup>) of the tender process and provided advice to HCIP.<sup>179</sup> The report identified several 'irregularities' and stated that:

In view of the gravity of the above issues, this QA has concluded that the selection of [*the preferred tenderer*] is based on an irregular process and therefore negotiations with that company alone should not continue. Further investigation is warranted to verify the above findings before deciding on a way forward ...<sup>180</sup>

**4.119** The irregularities comprised: (i) irregularities between senior executive direction to the tender board and the RFT, and within the RFT; (ii) irregularities

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178 A 'Quick Assessment' is a Defence term for an administrative review conducted to quickly determine the circumstances around a particular occurrence with a view to informing a decision about what to do next. A Quick Assessment results in a short report which identifies the facts and may make recommendations to the relevant commander or supervisor on a way ahead.

179 The QA was conducted in two parts. The first dealt with the conduct of the tender process; and the second covered the question of whether the tenderer had improperly obtained information about the process and potential outcome, or whether information had been provided by a Commonwealth employee. This second part of the QA led to the issue being referred to Defence's Inspector-General who, following an initial assessment, referred the matter to the Defence Security Authority in November 2012. Ultimately no investigation took place as DSA concluded that a large number of personnel (about 35) had access to the relevant information and this reduced substantially the likelihood of identifying the person(s) responsible for any unauthorised disclosure.

180 Defence, Quick Assessment Brief for Head, Commercial and Industry Programs, Disposal by Sale of Ex Defence "B" Vehicles, 25 October 2012.

between the RFT, Tender Evaluation Plan and the Source Evaluation Report; (iii) inadequate definition of the Tender Evaluation Criteria; (iv) failure to evaluate against all of the Tender Evaluation Criteria; (v) no assessment of value for money of the tenders; (vi) incorrect assessment of one of the tenderer's compliance with the RFT requirements; and (vii) inequitable treatment of tenderers by the Tender Evaluation Board.

**4.120** The report recommended that HCIP:

- (a) suspend the contracting process pending further investigation of the above significant assessments;
- (b) initiate a rapid follow-on independent investigation of the tendering process irregularities;
- (c) direct that at least interim processes with minimum requirements for sales by tender be developed by DMO Legal and approved before any further such disposals are commenced; and
- (d) direct that all Defence Disposals staff likely to be involved in future disposals involving sale by tender be trained on the minimum requirements necessary to conduct a tender process to ensure that disposal transactions are able to withstand public scrutiny in terms of value for money, probity and ethical conduct.

**4.121** On 26 October 2012, DMO Legal reviewed the QA. It concluded that the flaws in the tender process identified in the QA report were sufficient to warrant a re-tender and that DMO Legal would conduct further investigations into the complaint.

**4.122** On 2 November 2012, after considering additional documents related to the tender process, DMO Legal came to a different conclusion. This time it concluded that, while there were deficiencies in the tender process<sup>181</sup>, 'the outcome adhered with due process' and 'was not sufficiently flawed so as to render the outcome not legally defensible'.<sup>182</sup> DMO Legal then recommended

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181 The deficiencies DMO Legal identified included that: the evaluation criteria released to the market as part of the RFT were not an accurate reflection of the actual requirements of the Commonwealth; the Source Evaluation Report 'barely justifies and explains the decision' of the Tender Evaluation Board to recommend the preferred tenderer to the delegate; and that therefore, there was the potential for there to be deficiencies in the merits of the evaluation criteria and Source Evaluation Report.

182 The resulting report noted that the review was not into the merits of the quality of the evaluation against the prescribed criteria or the decision of the delegate to endorse the Source Evaluation Report. It was instead an assessment of whether the process adhered to relevant Commonwealth legislation and departmental policies.

that Defence Disposals continue with negotiations already under way with the preferred tenderer.

**4.123** On 5 November 2012, Contracting Services Branch reviewed DMO Legal's report of 2 November and disagreed with the conclusions. Consistent with its earlier QA findings, it took the view that the disposal outcome would not be able to withstand public scrutiny in terms of value for money, probity, ethical conduct and corresponding supporting requirements in the Defence Procurement Policy Manual. In its response to DMO Legal, Contracting Services Branch recommended that:

- (a) the current contracting process with the preferred tenderer should be suspended because it was the result of an irregular evaluation of the tenders;
- (b) there be a complete re-assessment of the competing offers against all of the evaluation criteria in the RFT with the level of detail required of the resulting report being comparable to that required for a major procurement;
- (c) the re-assessment against the RFT evaluation criteria should include a ranking of the tenderers' offers against value for money and the net outcome for the Commonwealth, with those two terms to be clearly defined;
- (d) the tender re-assessment team should not contain any staff from the original tender evaluation process; and
- (e) a new probity adviser should be appointed from DMO Legal or Contracting Services Branch.

**4.124** Also on 5 November 2012, DMO sought external (to Defence) advice on the matter. On 7 November 2012, the resulting advice presented Defence with four options for a way forward. The preferred option was to re-conduct the evaluation with a new team, while the least preferred was to proceed with the process and enter into a contract with the preferred tenderer chosen in the original process. Defence ultimately adopted the least preferred option.



**4.125** The external adviser also proposed that, should Defence adopt the least preferred option, it should ensure that the document trail was completed to provide greater detail about the methodology and logic behind its evaluation outcomes.

**4.126** Following advice from the DMO Special Counsel, on 14 November 2012, Defence approached the same external adviser for further advice, this time providing tender documentation that it had not provided as part of its earlier request. On this occasion, Defence sought specific advice on whether the process had been conducted in accordance with the RFT and Tender Evaluation Plan and whether the decisions made were defensible. The resulting advice, provided on 16 November 2012, concluded that, while there were some flaws in the process, assuming that the assessment of the tender submissions was supported by sound analysis (particularly from a financial perspective), Defence would have grounds to defend its decision. The assumption here should be noted.

**4.127** As in the first advice, the external adviser focused on helping Defence develop a defensible process. The adviser indicated that, at a minimum, Defence should document its response to the flaws identified by other review teams (including its reasons for concluding those flaws had not affected the evaluation outcome). In addition, attention was drawn to the value of training to ensure that the identified shortcomings did not recur in future disposal processes. The audit found no evidence that Defence had acted on the external advice to complete the document trail to support the evaluation outcome or document its response to the flaws identified by the other review teams.

**4.128** On 19 November 2012, Defence Disposals staff presented the delegate (HCIP) with a written brief recommending that he sign the contract with the preferred tenderer. The recommendation was made because the various reviews and advice showed that: some of the issues raised in the complaint were not relevant; Defence had a basis on which to defend its decision; and the advice had 'not identified any material that suggest[s] that the decision to proceed with [*the preferred tenderer*] resulted from bias, favouritism or mistake'.

**4.129** There is no evidence of any attempt to complete the document trail (as the external adviser had proposed—see paragraph 4.125) so as to inform the delegate appropriately before execution of the tender. The written brief received by the delegate immediately before signing the contract for the sale of the B Vehicles focuses on the complaint by the non-preferred tenderer, but not the critique by the subsequent reviews. It highlights the advice that 'Defence



has a basis on which to defend its decision to set aside the [*non-preferred tenderer's*] tender.' It does not mention that this is contingent on Defence being able to fulfil a range of requirements nor state whether these have been fulfilled. This leaves doubt as to whether the delegate was, in fact, fully and properly advised and informed before making his decision.<sup>183</sup>

**4.130** The advice to the delegate included the statement:

The RFT and SER [*Source Evaluation Report*] do not demonstrate best practice, however they do meet the required standard and comply with relevant DMO policies.

**4.131** The delegate had asked for, and obtained a 'brief sequence of the events that have occurred re probity' to be prepared to attach to the decision to sign the contract with the preferred tenderer, should he do so, so as to document 'reasons for the decision.' That attachment included a reference to the external advice that 'if the documented concerns were to come to light ... they would ... expose Defence to a significant risk of public criticism, loss of industry confidence and Ministerial concern'. Those advising the delegate did not reconcile the concerns in the attachment with the statement in paragraph 4.130.

**4.132** The delegate agreed with the recommendation to sign the contract. On the same day, the delegate signed a letter to the non-preferred tenderer advising that Defence's review of the process had concluded that the tender process was 'sound'. The delegate subsequently advised the ANAO that there were two main aspects which influenced his view in deciding to sign the contract:

- the fact that the cost and risk to schedule of not proceeding to contract was significant; and
- he had good reason to doubt the objectivity behind some of the views expressed by certain participants and advisers in this process.

**4.133** The delegate did not identify the cost and risk to schedule pressures he referred to. The main cost consideration reflected in internal discussions within Defence before contract signature was the risk of JLC having to accommodate

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183 Defence informed the ANAO that 'Prior to signing the contract the delegate reviewed documentation previously provided to HCIP in August 12 when the issue of the minority TEB complaint was first reported to the delegate, in particular minutes from the TEB Chair to the delegate of 2 and 21 August 12 as well as the SER documentation. In addition the delegate considered a brief prepared by the TEB Chair noting the review findings and actions to be taken'.

many 'parked-up' B Vehicles awaiting disposal. As events unfolded, this risk diminished and reversed, having been replaced by a lack of vehicles to supply to the contractor for disposal (see paragraph 4.136).

**4.134** If the delegate had reason to doubt the objectivity of some of the advice received then an appropriate course may have been one of the other options nominated by the adviser (see paragraph 4.124) or, at a minimum, to set out his own reasoning, dealing explicitly with any perceived lack of objectivity before exercising the delegation.

**4.135** The delegate further advised the ANAO that, 'on review and discussion with DMO Special Counsel the additional [*external*] advice of 16 November 2012 was then sought and based on this I was satisfied that there was a defensible basis to proceed to contract.' However, this external advice providing assurance of the defensibility of Defence's proposed course of action (discussed in paragraphs 4.126 to 4.127), and on which the delegate depended to form his view, was contingent upon completion of recommended actions to remediate the evaluation process, particularly by documenting it. Moreover, Defence was advised that—if its evaluation had in fact been sound—it needed to complete the document trail before executing the contract (paragraph 4.125). Since this was not done, before or after executing the contract, the defensibility of the course taken by Defence was not supported in the way the adviser recommended.

## **Progress with the B Vehicles contract**

**4.136** By May 2014 Defence Disposals regarded the project health of the B Vehicles disposal as one of 'concern'. This was due to the fact that the flow of surplus vehicles from Army had become constricted by delays in the replacement project (Project LAND 121 Phase 3B). The main concerns for the project were Defence Disposals' inability to control the outflow of surplus assets to the contractor and the development of a solution to the shortfall in supply.

**4.137** The shortfall in the supply of vehicles to the company resulted in Defence preparing a contract change for the 2014–15 financial year allowing a substantial increase in the proportion of revenue being retained by the contractor (see paragraph 3.48).

## **Conclusion—major case studies**

**4.138** The audit considered three case studies in detail, comprising the two disposals whose difficulties gave rise to the request for this audit, the Caribou and Boeing 707 (B707) aircraft fleets, and a more current disposal, B Vehicles.

## **The Caribou aircraft case**

**4.139** Defence sought to dispose of its last nine Caribou transport aircraft by sale, issuing a request-for-tender in October 2010. Two aircraft, earmarked for heritage purposes, were successfully sold to an historical aircraft society. However, the sale of the remaining seven aircraft proved troublesome. The preferred tenderer was replaced by another entity, and doubts arose over the latter's credibility and financial viability. While Defence proceeded with the disposal and the purchase of the aircraft by the replacement entity, which paid for the seven aircraft, Defence retained the aircraft until doubts about the entity could be resolved. In January 2015, Defence informed the ANAO that the sale to this entity had been cancelled and Defence was considering alternative disposal options for the aircraft.

**4.140** The Caribou disposal process demonstrated three key administrative shortcomings. Defence:

- did not observe that the original tenderer was being substituted by a separate entity and that the change was not merely a change of name;
- did not seek advice on the financial viability, background and integrity of the entity it was dealing with; and
- proceeded with the sale transaction (by issuing an invoice to the purchasing company) after becoming aware of concerns about the buyer. Not acting on available information exposed Defence and the Commonwealth to financial and reputational risk.

## **The B707 aircraft case**

**4.141** After first receiving an offer in mid-2007, Defence sold its B707 air-to-air refueller fleet to a private company based overseas, Omega Air, with an initial 2008 contract price of \$9.2 million. Selling the B707 aircraft fleet proved troublesome to Defence. The disposal process demonstrated three key administrative and contractual shortcomings. Defence:

- did not conduct adequate checks on the financial viability of the purchasing company—an issue which also arose in the Caribou aircraft case;
- agreed that the payment of \$3 million of the purchase price would be contingent upon US Federal Aviation Administration (FAA) certification of the aircraft, when it was known to Defence that this was

unlikely. In effect, this approach provided the company with a price reduction; and

- allowed the purchasing company to remove the aircraft from Commonwealth premises before full payment had been received. This arrangement was contrary to advice received from the Department of Finance and Deregulation and left the Commonwealth with reduced capacity to secure payment.

**4.142** During much of the period over which the B707 transaction took place, Defence hired air-to-air refuelling services from the purchasing company, at a cost of over \$24 million. The refuelling arrangement was cancelled in 2013 on the advice of the Secretary.

**4.143** The company ultimately paid Defence \$6.2 million for the B707 aircraft and related equipment. Defence did not receive the remaining \$3 million of the original contract price because FAA certification was not achieved by 31 December 2014.

## **The B Vehicles case**

**4.144** B Vehicles comprise about 12 000 Army trucks, trailers and four and six-wheel drives, which are beyond their expected operating life. Defence has sought to dispose of the vehicles through an arrangement with an external company to detect and remediate asbestos in brake linings, and on-sell the vehicles to the public. This arrangement is expected to operate over some years as the vehicles are progressively withdrawn from service.

**4.145** The B Vehicles disposal was arranged through a request-for-tender process which, following Defence's tender evaluation, drew a complaint from a non-preferred tenderer. Defence obtained several sets of internal advice about the tender evaluation process, some of it highly critical (and some of it contradictory), and twice sought urgent external advice.

**4.146** The external advice noted that there had been a number of fairly significant concerns raised about the evaluation process by internal review teams within Defence, raising doubt about the defensibility of the evaluation outcome and process. The reputational risks for Defence included exposure to criticism, loss of industry confidence and doubt about the integrity of the tender process. However, the final external advice also noted that Defence would have a basis to defend its decision provided it demonstrated that the

assessments undertaken (including financial assessments) were sound, factually correct and supported by reliable analysis.

**4.147** Defence persisted with its original tender decision without acting on the final external advice to demonstrate that its assessments were sound. The delegate's decision to proceed with the preferred tenderer did not set out his reasons for not acting on the external advice. Given the sensitivities and potential risks involved in proceeding with the original tender decision, it would have been prudent to escalate the matter to more senior management, for additional counsel, oversight or decision.<sup>184</sup> Defence records indicate that this course was not adopted.

### **Major case studies—common themes**

**4.148** Each of the major case studies considered in this audit took place in an environment of disposals reform focused on reducing costs and maximising revenue. This environment was due, at least in part, to Defence's Strategic Reform Program (SRP)<sup>185</sup> and later reinforced by the disposals reform program announced mid-2011. A consistent theme in the case studies has been pursuit of the disposal option that promised to yield the greatest revenue.

**4.149** The disposal of SME is a complex undertaking, requiring a broader understanding of the benefits, risks and costs of each disposal, and their effective management. The focus on revenue has not always been matched with appropriate consideration of disposal costs nor of risks of a non-financial kind, such as risks to reputation. Further, Defence did not monitor the net financial position—that is, revenue minus all significant costs incurred by the Commonwealth for each disposal—to help assess the overall benefit of its disposal strategies. Probity and financial checks and identifying non-financial risks also received either limited attention or were given reduced weight in decision-making.

**4.150** Disposing of SME through an RFT process requires Defence to strike a balance between optimising sale proceeds and minimising the Commonwealth's overall costs and risks. To achieve an effective outcome, Defence must

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184 At the time of the decision to proceed to contract the Branch Head, Defence Disposals (Senior Executive Service (SES) Band 1), was acting Head, Commercial and Industry Programs Division (SES Band 2).

185 In 2009, Defence began a decade-long major reform of its business intended to generate savings to be reinvested within Defence. This was known as its 'Strategic Reform Program'.

manage disposal activities, including any tender process, openly, fairly and equitably, and in a manner that will withstand scrutiny. Government and industry need to have confidence in the way Defence undertakes disposals, and the Defence Organisation needs to maintain fairness in its dealings with industry. Achieving these objectives necessarily requires a balanced assessment of risk and a broader, rather than narrower, view of Australian Government interests when planning and managing the disposal of SME.

## 5. Managing Hazardous Substances in Disposals

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*This chapter considers Defence's management of hazardous substances in carrying out its disposal of SME, focusing on asbestos.*

### Hazardous substances in Defence equipment

**5.1** Defence SME may contain a range of physical and chemical hazards (hazardous substances) that Defence must manage both when using and when disposing of such assets. Hazardous substances likely to be found in Defence equipment include radiation sources, polychlorinated biphenyls (PCBs), lead and chromate-based paints<sup>186</sup> and asbestos-containing material.<sup>187</sup> For example, asbestos has been used extensively to make gaskets for use in engines, such as those in the Iroquois helicopters and the Caribou transport aircraft; it was present in components of Defence's former Leopard tank fleet and Boeing 707 aircraft; and it is very widespread in the (retired) F-111 aircraft.

**5.2** Hazardous substances in Defence equipment present risks to the health of individuals and to the environment. These risks occur both while the equipment is in use by Defence personnel<sup>188</sup> and when it enters the wider community through disposal of the assets or their components. This second aspect is the primary focus here. However, there are two obvious relationships between management of hazardous substances within Defence and the disposal of equipment that contains them. First, if Defence can remove hazardous substances or minimise their use in its equipment then it can manage the disposal of the assets more easily. Second, disposal of equipment containing hazardous substances is itself a means of addressing the problems posed by the presence of those substances in Defence as a workplace. Thus,

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186 Chromate-based paints were used in naval ships until the early 1990s.

187 'Asbestos' is the term for a group of six naturally occurring mineral fibres. Because of its flexibility, tensile strength, insulation from heat and electricity, chemical inertness and affordability, asbestos has been used widely for insulation and as the key ingredient in products such as asbestos cement sheeting and roofing, water pipes, fire blankets, fillers and packing, as well as motor vehicle clutches and brake linings, gaskets and pads. Source: Australian Government, Asbestos Management Review Report, June 2012, available from <<http://employment.gov.au/asbestos-safety-and-eradication-agency>> [accessed 18 February 2014].

188 See, for example, Audit Report No.46, 2012–13, *Compensating F-111 Fuel Tank Workers*.

when DMO sought legal advice to help with its management of disposal of SME containing asbestos, its legal adviser noted that:

The Defence Materiel Organisation (DMO) is investigating a number of means by which it may dispose of defence materiel containing asbestos and other hazardous substances. One of these means is by gifting or selling the materiel to persons or organisations within Australia.<sup>189</sup>

**5.3** Legislation governs the handling, storage and disposal of hazardous substances in Australia and its workplaces.<sup>190</sup> When it disposes of equipment, Defence must meet legal obligations to address risks to life, health and the environment. Defence's Disposal Instruction (see paragraph 2.23) requires delegates authorising asset disposal to ensure that the disposal complies with legislation concerning hazardous substances.

**5.4** There is also a duty-of-care obligation on Defence to take reasonable steps to avoid foreseeable harm to any party from hazardous substances when it disposes of equipment. In the case of transfer, gift or sale this could include either removing the hazardous substance before disposal or ensuring that the recipient is aware of its nature and the hazard it presents before the transaction takes place.

**5.5** This chapter focuses on asbestos as the most prominent hazardous substance which Defence has had to contend with in recent disposals. Asbestos has been used very widely in Defence materiel. In examining how Defence has managed the disposal of equipment containing asbestos the audit considered:

- the risks of asbestos and the controls in place in Australia since 2003;
- Defence's work in recent years to assess the presence of asbestos in its assets, and to manage or remove it.<sup>191</sup> This has involved a number of reviews both by Defence and consultants;
- Defence's governance arrangements for managing asbestos; and
- selected case studies of recent SME disposals to illustrate how Defence has actually dealt with asbestos in disposals. These disposals were

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189 AGS advice: 'The gifting or sale of Defence materiel containing asbestos or other hazardous substances', 16 November 2009, p. 3.

190 Management of asbestos in Australia is regulated by government agencies at the local, state, territory and Commonwealth level.

191 Earlier work on asbestos in Defence assets had been done. For example, in 1991, a former Public Service Commissioner prepared the *Report of the Independent Review of Asbestos in Defence*, which was tabled in Parliament by the then Minister for Defence Science and Personnel.



under way while Defence was reviewing and remediating asbestos in its inventory and developing governance arrangements to deal with it.

**5.6** In considering Defence's management of asbestos when disposing of SME, the ANAO made no assessment of the specific risks associated with asbestos that might still be in equipment being disposed of by Defence. Rather, the chapter considers Defence's actions in light of the governance arrangements the organisation put in place in 2009 for managing asbestos.

## **The risks of asbestos and controls in place since 2003**

**5.7** Asbestos is a substance with hazardous properties. In particular, it poses a risk to health by inhalation if the asbestos fibres become airborne and people are exposed to these airborne fibres. Asbestos-related diseases (such as mesothelioma, lung cancer and asbestosis) can be contracted by breathing in airborne particles when asbestos is disturbed. The main risk factor for mesothelioma is asbestos exposure and the disease is fatal and incurable.<sup>192</sup> The mortality rates for other asbestos-related diseases, such as lung cancer and asbestosis, are also very high. Australia has the highest reported per capita incidence of asbestos-related disease in the world, including the highest incidence of mesothelioma.

**5.8** Asbestos was used extensively in Australia in buildings, plant and equipment and in ships, trains and motor vehicles from the 1950s to the 1980s. Some uses of asbestos, for example, in gaskets, continued thereafter. Australian jurisdictions have progressively banned the use of asbestos in workplaces.

## **Controls on asbestos and exemptions granted to Defence**

**5.9** An Australia-wide ban on the importation, manufacture and use of all forms of asbestos and asbestos-containing products took effect from 31 December 2003, when the use of asbestos in the workplace was prohibited, with very limited exemptions. While the ban did not extend to the use of

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<sup>192</sup> The average life expectancy of a person diagnosed with mesothelioma is between 10 and 12 months. While only a small percentage of people exposed to asbestos will develop mesothelioma, a small exposure can be enough to trigger the cancer. The World Health Organization has stated that there is no minimum safe exposure level for any form of asbestos fibres. Following exposure to asbestos it can take between 20 and 50 years to develop symptoms of asbestos-related disease. Source: Australian Government, Asbestos Management Review Report, June 2012, available from <<http://employment.gov.au/asbestos-safety-and-eradication-agency>> [accessed 18 February 2014].

asbestos-containing items in situ as at 31 December 2003, these items could only be replaced by items not containing asbestos.<sup>193</sup>

**5.10** The management of asbestos in Defence as a workplace is overseen by Comcare as the Commonwealth's work health and safety regulator.<sup>194</sup> Defence obtained exemptions from Comcare for its continued use of 552 types of asbestos-containing parts (not in situ) beyond 31 December 2003 because they were assessed as being mission-critical. Further, from 2004 Defence continued to use asbestos in specified platforms under exemptions made by the Safety, Rehabilitation and Compensation Commission (SRCC).<sup>195</sup> These exemptions were for three air platforms: the F-111, the Caribou and the Hawk Lead-In Fighter. The exemptions were to expire progressively by December 2010 with the Caribou and F-111 aircraft scheduled for disposal by then and non-asbestos parts having been found to replace asbestos parts in the Hawk aircraft.<sup>196</sup>

## Defence's management of asbestos in its assets

**5.11** Defence has reviewed the management of asbestos in its inventory regularly since the prohibition on importation and use of asbestos came into force in 2003. The important events in recent years have been:

- contractor reports (2008), which found asbestos items in maritime inventory being used without exemptions;

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193 In situ, in relation to a product that contains asbestos, means that, 'the product is fixed or installed: (a) in:

(i) a building or any other structure that forms a workplace; or

(ii) a plant, a vehicle or any other thing that is for use at a workplace; and

(b) in a way that does not constitute a risk to users until the asbestos contained in the product is disturbed'. Source: OHS Regulations 1994, Part 6, Regulation 6.3.

194 Comcare, established under the *Safety, Rehabilitation and Compensation Act 1988*, has a number of powers and functions conferred under this act and the *Workplace Health and Safety Act 2011* (Cth) (WHS Act) (formerly the *Occupational Health and Safety Act 1994* (Cth)). Comcare is also responsible for managing the Commonwealth's asbestos-related claims liabilities under the *Asbestos-related Claims (Management of Commonwealth Liabilities) Act 2005* (ARC Act). Source: Comcare, *Annual Report 2012–13*, available from: <[http://www.comcare.gov.au/annual\\_report\\_2012-13/overview/about\\_comcare#topofcontent](http://www.comcare.gov.au/annual_report_2012-13/overview/about_comcare#topofcontent)> [accessed 21 May 2014].

195 The Safety, Rehabilitation and Compensation Commission (SRCC) is a statutory body established under the *Safety, Rehabilitation and Compensation Act 1988* (SRC Act) and is responsible for the enforcement of Federal Laws relating to Asbestos. The SRCC has regulatory functions in relation to Comcare and other authorities which determine workers' compensation claims under the SRC Act. The SRCC has an oversight role under the WHS Act. Source: <[http://www.srcc.gov.au/about\\_the\\_srcc](http://www.srcc.gov.au/about_the_srcc)> [accessed 22 May 2014].

196 The exemptions for the Caribou and Hawk aircraft expired at the end of 2009. The F-111 was the only platform continuing to hold an exemption for asbestos throughout 2010.

- an unequivocal directive from the then Minister for Defence to remove asbestos from Defence by 31 December 2010<sup>197</sup>;
- the 'Report on Options to Accelerate the Remediation of Asbestos from Defence Equipment and Facilities' (Orme Review) (August 2008) which Defence prepared in response to the Minister's concerns; and
- a number of Comcare investigations of Defence including one into asbestos, launched in December 2008.

### **Contractor's report found asbestos being used without exemptions**

**5.12** In December 2007, Defence engaged a contractor to investigate and instigate removal of items containing asbestos from Defence's maritime inventory. The contractor, who was particularly critical of Defence's records, provided a final report in June 2008, confirming that 315 items contained asbestos and reporting that some 235 723 items 'might' contain asbestos, an estimate which Defence viewed as much greater in number than was likely. The contractor noted that Defence records indicated some exemptions held by Defence for certain items were no longer current. Further, the ban on the use of asbestos had come into effect on 31 December 2003, and Defence had issued several hundred confirmed asbestos items from its inventory to operational units in direct contravention of state and federal laws.

**5.13** The relationship between the contractor and Defence broke down. One of the contractor's reports was referred to in press articles in January 2009. Nevertheless, the contractor's reports provided a basis for further remediation work.

### **Defence Minister's directive to remove asbestos from Defence**

**5.14** In April 2008, the then Minister for Defence wrote to Defence's Director-General Occupational Health and Safety, stating:

I regard the continued usage by Defence personnel and contractors of equipment and facilities containing asbestos to be unacceptable ... I will not be considering supporting extensions to exemptions prohibiting the importation of equipment and parts containing asbestos beyond 2010 ...

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197 In June 2010, a Defence internal audit on progress in implementing the Minister's directive concluded that 'the eradication of [asbestos-containing material] from Defence inventory by 31 December 2010 will not be achieved'.

The continued exposure of people to asbestos is something that is no longer accepted by the Australian community, nor this Government, and I expect Defence to change its attitude to reflect this position.

**5.15** The Minister directed Defence to ‘produce an active strategy for ensuring that by no later than 2010 no Defence facilities or equipment contain asbestos.’ This raised concerns within Defence because of the capability and financial implications of meeting the deadline. In response, Defence proposed to provide the Minister a report scoping the extent of asbestos in Defence equipment and facilities, with the capability and cost implications of accelerated remediation. The Minister agreed and the review that ensued was known as the ‘Orme Review’.

### **The Orme Review**

**5.16** Defence completed the ‘Report on Options to Accelerate the Remediation of Asbestos from Defence Equipment and Facilities’ (Orme Review) in August 2008. As part of the review, the Defence Science and Technology Organisation (DSTO) provided advice on materials suitable for asbestos replacement in Defence equipment. It found that there was now ‘a wide range of commercially available materials as alternatives to asbestos-containing parts’ and ‘no apparent reason why satisfactory physical performance cannot be obtained from current alternatives to asbestos.’ Therefore, it concluded, ‘efforts must continue with prime contractors to identify suitable alternatives to asbestos-containing parts.’

**5.17** The Orme review found that Defence’s records of asbestos in inventory, platforms and the Defence estate were incomplete and that remediation was not practicable in the timetable the Minister had set. In December 2008, the Minister noted the Orme Review but did not agree to a recommendation that he reconsider his directive to remove all asbestos from Defence by 2010. In effect, this reaffirmed the Minister’s earlier directive.

**5.18** The Orme Review did not consider the implications of in situ asbestos in equipment and platforms for their eventual disposal.

### **Comcare investigation**

**5.19** On 21 November 2008, Defence wrote to the SRCC and Comcare. It informed them that reports from the contractor’s review (see paragraphs 5.12 to 5.13), would be released to a journalist in late November 2008 under the *Freedom of Information Act 1982*. The reports identified that asbestos items, not

covered by an exemption, had been inadvertently supplied to Navy units between 2004 and 2007. In December 2008, Comcare commenced an investigation into Defence's use of asbestos in Commonwealth workplaces to determine its compliance with occupational health and safety laws and regulations.<sup>198</sup>

**5.20** The July 2010 report of the Comcare investigation concluded that Defence had breached the *Occupational Health and Safety Act 1991* citing, among other things, significant deficiencies in implementing occupational health and safety systems at multiple Defence worksites in handling, storing and disposing of asbestos in the workplace.

**5.21** Comcare found that while Defence had policy guidance for managing asbestos parts, the policies were not being applied consistently. The report also concluded that 'It is beyond Defence to guarantee or confirm that all asbestos items, known and unknown, remaining in the Defence system ... are low risk.'

## Defence's governance arrangements for asbestos

**5.22** In light of the foregoing events and during the course of the Comcare investigation, in January 2009 the VCDF announced revised asbestos governance arrangements in Defence to 'ensure expedient implementation of the Minister's directions.'<sup>199</sup> The VCDF identified himself as the single point of authority and accountability across Defence and issued directives to the Service Chiefs, CEO DMO and Deputy Secretary Defence Support.

**5.23** Under the VCDF's directive, DMO was assigned portfolio responsibility for asbestos in inventory.<sup>200</sup> Consistent with the Orme review, the Director-General Defence Assets and Inventory Management (DGDAIM) was assigned to lead a Defence-wide 'tiger team' (the Asbestos Inventory Tiger Team, AITT) to accelerate remediation for items in inventory. The AITT's first priority was to 'establish a complete record of all accessible in situ asbestos.' A

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198 In December 2008, Comcare granted Defence exemptions for 123 mission-critical items, all held by DMO SPOs for RAAF platforms. Of these, six exemptions were granted for new items and 117 for items for which exemptions had previously been granted. All 123 exemptions ceased by 31 December 2009. By July 2010, Defence again held exemptions for 34 items, all of which applied to the F-111 aircraft. All of these exemptions ceased on 31 December 2010.

199 Defence, VCDF Minute (VCDF/OUT/2009/8), 'Revised Asbestos Governance Arrangements within Defence', 14 January 2009.

200 In December 2009, DMO issued a Departmental Procurement Policy Instruction to promulgate the VCDF's instruction and a statement that the relevant chapter of the Defence Procurement Policy Manual would be updated in due course.

similar record would be made for in situ asbestos that was not accessible. These records would then ‘inform eventual platform disposal decisions.’ The AITT later identified the impetus for its work as ‘the confluence of the need to accelerate the removal of asbestos items from Defence’s inventory and increased media and regulatory scrutiny of asbestos within Defence.’<sup>201</sup>

## The work of Defence’s Asbestos Inventory Tiger Team

**5.24** Early in its program of work, the AITT inspected 16 Defence worksites for asbestos (Navy, Army and Air Force) and found unaccounted for or unidentified asbestos components at each one. A notable example was where a gasket for an RAAF aircraft had been withdrawn from use by the manufacturer in 1993 because it contained asbestos. The manufacturer had issued a warning about the asbestos and had identified a suitable non-asbestos part. However, in the 16 years after the manufacturer’s advice until the AITT inspection in 2009, Defence had not removed the asbestos-containing item from inventory. During an inspection, the AITT detected the asbestos-containing item being installed in an airframe during monthly servicing.

**5.25** The AITT’s final report, completed in March 2011, noted that:

The number of ACM [*asbestos-containing material*] items remaining for disposal as at 31 March 2011 stands at 10 732 items all of which are in the disposal pipeline, and being processed for disposal. Of this total number 10 201 items relate to the F-111 and Caribou aircraft fleets which have been decommissioned. These items are subject to bulk disposal with the final Request for Tender due to close on 31 March 2011. It is anticipated that the subsequent disposal action will be completed by the end of 2011. Excluding F-111 and Caribou ACM items, there remains a small tail of some 531 identified ACM items which will require disposal by the existing Defence disposals organisation following closure of the AITT Project.<sup>202</sup>

**5.26** In light of the progress the AITT made, Comcare decided to close its investigation without further enforcement action against Defence, but with the intention of monitoring Defence’s asbestos control arrangements. The *DMO Bulletin* reported the AITT’s work as a ‘life-saving project’<sup>203</sup> which, to that

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201 Defence, Asbestos Inventory Tiger Team, Final Report, 31 March 2011, p. 2.

202 Defence, Asbestos Inventory Tiger Team, Final Report, 31 March 2011, p. 3.

203 Defence estimates that the cost of the inspection program was \$8.6 million. This does not include the costs incurred by the ADF Services and Defence Groups in supporting the inspection and eradication program or the cost of finding substitutes for and replacing asbestos in weapons systems.

time, had identified and removed more than 67 000 of the 76 500 asbestos-containing catalogued items in Defence's inventory as well as a substantial number of miscellaneous asbestos items:

Just over 10 700 items still need to be disposed of, 96 per cent of which are F-111 aircraft and Caribou aircraft parts and have disposal plans which will be actioned by the existing Defence Disposals Agency.<sup>204</sup>

**5.27** The report indicated that Defence expected that it would remove most of its remaining asbestos items through disposal of the Caribou and F-111 aircraft.

### **Directive on disposal of assets and inventory containing asbestos**

**5.28** During the work of the AITT, in October 2009, the VCDF also issued a directive on the disposal of assets and inventory containing asbestos. The DGDAIM, the branch head responsible for the AITT and Defence Disposals, had sought VCDF guidance and the directive was the response.

**5.29** The VCDF noted that Defence had received Australian Government Solicitor (AGS) legal advice that there were no laws in Australia that absolutely prohibited dealing in or disposing of goods containing asbestos. Nevertheless:

the potential to adversely impact the health of future users of these items and the resultant impact on Defence is significant. Accordingly, I have determined that those assets and inventory items that contain asbestos should only be disposed of by sale or gift if the asbestos contained within the item cannot be accessed by future users of the item, and as such does not pose a health risk to those future users.<sup>205</sup>

**5.30** The directive gave an illustrative example of an item with asbestos whose disposal by sale or gift was permissible and also an example whose disposal would be prohibited. An allowable disposal was the Leopard tank being made available to Returned and Services League (RSL) clubs and similar community bodies for display: 'The tanks are deemed to be safe as the asbestos is contained within the tank and the tank will be sealed and welded shut, preventing access to the asbestos.' In contrast, an item which could not be sold or gifted was the 10kVa generator then held for disposal. This was because 'the

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204 Defence, DMO Bulletin, April 2011, p. 10.

205 Defence, VCDF Minute (VCDF/OUT/2009/704), 'Defence Management Position on the Disposal of Assets and Inventory Containing Asbestos', 14 October 2009.



generator contains asbestos gaskets that can be accessed by future users and may become friable during any removal/replacement activity.’<sup>206</sup>

**5.31** Notably, where uncertainty existed, the directive required that DGDAIM ‘take a cautionary approach and must *not* dispose of by sale or gift.’<sup>207</sup> In April 2014, Defence’s VCDF Group confirmed to the ANAO that this directive had not changed nor had it been replaced.

## Case studies on management of asbestos in Defence SME disposals

**5.32** The audit examined five case studies to identify how Defence had, in practice, managed asbestos items in SME being disposed of in recent years:

- (1) Leopard tanks;
- (2) Caribou transport aircraft;
- (3) F-111 aircraft;
- (4) B Vehicles; and
- (5) Bell UH-1H Iroquois helicopters.

**5.33** Additionally, as an example of enduring consequences for Defence of disposal of SME containing hazardous substances, the audit briefly considered the current status of an item of SME, no longer in the possession of the Commonwealth, which is presenting a major asbestos hazard.

### Management of asbestos in the Leopard tank disposal

**5.34** Defence advised ministers in September 2005 that it was commencing the disposal of Defence’s Leopard 1 tank fleet. These 103 vehicles had been acquired in the 1970s and were being replaced by M1A1 Abrams tanks.<sup>208</sup>

**5.35** In July and September 2007, Defence advised the then Minister for Defence of the potential for the Leopard tanks to contain hazardous polyurethane paint, which (according to the advice) was toxic under specific

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<sup>206</sup> *ibid.*

<sup>207</sup> *ibid.*

<sup>208</sup> The Leopard tank fleet comprised 75 Leopard main battle tanks, 15 main battle tank dozers, eight armoured recovery vehicles medium, and five armoured vehicle launched bridges. Source: ANAO Audit Report No.1 2007–08, *Acquisition of the ABRAMS Main Battle Tank*, p. 11.



conditions, such as when the paint was heated or sanded.<sup>209</sup> Further, the ‘Leopard Disposal Plan Synopsis’ given to the Minister in September 2007 stated the Commonwealth’s duty of care in the disposal of vehicles and an obligation to remove hazardous substances from them. Where this was not reasonable, Defence would provide full disclosure to the end-user, identifying hazardous substances and residual risk. There was no mention of asbestos in any advice to the Minister at this time.

**5.36** In September 2007, the Minister for Defence issued a press release entitled ‘Get yourself a Leopard’ announcing that the Leopard tanks would soon be available for gifting to veteran and historical organisations. The press release invited interested organisations to register their interest. In November 2007, the Minister issued a further press release entitled ‘New Homes for Retired Tanks’ announcing a list of 30 successful applicant organisations.<sup>210</sup>

**5.37** When the disposal plan for the Leopard tanks had been fully developed and approved (February 2009), asbestos was identified as a hazardous substance requiring attention. However, the plan expressed a sanguine view:

Asbestos-free replacement parts were generally available from about 1990 and it is likely that any replacement since that time will have been with a non-asbestos part. The nature of these items is that they are contained within assemblies that will either be removed during decommissioning or are inaccessible without tools and maintenance equipment. Therefore it is considered that any remaining asbestos items pose no environmental hazard.<sup>211</sup>

**5.38** Defence’s intentions regarding asbestos in the Leopard tanks were reviewed after discussion between the DGDAIM and VCDF in June 2009. The VCDF stated that he preferred to be ‘conservative on this issue and therefore [I] favour removing the asbestos’. The Deputy Chief of Army subsequently took the view that ‘This is a case ... where a perfectly well-developed Disposal Plan needs now to be reviewed in light of asbestos implications.’ The estimated cost of removing asbestos was \$20 000 for each tank. This would amount to

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209 Later advice from DSTO indicated that this paint presented a risk only during spray application due to its isocyanate content, and that once cured, it was free of this substance and no more hazardous than other types of paint.

210 Minister for Defence, press release, ‘Get yourself a Leopard’, 14 September 2007 and ‘New Homes for Retired Tanks’, 13 November 2007. The second press release was issued during the campaign period for the 2007 federal election.

211 Defence, Leopard Tank Disposal Plan, February 2009, p. 5.

\$600 000 for the 30 tanks to be gifted to RSL clubs and a further \$540 000 for the 27 tanks intended for Defence displays.

**5.39** A brief prepared in August 2009 for Defence officers for a Senate committee hearing indicated that ‘Asbestos removal has become a major issue. To remove asbestos from all vehicles ... would incur a cost of \$1.5 million and add one year to the disposal schedule.’ However, funding for the Leopard tanks disposal had been allowed for within the project to replace them (Land 907), and this included sufficient funds to remove asbestos from all tanks if required. The following text box presents the AGS’s understanding, based on Defence advice, of where the asbestos lies in the Leopard tanks and its treatment.

#### Where the asbestos lies in the Leopard tanks

*When DMO sought legal advice on disposing of the Leopard tanks with asbestos components, the adviser summarised its understanding of the asbestos contents of the vehicles as follows:*

Defence proposes gifting leopard tanks to various RSL clubs.

The tanks will be decommissioned, and part of this will involve the removal of the power packs [*engines*] (which contain asbestos).

After decommissioning, the tanks will still contain asbestos in the exhaust wrapping and gasket seals. However:

- for tanks which are gifted to a museum for display, the asbestos wrapping on the exhaust will be removed. All other asbestos is integrated in, or as a part of, an intact functioning element of the tank and does not exist in the form of airborne particles, e.g., the asbestos in the gaskets is actually mixed in the gasket itself and so long as the gasket remains intact the asbestos cannot become fibrous; and
- the tank hull in which both the gaskets and wrapping will be contained is metal, is five inches thick, and will be welded shut when being gifted to RSL Clubs. It will be impossible to enter the hull without heavy machinery, and therefore it will be very difficult for people to have contact with the gaskets or wrapping, or for any fibre or particle (should it develop) to escape the tank.

Source: AGS advice to DMO, ‘The gifting or sale of Defence materiel containing asbestos or other hazardous substances’, 16 November 2009.

**5.40** Defence briefed its ministers in August 2009, noting that ‘the principal issue relates to the extent of asbestos removal required and the extent of the associated Defence costs for a capability that is no longer sustained.’ This wording suggests concern at devoting resources to remediating equipment

that was no longer needed. Defence undertook to recommend specific disposal action once all issues had been finalised.

**5.41** The Minister for Defence Personnel, Materiel and Science sought prompt further advice on the asbestos strategy and directed that ‘Tanks should only be gifted if there is absolute confidence of the containment [*of asbestos*], otherwise the wrapping products in particular should be safely removed.’<sup>212</sup> On receipt of that further advice, the Minister directed that the ‘asbestos strategy must be finalised before decommissioning.’<sup>213</sup>

**5.42** By the time the Minister for Defence Personnel, Materiel and Science approved the completed strategy in March 2010, the VCDF had issued the directive referred to earlier (see paragraphs 5.28 and 5.29). The ministerial submission referred to—and quoted—that directive, which specifically described the Leopard tanks as safe and to be an allowable disposal because the remaining asbestos lay in areas welded shut and inaccessible.

**5.43** The ministerial submission also contained a table indicating the proposed approach to managing the asbestos content according to the intended future use of the tanks. Thus, for example, vehicles to be used for Defence displays or gifted to RSL clubs would be welded shut; vehicles to be used as range targets by Defence would have all asbestos removed. However, VCDF queried the proposed approach for the 16 vehicles allocated to the Army History Unit (AHU) and for use as training aids, where the vehicle interior would be accessible and asbestos was to be ‘managed in accordance with Defence Instructions’. Defence Disposals subsequently advised the VCDF that ‘Whilst originally intended to be managed as in situ, all [*asbestos-containing material*] will now be removed. Note also, that the AHU are intending to appeal to CA re the decision not to give them operable tanks.’ In the event, the AHU was provided with 13 Leopard tanks. At the direction of Army headquarters, these were provided ‘in operational condition’, and the asbestos was not removed.

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212 Defence, Ministerial Submission, ‘Disposal of Leopard Tanks Background Brief & Options for Asbestos Management’, 31 July 2009. The reference to ‘wrapping products’ was to asbestos contained within wrapping around exhaust manifolds and similar items that emit heat.

213 Defence, Ministerial Submission, Supplementary advice on disposal of Leopard Tanks—Asbestos Strategy’, 14 September 2009.

## *Warnings to recipients and users about asbestos*

**5.44** As mentioned earlier, in 2009, DMO sought legal advice on 'The gifting or sale of Defence materiel containing asbestos or other hazardous substances', which encompassed the Leopard Tanks. Among other things, it was advised:

Regardless of the approach taken by Defence, we recommend that Defence ensure that as much information as possible is provided to the recipient in the deed of gift in relation to the asbestos or other hazardous materials contained in ... any gifted or sold item. Further, ... it would also be prudent for Defence to affix a warning about the asbestos to any items it gifted or sold.<sup>214</sup>

**5.45** The deed of gift for the Leopard tanks includes the following:

9.3 The RSL acknowledges the possible presence of asbestos in the Leopard Tanks and agrees that in the Leopard Tank's delivered form, the asbestos is contained in such a manner so as not to present a danger or risk to the health of the public. The RSL acknowledges and agrees that any deterioration or damage to the Leopard Tanks may expose an asbestos hazard to the public.

9.4 The responsibility and risk of ensuring that the public is not exposed to an asbestos hazard lies with the RSL from Delivery.<sup>215</sup>

**5.46** It is not known how the services clubs formed a view that any asbestos in the tanks is safely contained and to what extent they may have relied on Defence's assurances about that. However, oral advice from Defence is that: 'as the tanks were welded shut and any asbestos-containing material (ACM) parts are inaccessible ... it was deemed not necessary to detail the ACM components to the recipient organisations.' This is not consistent with the recommendation in the legal advice Defence received, relating to the provision of as much information as possible (see paragraph 5.44).

**5.47** Defence also advised the Minister that:

as a part of the Asbestos Notification and Mitigation Plan to be developed and issued with each vehicle, all vehicles, other than vehicles allocated as range targets, will be fitted with appropriate notification plates identifying in writing that asbestos is contained within the vehicle.<sup>216</sup>

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214 AGS advice, 16 November 2009, paragraph. 10.29.

215 This is quoted from the copy of the deed used for gifting the tanks to the RSL New South Wales Branch. Defence stated that all the gifted Leopard tanks were provided under very similar terms.

216 Department of Defence, Ministerial Submission, 'Disposal of Leopard Tanks Background Brief & Options for Asbestos Management', August 2009.

**5.48** The ANAO found, upon inspection, that the notification plate on a Leopard tank gifted to a services club does not mention asbestos, instead indicating that ‘components within this vehicle may contain hazardous substances’ (Figure 5.1). This is contrary to Defence’s undertaking to the Minister and inconsistent with the recommendation in the legal advice (see paragraph 5.44). It is also inconsistent with Defence’s selection of suitable signs for equipment containing asbestos remaining on its own premises.<sup>217</sup>

**Figure 5.1: Hazardous substances sign on Leopard tank**



Source: ANAO. The warning sign on the Leopard Tank, Canberra Services Club, Manuka, ACT, June 2014.

**5.49** The sign on the Leopard tank refers the reader to a data pack ‘provided with this vehicle’ for further information. However, Defence advised the ANAO that it supplied no data pack to the RSL clubs that received a Leopard tank.

**5.50** Defence received further legal advice in 2014 relating to an asbestos hazard in former Defence equipment gifted to a community group. This legal advice put the view that Defence’s potential liability for damage incurred because of the asbestos would be significantly reduced to the extent that records could be located which demonstrate that Defence did inform the recipient of the equipment.

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<sup>217</sup> Defence informed the ANAO that the Caribou heritage aircraft on Defence premises are affixed with highly visible ‘Contains Asbestos’ warning signs.

## Management of asbestos in the Caribou aircraft disposal

### *Withdrawal of the Caribou aircraft*

**5.51** As mentioned in the case study on the disposal of the Caribou aircraft (see paragraph 4.5), a January 2008 brief advised the CAF that Caribou availability was satisfactory but there was doubt about ‘future Caribou viability’ due to asbestos within the aircraft. When the then Minister for Defence announced the earlier-than-planned retirement of the Caribou aircraft on 19 February 2009, he cited asbestos, corrosion, fatigue, and obsolescence as reasons.

### *Identifying and replacing the asbestos in the Caribou aircraft*

**5.52** As part of Defence’s work to remove asbestos from its inventory and equipment, DMO’s Air Lift Systems Program Office (ALSPO) had replaced some of the Caribou’s asbestos-containing items. In January 2009, the DMO’s Head of Human Resources and Corporate Services assured the VCDF that DMO was replacing all asbestos parts with non-asbestos alternatives. In February 2009, while the Minister’s announcement of the early retirement of the Caribou was being drafted, the Director-General Airlift Training and Systems stated that Caribou asbestos remediation would continue regardless of any decision to retire the aircraft early, as Defence had an obligation to fix the asbestos issue before the aircraft were placed on the second hand market.

**5.53** Notwithstanding this assurance, Defence discontinued asbestos remediation on the Caribou aircraft. The Director-General Aerospace Materiel Management stated that ALSPO ceased work because ‘the cost ... no longer presents a valid business case’ given the approaching planned withdrawal date of December 2009.<sup>218</sup>

**5.54** ALSPO decided not to remove in situ asbestos from the aircraft. It also decided not to remove asbestos parts fitted to the aircraft. While Defence held exemptions for those parts, it had non-asbestos alternatives available and had intended to replace the parts only when they needed to be disturbed for maintenance. ALSPO anticipated that by the time the platform was retired at the end of 2009, it would still have on hand about 40 asbestos items, mainly

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218 This is based on advice to DGDAIM, 25 and 26 May 2009. In 2008, Naval Aviation Systems Program Office (NASPO) took a similar view arguing that, given the ‘Sea King [helicopter] will be progressively replaced by MRH90 from 2010 until its final planned withdrawal in 2012, NASPO does not consider an asbestos removal program for the Gnome engine/Sea King fleet to represent value for money.’



spare engines and engine components, with a larger number of in situ asbestos items still fitted to the fleet.

**5.55** In October 2009, internal advice to the DGDAIM stated that removing the asbestos from the Caribou engines would make them totally unviable (except for scrap). This would prevent Defence from selling the aircraft as operational. Further, as Defence no longer had a contract to maintain the engines, it would now cost in the vicinity of \$5 million to replace the asbestos in the engines.

*Approval of Caribou disposal strategy*

**5.56** In December 2009, the then Minister for Defence Personnel, Materiel and Science approved Defence's disposal strategy for the Caribou aircraft (see paragraph 4.11). In proposing the strategy to the Minister, Defence stated unequivocally that the Caribou airframe contains in situ asbestos and that the aircraft also has a number of replaceable parts that contain asbestos. Defence also advised the Minister that the estimated cost to remove the known and suspected asbestos within the Caribou aircraft, and to design and install replacement panels and sections, was more than \$500 000 per aircraft.

**5.57** The advice to the Minister did not mention the October 2009 VCDF direction effectively banning the disposal of items containing asbestos through gifting or sale where the asbestos could be accessed by future users of the item (see paragraphs 5.28 and 5.29). Given the aircraft were proposed for sale as going concerns and maintaining some of the aircraft in flying condition was a condition of sale, there was a strong possibility of future users accessing the asbestos-containing items to maintain the aircraft.

**5.58** Defence also informed the Minister that in situ asbestos would either be removed at the sole expense of the proposed recipients or safely contained so that it would not present a hazard to users. For its part, Defence did not remove the in situ asbestos nor safely contain it before disposal commenced.

*Request-for-Tender did not directly disclose the presence of asbestos*

**5.59** Legal advice obtained by Defence on the Caribou disposal included the following statement in relation to the asbestos content of the aircraft:

We note that based on the Disposal Strategy, it appears that Defence's intention is to ensure that the successful tenderer(s) assume all responsibility for the removal/containment of asbestos and other hazardous substances subsisting in the Assets. To effectively transfer this compliance burden, Defence will need to carefully assess, and make available to tenderers, all

information relevant to asbestos and other hazardous materials subsisting in the Assets. This may require providing tenderers with access to information/data (such as Materiel Data Sheets) as well as the ability to physically inspect the Assets to determine the extent of any compliance burden that they will be assuming.

**5.60** On 28 October 2010, Defence Disposals released an RFT for the sale of the aircraft, spares packages, spare engines and other items. This included two aircraft to be made available only to heritage organisations. Even though Defence was aware of the prevalence of asbestos in the Caribou aircraft, the high cost of removing it and the legal advice on notification to tenderers, neither the body of the RFT nor the accompanying draft contract specifically mentioned asbestos.

**5.61** The RFT did state that the assets ‘may contain hazardous substances’. It referred tenderers to hazardous substances information at ‘Attachment A, Appendix 9 which [was] provided for information purposes only’. This document was a copy of a chapter from what was, at the time, Defence’s manual about aircraft accident safety.<sup>219</sup> The normal purpose of this manual is to give Defence personnel general information necessary to provide a safe and healthy workplace at an aircraft accident site. However, it does list hazardous substances, including asbestos-containing items within each aircraft type, including the Caribou.

**5.62** Under the terms of the draft contract of sale, Defence was to provide tenderers with a hazardous substances register before the ‘effective date’ (the date the contract is signed). However, the wording in the draft contract of sale cast doubt on the value of any such register provided by Defence. The purchaser was to acknowledge that any information about the aircraft provided by Defence before contract signature, including the presence of hazardous substances, could not be relied upon because:

the Commonwealth has not made and does not make any representation, warranty or commitment that the description of the Asset (or any other information) communicated or provided to the Purchaser prior to the Effective Date was or is accurate, current, complete or fit for any purpose; ...

the Commonwealth does not represent, warrant or commit that any information communicated or provided by virtue of or in connection with the

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219 SAFETYMAN, volume 3, Defence Aviation Safety Manual, Part 2, Aircraft Accident OHS Manual, Chapter 4 – Caribou, May 2005.



Asset, its sale or this Contract was prepared by the Commonwealth with any due care, skill or diligence.

**5.63** While these contract provisions were designed to protect the Commonwealth, they do not reflect the substance of the proposed transaction, involving a wholly Commonwealth-owned and operated asset. In circumstances where it was clear that the equipment contained asbestos, this should have been explicitly referenced as a material fact about a Defence asset. There would be benefit in Defence reviewing the use of such contract provisions.

**5.64** In the event, Defence is still in possession of the seven Caribou aircraft that Defence sought to sell as going concerns (see paragraphs 4.11 and 4.15) and the funds received for their purchase of those aircraft (see paragraph 4.43).<sup>220</sup> In October 2014, Defence informed the ANAO that the asbestos remains in the Caribou aircraft.

## **Management of asbestos in the disposal of the F-111s**

**5.65** On 6 March 2007, the then Minister for Defence announced that the RAAF's fleet of F-111 aircraft would be retired from service. The bulk of the fleet, comprising F/RF-111C aircraft, underwent a staggered withdrawal through to the planned withdrawal date of December 2010. The F-111G fleet, acquired in the 1990s to help sustain the existing aircraft, was retired on 3 September 2007. The following text box discusses the make-up and disposal of the F-111 aircraft fleet.

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<sup>220</sup> Defence is no longer in possession of the two aircraft sold to the Historical Aircraft Restoration Society in May 2011 (see paragraph 4.15).

## The RAAF F-111 aircraft fleet

The RAAF F-111 supersonic long-range strike aircraft entered service in 1973, when the first four F-111C aircraft were based at the RAAF Base Amberley, Queensland. To begin with, 24 aircraft were acquired, supplemented by a further four F-111A aircraft for attrition replacement (these four were modified to match the F-111C). Over the years, the RAAF lost seven F-111C aircraft in flying accidents. Of the remaining 21 aircraft, 17 were modified with Pave Tack capability (a targeting system for precision-guided weapons) and four converted into the RF-111C reconnaissance variant.

In 1994, Defence acquired 15 F-111G aircraft to supplement the fleet and extend its operating life. Eight were brought up to RAAF airworthiness standards. The remaining seven never again took flight. Five were placed in long-term storage and two were designated to provide spares. However, in practice, all were 'cannibalised' for spares. One F-111G was lost in a flying accident in 1999.

Defence prepared separate disposal plans for each of the two types of aircraft. Those plans mention hazardous substances within the aircraft but do not specifically mention asbestos.<sup>221</sup> In August 2008, the then Minister approved the disposal of the F-111G fleet by destruction. However, actual destruction was delayed until some of the F-111C aircraft were also destroyed. Defence attributed the delay partly to the presence of hazardous substances throughout the aircraft.

Ultimately, the ubiquity of asbestos-containing items in the aircraft had a major bearing on their disposal. Twenty-three aircraft and 128 engines were disposed of by destruction. Six aircraft, five crew modules and five engines were retained and transferred to RAAF bases. Six de-militarised aircraft were retained and loaned to Australian historical organisations for display. One demilitarised aircraft was gifted to the US Pacific Aviation Museum, Pearl Harbour, Hawaii.

Primary sources: Defence, Disposal Plan F-111G Aircraft, August 2008; F/RF-111C Weapon System Disposal Plan, April 2009; DMO, Final Disposition: F-111 Items and Components, 4 November 2013.

**5.66** Defence mentioned asbestos as an aspect of F-111 disposal in a ministerial submission in May 2010, which proposed a disposal strategy for the F-111C aircraft. The then Minister for Defence noted Defence's estimated cost of up to \$2.5 million to 'demilitarise and remediate each aircraft for potential use as an exhibit by non-Defence entities'.<sup>222</sup> He approved a strategy of

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221 The 'F-111 Public Display Risk Assessment Final Report', March 2012, p. 23, identifies asbestos, beryllium, boron fibres, chromates, lead, zinc and low level radioactive materials as the hazardous materials that 'may exist' within the display. It rated asbestos as the most common potentially hazardous substance in the aircraft.

222 Subsequent Defence records indicate that this estimate was developed without a full understanding of the extensive presence of asbestos in the aircraft.

retaining one F-111C aircraft at RAAF Museum, Point Cook, and up to six more within Defence for display, training and test, with hazardous substances to be managed by Defence. The Minister also approved a strategy of sale by tender of the remaining aircraft and equipment provided they could be demilitarised and asbestos could be safely removed, and prospective recipients would pay for this. Those items that could not be sold would be scrapped or recycled.

**5.67** The Minister was also advised that asbestos removal could prove prohibitively costly for most interested entities.<sup>223</sup> Defence mentioned its legal advice that aircraft containing asbestos could legally be sold in Australia. Nevertheless, Defence was observing a higher standard of treatment than required by law and any accessible asbestos would be removed as hazardous waste and not sold or gifted (it cited the VCDF's directive (see paragraphs 5.28 and 5.29). Defence also advised the Minister that there may be some public concern over Defence placing asbestos-containing items such as the F-111 aircraft into the public domain, even if only for display.

**5.68** About a year later, in March 2011, Defence advised the Minister for Defence Materiel that a recent technical assessment had shown that asbestos could not be removed from the F-111 aircraft (see the following text box, 'Asbestos in the F-111 aircraft'). Therefore, Defence stated, for safety reasons it did not intend to make them available to non-Defence organisations.

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<sup>223</sup> In 2009, there had been about 11 ministerial representations making enquiries about or asking for F-111 aircraft for display.

## Asbestos in the F-111 aircraft

Testing during 2010 confirmed the presence of asbestos (white chrysotile) within adhesive used in the [*the F-111*] aircraft structure and bonded panels.

The adhesive was used within the F-111 as an adhesive or potting compound during the manufacture and/or repair of bonded panels and aircraft structure [and] as a liquid shim to align panels and aircraft structure during assembly. The adhesive is present in removable bonded panels and flight control surfaces [and] fixed bonded structural components

There are 200 to 300 individual bonded panels in the aircraft ... The F-111 includes heavy use of bonded panel structures in its design. Not all panels are removable. While not every bonded panel will contain asbestos as a result of either manufacture or repair, there is no record through design, manufacture or repair data that can be used to verify the asbestos status of an individual panel ... Therefore it must be assumed that all panels/liquid shim applications potentially contain asbestos.

It is not practical to remove all asbestos from an F-111 and certify the aircraft as asbestos free. This is due to potential presence of asbestos-containing adhesive within all bonded panels and primary structure of the aircraft.

Advice of \$1 million to demilitarise an aircraft and up to \$1.5 million to remove and remediate asbestos was developed prior to having an understanding of the true extent and nature of asbestos-containing adhesive within the aircraft ... The large number of bonded panels (removable and non-removable) and primary non-removable structure that may contain asbestos, the semi-destructive nature of any testing regime, and the significant effort to manufacture replacement panels makes it an utterly impracticable undertaking within currently available Defence and Defence industry capability and capacity. An F-111 aircraft can only practicably be preserved on the basis that it still contains in situ asbestos.

Source: Abbreviated from advice provided by the Manager, F-111 Disposal Project to the acting Head of Acquisition Sustainment and Reform Division, DMO, 9 March 2011.

**5.69** Defence records indicate that ministers were concerned at the potential for perceived inequity between, on the one hand, Defence being able to display the aircraft but, on the other, museums external to Defence not being able to do so. The Minister for Defence Materiel directed that options be provided to inform a decision. A range of options was prepared:

- (1) not making the aircraft available outside Defence (which remained Defence's preferred position);
- (2) sale to non-Defence entities with the recipient paying for demilitarisation and preparation;
- (3) gifting to non-Defence entities with the Commonwealth paying for demilitarisation and preparation; and

- (4) loaning to non-Defence entities with the Commonwealth paying for demilitarisation and preparation.

**5.70** The fourth option, Defence advised, would require a regime of compliance, assessment and monitoring estimated to cost up to \$100 000 a year, for which no specific funds had been provided. Maintenance of the aircraft would cost a further \$100 000 a year, which was also not specifically funded.

**5.71** On 31 May 2011, the Minister for Defence Materiel selected the fourth option, with up to eight F-111 aircraft to be made available to non-Defence entities. The Minister also sought more detailed advice on how the option would be implemented and asbestos managed. Defence set about preparing a strategy and risk assessment for the display of the aircraft and also, in particular, a risk assessment for placing them in non-Defence sites.

**5.72** In August 2011, Defence advised the Minister for Defence Materiel of its set of mandatory requirements for aircraft display, including housing the aircraft in a completely enclosed facility, restrictions on public access, and the recipient accepting Commonwealth auditing and reporting requirements. The Minister subsequently issued a press release, announcing that up to seven F-111 aircraft would be available to aircraft museums and other historical organisations.<sup>224</sup>

*Asbestos becomes the major concern in organising F-111 display*

**5.73** An answer provided by the Minister to a Parliamentary question in August 2011 nominated 'finding a way to deal effectively with the asbestos on the aircraft' as an essential step in making them available to museums. Defence Disposals, in its monthly report to the CEO DMO mentioned that the tender for obtaining an F-111 for display was shortly to be issued and identified asbestos as a risk:

One risk area for Defence's reputation will be asbestos, in that we are placing these aircraft into the community with asbestos pervasive throughout the aircraft. Background is that Defence advised against placing aircraft outside Defence but Government decided on the current process. Response to any adverse public or media comment will need to focus on the controls etc that

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<sup>224</sup> The Minister for Defence Materiel also directed that costs incurred in transporting the aircraft to the recipients' sites (then estimated at about \$600 000) be incurred by Defence. Defence advised the Minister that this had not been budgeted for.

we are putting in place to ensure that the aircraft do not present a risk to the public.

**5.74** A further press release in November 2011 announced the release of the request-for-offer (RFO) to potential hosts of the aircraft to be loaned. By September 2012, an evaluation of RFO responses was complete and the Minister announced six successful organisations. One aircraft remained. The Minister subsequently agreed to a proposal from Defence to gift the final aircraft to the Pacific Aviation Museum, Hawaii. It was delivered in 2013.<sup>225</sup>

**5.75** A 53-page, *F-111 Public Display Risk Assessment Final Report* was completed by contractors in March 2012. It set out detailed asset recording, reporting, monitoring and auditing requirements to manage the asbestos risk. Defence informed the ANAO that the report cost \$410 624.

**5.76** There are six F-111C airframes and three F-111C crew escape modules on loan and on display at nine Australian historical organisations (AHOs) around the country. Most of the aircraft were delivered between April and August 2013. Defence stated (March 2014) that the annual audit/review for the F-111 display items at AHOs had not yet started. It had budgeted \$15 000 for one visit to each location next financial year. A small number of Defence staff have duties involving management of the F-111 loan agreements and refurbishing and repairing the static display fleet under Air Force Heritage control. The performance of the AHOs in displaying their F-111 (or crew escape module) is to be assessed against the loan agreement criteria, including:

- safety management;
- security management;
- environmental management;
- the approved display management plan;
- visitor numbers; and
- financial performance of the museum.

**5.77** Defence did not provide an estimate of staff costs to manage the F-111 loan agreements and refurbish and repair the static display fleet. The extent of

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225 The 'Asset Gift Agreement' for this arrangement provided extensive detail of the hazardous substances in the aircraft and their management.

these costs, and the performance of the custodian organisations, may not be apparent until some experience has been gained.

*The possibility of injury relating to F-111 asbestos exposure*

5.78 Following the Minister's announcement of the loan arrangements, a senior ADF member (a former F-111 pilot) expressed concern to DMO senior management at the prospect of claims for compensation relating to asbestos exposure. This was based on the possibility of heightened sensitivity to such hazards following the deseal/reseal experience with the F-111 aircraft.<sup>226</sup>

5.79 Defence informed the ANAO in June 2014, that it held 'limited useful information' on claims for compensation attributed to asbestos exposure. Defence was aware of only one record of an RAAF member who submitted a compensation claim for exposure to asbestos, but the claim was denied by the Department of Veterans' Affairs (DVA). Defence does not know the member's work history and, therefore, cannot say whether it was connected with the F-111 aircraft.

5.80 Comcare has no arrangements for access to ADF compensation claims as they are processed by DVA. Comcare has stated that 'this is an anomaly in the Comcare scheme.'<sup>227</sup> However, Comcare did state in its report on its investigation of Defence that 'there have been a large number of incidents and near misses involving hazardous substances.'<sup>228</sup>

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226 From 1997 to 2000 Defence conducted various deseal/reseal programs to remediate deteriorating sealant in the fuel tanks of its F-111 aircraft. Specifically, this involved removing the sealant (deseal) and replacing it (reseal). Concerns over the adverse health effects experienced by F-111 fuel tank maintenance workers and their families gave rise to a range of inquiries and support measures by the Australian Government. A 2001 Defence Board of Inquiry found that more than 400 people had suffered long-term damage to their health as a result of exposure to hazardous substances while undertaking the repair work. The number of workers potentially affected by exposure to hazardous substances from the deseal/reseal programs has since risen to an estimated 3100. The Joint Standing Committee on Defence, Foreign Affairs and Trade conducted an inquiry, and tabled its report *Sealing A Just Outcome: Report from the Inquiry into RAAF F-111 deseal/reseal workers and their families* in June 2009. ANAO Performance Audit Report No.46, 2012–13, *Compensating F-111 Fuel Tank Workers* examined the Department of Veterans' Affairs and Defence's administration of the Australian Government's \$55 million support package announced in the May 2010 Budget.

227 Comcare, Report of Investigation to assess compliance with the *Occupational Health and Safety Act 1991* and Part 6 of the *Occupational Health and Safety (Safety Standards) Regulations 1994*, (Report No. 4143), January 2010, p. 5.

228 Over the 22 month period, January 2007 to November 2008, Defence made 580 notifications to Comcare concerning hazardous substances. These comprised no deaths, three cases of incapacity, 26 cases of serious and permanent incapacity and 551 dangerous occurrences. These last instances are interpreted by Comcare as 'near misses'.

## **Management of asbestos in the disposal of the Army B vehicle fleet**

**5.81** As discussed earlier (see paragraph 4.109), Defence is disposing of about 12 000 B Vehicles between 2011 to 2020 because the fleet is old and increasingly costly to maintain, repair and operate.

**5.82** In 2008, DMO's Head of Land Systems Division had advised the Orme Review that the only way to create a definitive list of asbestos in all its platforms would be to disassemble at least one of every vehicle type it managed. Further, the level of identification and remediation effort implied would require in excess of \$200 million and 2.2 million hours of effort.

**5.83** In May 2009, as part of Defence's efforts to identify and then dispose of asbestos items from Defence stockholdings, the AITT identified a number of B Vehicle parts that contained asbestos, including parts previously assumed to be asbestos free. The inspections also identified that some suppliers of B Vehicle repair parts were inadvertently supplying asbestos parts by repackaging them into repair kits that were subsequently assumed to be asbestos-free. Defence noted the potential ramifications were 'quite serious'.<sup>229</sup>

**5.84** In July 2009, the Project Director of the AITT (see paragraphs 5.23 and 5.24) explained why he was advocating a conservative approach to testing for asbestos in the B Vehicles and their repair parts:

The problem the teams are having on the ground is that they cannot identify one way or the other, especially when the part is in its supplied packaging and it still fails to clearly indicate asbestos free. Brakes, as you know, are a friction item and have a nasty dust hazard that can be inhaled. These cannot be left to chance so we have been, and will continue to need to test, suspect items.<sup>230</sup>

**5.85** Compounding the problem of recontamination of the spares chain was the identification of the parts in Defence's inventory system as 'asbestos-free'. Defence could not rely on its inventory system because the inspectors were finding that such items could still contain asbestos:

Unfortunately, as this is a very emotive environment and unless we have positive proof to the contrary, every suspect item must be treated with caution and the AITT will have to make a decision to send for testing or collect for

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229 Defence internal correspondence, May 2009.

230 The explanation was in response to a view expressed by a senior ADF officer in Land Systems Division (the DMO division within Defence responsible for the sustainment of the B Vehicles) that there had been an overreaction to the discovery of asbestos in the B Vehicle fleet and spares inventory.



disposal. This is especially so with brake shoes that have a long history of containing asbestos. We have already had a number of instances where caution wasn't applied and the next action is staff filling in [*incident forms*] and [*Defence units*] calling in commercial decontamination firms.<sup>231</sup>

### *Commencement of planning for the B Vehicle disposal*

**5.86** When, by mid-2010, Defence had started planning to dispose of its B Vehicle fleet, one option was to sell them, which would not only reduce sustainment costs but could generate revenue, which Defence might be able to access. A complicating factor was the presence of asbestos and VCDF's direction of October 2009 not to dispose of assets or inventory containing accessible asbestos by gifting or sale. Defence's disposal directives for the B Vehicles clearly identify a recorded in situ asbestos risk for nearly all B Vehicles other than motorcycles and small trailers.

**5.87** Before entering into the disposal arrangement, Defence Disposals understood that some of the B Vehicles fleet contained asbestos in, for example, brake linings, engine, gearbox and differential, and possibly in the exhaust and engine firewall. This was known within Defence in 2008 and possibly earlier. Defence had estimated that the asbestos remediation cost could greatly reduce the net revenue from sales.<sup>232</sup> Defence Disposals developed an option in which the B Vehicles would be 'tendered for sale to companies that can demonstrate the capacity and intention to remediate accessible asbestos, such as in the brake linings.'

**5.88** On 30 August 2010, the Head of Land Systems Division and the branch head of Defence Disposals<sup>233</sup> met to discuss a strategy to sell the B Vehicles. They agreed that proceeding along the lines proposed by Defence Disposals 'could be done in compliance with the intent of the VCDF's directive'. Defence saw this approach as a way of generating revenue and transferring its risk. In light of this agreement, work began on a submission setting out the disposal strategy for ministerial approval.

**5.89** In October 2010, DMO's Head of Acquisition and Sustainment Reform Division (HASRD) obtained agreement from Defence's CFO that any revenue

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231 Defence internal correspondence, July 2009.

232 Defence's LAND 121 project, which was providing replacement vehicles, recorded a risk that asbestos remediation costs for the B Vehicles could be up to \$200 million.

233 The branch head of Defence Disposals was acting Head of Acquisition and Sustainment Reform Division (HASRD) at the time.

from the proposed sale of the B Vehicle fleet could be retained by the department rather than returning the funds to the Commonwealth.<sup>234</sup> Within Defence it was agreed that the proceeds would be retained by Army. Army therefore had a more direct interest in selling the B Vehicles for the maximum revenue obtainable.

**5.90** The tension between observing the VCDF's direction and the desire to generate revenue caused reluctance, in some areas of Defence, to follow the proposed strategy. Defence Disposals staff lamented they had been 'unable to convince [*Land Systems Division staff*] to look beyond the "cautionary approach"' given the widespread locations in the vehicles where asbestos could lie:

In this case, some officers within [*Land Systems Division*] are, perhaps understandably, reluctant to follow an interpretation of the VCDF policy, for fear that this might alternatively be viewed as failing to follow (VCDF) direction.

The VCDF direction ... from 2009 is quite clear in setting out the Defence requirement to maintain a standard above that which is dictated in law. [*Defence Disposals*] have set about implementing and extrapolating this policy for various scenarios and equipment types that contain asbestos, as well as hazardous materials in general. While most of this advice has been accepted, some elements within DMO and Defence have been reluctant to use it as authoritative interpretations of the VCDF policy.

**5.91** Staff in Defence Disposals and Land Systems Division developed an expectation that Defence Disposals would seek a waiver or exemption from the VCDF to allow the vehicles to be sold. HASRD arranged a meeting with the VCDF 'to discuss his tolerance on the asbestos issue'. That meeting took place on 7 March 2011, and afterwards HASRD stated on several occasions that the VCDF was 'still of the view that no asbestos goes out into the community.' These statements reinforced the VCDF's original position.<sup>235</sup>

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234 The CFO concluded that 'the amounts received in relation to the disposal of B Vehicles and trailers could be identified as relevant agency receipts for the purpose of FMA Regulation 15, and therefore treated as s. 31 receipts' because each vehicle was considered by Defence to meet the definition of a 'minor departmental asset' with a purchase price less than \$10 million and therefore the revenue from any sale of the vehicles could be retained by Defence.

235 A week later, when the Director of Defence Disposals stated in an email that the 'intention is to tender the [B] vehicles for sale to organisations that can remediate accessible asbestos (e.g. brake linings) prior to on-selling in Australia or to export', the acting HASRD responded: 'One point—VCDF requirement is to remediate all asbestos ...'.

*Disposal strategy and assurances provided to the Minister on asbestos*

**5.92** On 21 June 2011, the then Minister for Defence Materiel approved Defence's recommended strategy for the disposal of approximately 12 000 Army B Vehicles over 10 years (2011–20), through:

sale of the vehicles to companies or entities that can demonstrate the capacity and intention to remediate any accessible asbestos (such as in gaskets and brake linings) as part of a process to repair and upgrade the vehicles, prior to their on-selling them in Australia or overseas.<sup>236</sup>

**5.93** In support of this recommendation, Defence advised the Minister that this approach would allow:

a holistic approach to marketing the capability represented in the vehicles, and would appear to offer the greatest opportunity for value creation, while at the same time meeting the spirit and intent reflected in the Enforceable Undertaking to Comcare of 4 June 2010, which requires Defence to not only meet but exceed the requirements of the *Occupational Health and Safety Act 1991*.<sup>237</sup>

**5.94** Defence had earlier advised the Minister in May 2011 that while an alternative disposal option was the sale of vehicles by auction, this option was not recommended, as it would 'not meet with the spirit and intent of the [Comcare] Enforceable Undertaking' unless the asbestos in the vehicles was removed before sale. Defence advised the Minister that:

Where the vehicles do contain asbestos, this is considered by Defence to be in situ and in compliance with the Occupational Health and Safety (Safety Standards) Regulations of 1994.<sup>238</sup> While most vehicles (95 per cent) are assessed by Defence to be asbestos free, the assessment of each vehicle in order to determine the existence or otherwise of asbestos would be costly and in any case may not be determined without their being dismantled.

The cost of doing so could reduce their value to that of parts and scrap.

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236 Defence, Ministerial Submission, Disposal Strategy for Surplus Army B Vehicles, 25 May 2011.

237 Defence, Ministerial Submission, Disposal Strategy for Surplus Army B Vehicles, 25 May 2011.

238 ANAO comment: 'In situ' asbestos is defined in Regulation 6.3 of the Occupational Health and Safety (Safety Standards) Regulations 1994 as being asbestos that was already installed at 31 December 2003 and 'fixed or installed in a way that does not constitute a risk to users until the asbestos contained in the product is disturbed'. Discussions within Defence in 2009 had determined that items such as brake linings would not meet the legislative requirements of 'in situ' as they are not safely contained in a way that does not present a hazard to users.

Vehicles may contain in situ asbestos, in ... brake linings, in the engine (in such as gaskets), gearbox and differential and possibly in other parts of the vehicles, notwithstanding that 95 [*per cent*] of vehicles are assessed by Defence to be asbestos-free.<sup>239</sup>

**5.95** In addition to misunderstanding that brake linings containing asbestos could not be treated as being in situ, the submission did not explain to the Minister why, on the one hand, it would be prohibitively costly for Defence to detect and remove all asbestos from the vehicles but, on the other, it would be economical for third parties to do so. Defence has been unable to advise the basis for its advice to the Minister that 95 per cent of the vehicles were asbestos free.

**5.96** In its May 2011 submission, Defence provided the Minister with assurances about the overall risk posed by the presence of asbestos in the vehicles being disposed of by sale to the public:

Land Systems Division has completed risk assessments for each platform type or fleet of vehicles and risk assessments for each with regard to asbestos contained within the vehicles. Overall these consider the risks posed by asbestos-containing material, and the possibility that asbestos may be accessed by future users of vehicles sold or gifted by Defence (such that it could become friable during removal or replacement), to be low.

**5.97** During the drafting of this advice to the Minister, Land Systems Division informed Defence Disposals that the risk assessments:

were completed to provide assurance to [*the Chief of Army*] that the platforms that contained in situ items were safe for his soldiers to operate to the end of their service life. The assessments were not primarily completed for the disposal or for the 'Public Punter'.

**5.98** While Defence referred to the VCDF's directive in the background information attached to the May 2011 ministerial submission and provided the Minister with a copy of it, Defence made no comment on the extent to which the recommended option complied with the direction. Moreover, it was not made clear to the Minister that a decision to approve the recommended option had the effect of arbitrating between competing views within Defence as to the interpretation of the VCDF's directive (see paragraphs 5.90 and 5.91).

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239 Defence, Ministerial Submission, Disposal Strategy for Surplus Army B Vehicles, 3 June 2011.

**5.99** After the Minister approved the B Vehicles disposal strategy in June 2011, a senior officer from each of JLC and Defence Disposals met and discussed the problem of asbestos in the B Vehicles. The JLC officer subsequently advised the Defence Disposals officer that he had instructed a staff member to ‘put some words in an email ... that may suit our collective cause better than the “strip ACM [*asbestos-containing material*]” mentality currently in vogue as a result of old (my view) VCDF guidance.’ The email the JLC officer referred to included the following statement:

A number of BVRP [*B Vehicle reduction program*] equipments have been identified as containing asbestos. As we witnessed at [*Joint Logistics Unit – Victoria*], these equipments are having the asbestos affected items removed, and the remaining items which do not contain asbestos are being put into a scrap metal bin, including the equipment's carcass—I am guessing Defence is getting a return of about \$150 per tonne for the scrap metal. Given the experience gained from your visit with [*the branch head of Defence Disposals*] to the UK last month, I suggest this process is not representing very good value for money for the Commonwealth.

On 26 May 11, MINDM [*Minister for Defence Materiel*] approved a MINSUB [*Ministerial Submission*]*—Disposal Strategy for Surplus B Vehicles*. One of the recommendations of that MINSUB is that B Vehicles be sold to companies that can demonstrate the capacity to remediate accessible asbestos. As a result of this MINSUB, the position in the VCDF minute has now been altered.

**5.100** There is no evidence that the VCDF (whose minute was a directive, not merely guidance) was consulted on this position. It is also apparent that the common cause between JLC and Defence Disposals was obtaining the best revenue from the B Vehicles disposal without necessarily ensuring that all asbestos content was identified and/or removed before the vehicles left Defence, an objective not likely to be realised while adhering to the VCDF's directive—the ‘strip asbestos-containing material’ approach. Further, and as discussed in paragraph 5.95, there was a continued assumption that third parties could economically remove asbestos from the B Vehicles where Defence could not.

#### *Defence tender assessment was deficient*

**5.101** Having given the Minister assurances that the vehicles would be sold to an entity that could ‘demonstrate the capacity and intention’ to remove asbestos prior to the entity then on-selling them, it would be reasonable to expect to see that requirement reflected in the process of evaluating the tenderers.

**5.102** An internal review of the tender evaluation and selection process concluded that the selection of the preferred tenderer was based on an irregular process.<sup>240</sup> The review recommended, among other things, that negotiations with the preferred tenderer should not continue until further investigations were conducted. Further review was undertaken but, in the event, the process continued.<sup>241</sup>

**5.103** One of the ‘significant’ issues identified by the internal review was the Tender Evaluation Board’s failure to evaluate against all the tender evaluation criteria, describing the resulting evaluation report as ‘very thin with respect to evaluation of criteria other than the cost model’.<sup>242</sup> Despite Defence having highlighted removal of asbestos in its assurances to the Minister, there is no evidence of any specific assessment of the tenderers’ demonstrated capacity to undertake asbestos removal.

#### *Costing asbestos remediation*

**5.104** In July 2012, Defence arranged for its Financial Investigation Service (FIS) to conduct a financial review of DMO’s preferred tender response. The focus of the review was on the summary profit and loss of the submitted proposal and the viability of the proposed business model.

**5.105** The subsequent analysis noted that the tenderer’s proposal on hazardous waste disposal represented ‘the costs incurred to dispose of asbestos brakes and possible fluids.’ This is consistent with there being either no plans to identify and address asbestos in any other part of the vehicles or, at least, none having been costed in the business proposal.

**5.106** The FIS analysis also stated, for the hazardous waste item, that: ‘It is acknowledged that savings might be achieved. This item has been calculated at five percent of vehicles @ \$400 per vehicle.’ This is broadly consistent with the advice provided to tenderers that ‘95 per cent of vehicles are asbestos free’ in

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240 The evaluation of tenders is discussed in more detail in Chapter 4.

241 Defence subsequently sought external legal advice and then determined that there was no legal impediment to proceeding to contract signature with the preferred tenderer and, while the quality of the RFT and the Source Evaluation Report did not demonstrate best practice, they did meet the required standard and complied with relevant DMO policies. The reviews of the tender process are considered in more detail in Chapter 4.

242 The review also found that there was: no assessment of value for money of the tenders submitted; inadequate definition of the tender evaluation criteria; incorrect assessment of one of the tenderer’s compliance with the tender requirements; inequitable treatment of tenderers by the Tender Evaluation Board and a number of irregularities between the RFT, the Tender Evaluation Plan and the Evaluation Report.

the earlier industry briefing for the tender. It is also notable that Defence had earlier estimated the costs of remediating the brakes on the vehicles as much more expensive: between \$879 and \$1323, according to the vehicle.

***Minister announces vehicles will be available to the public***

**5.107** On 31 January 2013, the Minister for Defence Materiel announced the successful tenderer and that ‘sale of the vehicles gives Australians a chance to buy their own part of Australian military history’.

**5.108** ANAO examined a copy of the contractor’s asbestos testing process; the document used by the contractor to certify that each vehicle has been checked for asbestos-containing material; and a report provided by the contractor to Defence on the project. The last item includes a list of vehicles the contractor has received from Defence during the month and checked for hazardous substances.<sup>243</sup> The documents provided to Defence show that only brakes are checked for asbestos.<sup>244</sup>

**5.109** Defence advised the ANAO in January 2015 that, as a result of the findings of this performance audit, Defence had again reviewed the controls relating to B Vehicle disposal.

**Management of the Bell UH-1H Iroquois helicopter disposal**

**5.110** The RAAF commenced acquisition of Iroquois helicopters in 1961. They were deployed in Vietnam and many other places overseas over a 45 year period. The capability, with a fleet of 25 aircraft, passed to the Army in 1989.<sup>245</sup> The Chief of Army decided, in May 2007, to withdraw the helicopters in view of the imminent need to train support personnel to maintain the new MRH90 helicopters. The Iroquois aircraft were to cease operation on 1 October 2007 and the last of the type was to be withdrawn from service on 31 December 2007.

**5.111** A first draft of the disposal plan for the Iroquois aircraft was completed in September 2007 and a completed plan endorsed in March 2008. The plan

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243 DMO stated (30 June 2014) that there had been 12 instances where hazardous substances had been located in the 2300 vehicles and trailers sold as at April 2014.

244 A table listing 79 vehicles and which includes a column ‘ACM’ [*asbestos-containing material*] with an entry for each vehicle contains only the values ‘No ACM’, ‘ACM detected’ and ‘No brakes’ in that field. Defence is dependent on the contractor for reports on its performance and has no independent method of verifying the contractor’s remediation of asbestos.

245 The Royal Australian Navy also operated Iroquois helicopters from 1967, with the type being withdrawn from Navy service in 1989.



stated that it was intended that all hazardous substances would be identified, located and advised to those who purchase the aircraft:

**Identification of Hazardous Material.** All hazardous material used in the construction or support of the Iroquois aircraft and its components are to be identified and consolidated in a single document which is to be made available to purchasers of the Iroquois aircraft and its components. Maintenance publications are to be amended to reflect the location and type of hazardous material evident within the aircraft and its components.<sup>246</sup>

**5.112** In October 2008, DMO prepared an options paper on disposal of the Iroquois aircraft for the Chief of Army. This paper identified the duty of care in relation to asbestos as extending principally to notification, presumably meaning that it would be incumbent on Defence to notify the recipient of the aircraft of the presence of the material, as contrasted with removing it before transferring custody:

**Asbestos Removal.** The Iroquois contains Chrysotile Asbestos and you have some duty of care with regard to its treatment. Because the asbestos components are 'in situ' within the engine (ie persons are unlikely to come into contact with the asbestos-containing parts) this duty of care would principally extend to notification. While you have no duty of care in regard to foreign governments, you could also gift to them the replacement non-asbestos components that are in stock along with each engine as a good will gesture. Even though the likelihood of exposure is remote, the presence of in situ asbestos adds weight to the cost reasons for removal of the engines from static display 'shell' aircraft. The only real risk applies to the Iroquois intended for loan to the [*a private Australian museum external to the Commonwealth*] and this can be mitigated by requiring [*the CAF*] to control usage and supplying non-asbestos replacement parts with the aircraft.<sup>247</sup>

**5.113** A range of options for the disposal of the Iroquois aircraft was considered over the period from 2008 forward. Ultimately, most of the fleet was kept by the Commonwealth (sixteen by Defence for display and training, and one transferred to the Australian War Memorial). However, the RSL National Headquarters and National Vietnam Veterans' Museum were offered one each. The last six were made available for static display to historical organisations through a request-for-offer process which commenced in 2011.

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246 Defence, Iroquois UH-1H Disposal Plan, April 2008, p. 33.

247 Defence, Disposal of UH-1H Iroquois Helicopters, An Options Paper for CA Consideration, October 2008, p. 3.



**5.114** The conditions of contract offered by DMO to the prospective purchasers of the Iroquois aircraft differed in important respects from earlier commitments in relation to asbestos and other hazardous substances:

- Contrary to the VCDF directive, accessible asbestos was to remain in the equipment sold, in particular, in gaskets.
- The intention was to leave the asbestos items in place and contractually prohibit the purchaser from disturbing any component containing problematic substances. In contrast, in the case of the B Vehicles, the VCDF's directive was 'interpreted' to permit sale 'to companies or entities that can demonstrate the capacity and intention to remediate any accessible asbestos'.

**5.115** The contract required the Commonwealth to provide a register of problematic substances. However, it provided no assurance of its accuracy and required the purchaser to assume all risk for identifying such substances. This approach stands in contrast to the commitment in the March 2008 disposal plan to identify, locate and advise all hazardous materials to purchasers (see paragraph 5.111).

**5.116** Defence's approach to the sale of the Iroquois aircraft and B Vehicles suggests that it has moved by increments from the VCDF's original position of allowing no accessible asbestos to be gifted or sold. As mentioned earlier (paragraph 5.31), Defence informed the ANAO during the audit that the directive remains in place.

## **Management of an old case**

**5.117** Towards the end of the fieldwork for the audit, DMO drew attention to a case of a former major item of Defence SME which has long been outside the control of Defence, but which now presents an asbestos management problem to the current owners. The owners have estimated the cost of asbestos removal at \$1 million to \$1.5 million, and sought Australian Government funding to do so.

**5.118** Several decades ago, the Government decided to gift the item of SME on an 'as is, where is' basis and on the condition that it be properly maintained at no further cost to the Australian Government. Contemporaneous correspondence shows no evidence that risks of asbestos were considered at the time. The owners have now found that the asbestos-containing material is deteriorating and may present a risk which the organisation cannot manage. In

December 2014, DMO advised the Minister of its intention to deny a request from the owners for funding assistance to remove asbestos containing material.

**5.119** The ANAO sought to identify how many other former Defence SME assets are now residing in locations not under Australian Government control. A register of such items would enable Defence to assess risk flowing from similar items elsewhere. However, Defence has no systematic record of SME assets gifted or sold.<sup>248</sup> In the absence of such records it is difficult to assess whether other legacy cases could arise or the magnitude of that risk. If Defence had maintained such a register, it might be possible, for example, for it now to advise others with custody of ex-Defence equipment about the likelihood of the presence of asbestos.

**5.120** In December 2014, DMO also advised the then Minister for Defence that it was ‘proposing to undertake a review of a number of past disposal activities to identify those items that contain hazardous substances, in particular asbestos containing material, that may give rise to potential future liabilities’. DMO did not indicate when that review was expected to be complete nor what action it proposes should the review identify further risks related to past disposal activities.

## Conclusion—managing hazardous substances in disposals

**5.121** Hazardous materials, in particular, asbestos, have been used widely in the manufacture of Defence SME. Over the last decade, Defence has put substantial effort and resources into remediating asbestos in its inventory and its SME.

**5.122** A major decision in the management of asbestos in disposals was the VCDF’s clear directive to the Defence Organisation in October 2009: items that contain asbestos should be disposed of by sale or gift only where any asbestos contained within the item cannot be accessed by future users, and as such do not pose a health risk to those future users. A tension subsequently arose between the VCDF’s directive and the approach within Defence to maximise revenue from major equipment disposal.

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<sup>248</sup> In response to ANAO enquiries about the existence of such registers, Army advised that ‘the short answer is “No”.’; Air Force advised it has a formal register for the F-111 artefacts on loan to [*Australian Historical Organisations*] but does not have any registers or other systematic records of previous disposals outside national collections; and Navy advised only of a record going back 15 years of loans (but not gifts or sales).

**5.123** In several cases examined by the ANAO—in particular, the Caribou aircraft and B Vehicles fleet—Defence has struggled in its efforts to manage the risks posed by asbestos in equipment intended for disposal. In the case of the Caribou aircraft, equipment disposal was a trigger to cease asbestos remediation. The sale of the majority of the Caribou was not completed and asbestos components remain in place, and it is now a matter for Defence to decide a future course of action. The two aircraft sold to an historical aircraft society retained any asbestos items previously contained in them.

**5.124** Defence has not always provided appropriate information to potential purchasers or recipients about the asbestos content of SME subject to disposal, notwithstanding legal advice to do so, senior leadership expectations and undertakings to government. This is the case, for example, with the B Vehicles.

**5.125** The B Vehicles may contain accessible asbestos in various locations such as brake linings and gaskets. The vehicles are on-sold to the public by a company established for this purpose which, after receiving them, only reports back to Defence on the results of its checking for asbestos in the vehicle brakes, and remediating these components where necessary.<sup>249</sup> This disposal is ongoing.<sup>250</sup>

**5.126** The F-111 aircraft disposal was largely managed by the DMO's Disposal and Aerial Targets Office. Defence's preference, given the use of asbestos throughout the aircraft, was to destroy most of them and retain only a few for Defence museums. Ministerial preferences led to a small number of aircraft also being retained for display outside Defence's direct control in private museums, but with ongoing Defence involvement in monitoring and reporting on risks. Defence has based its management of this arrangement on a professional assessment of the risks, but the costs of ongoing monitoring and reporting by Defence are yet to be assessed.

**5.127** Defence's approach to some more recent disposals suggests that it has moved by increments from the VCDF's original position of allowing no accessible asbestos to be gifted or sold. Defence informed the ANAO during the audit that the directive remains in place.

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249 Defence advised the then Minister for Defence Materiel in 2011 that 95 per cent of the B Vehicles were free of asbestos components. However, it has been unable to provide evidence for this estimate.

250 Defence advised the ANAO in January 2015 that, as a result of the findings of this performance audit, Defence had again reviewed the controls relating to B Vehicle disposal.

**5.128** The potential long-term risks of SME containing asbestos have been highlighted by a request for Australian Government assistance from an external organisation. The organisation was gifted a major item of Defence SME by the Australian Government several decades ago. The item has asbestos-containing material that is widespread through its structure and the organisation has advised Defence that the asbestos is now posing a hazard. While the SME is no longer owned by the Commonwealth and the issue of Defence or Commonwealth assistance is yet to be determined, it raises the question of whether other legacy cases exist and what action may be needed to address any risks posed.

## 6. Gifting Defence Specialist Military Equipment

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*This chapter examines the Australian Government's gifting rules and how Defence has set about gifting SME assets that are no longer required.*

### How Defence specialist military equipment is gifted

**6.1** An option for disposing of Defence specialist military equipment is gifting the asset to a party outside the Commonwealth. In the past 20 years, for example, many de-commissioned naval ships have been gifted to Australian states to be sunk deliberately to form recreational diving attractions, and some 30 of the Army's former tank fleet of 103 Leopard I vehicles have been gifted to Returned and Services League (RSL) clubs and similar community bodies around Australia for display.

**6.2** Disposal of Defence equipment often has a high public profile which, in turn, makes it more likely that ministers will become involved. When the public becomes aware of the prospect of Defence items becoming available for disposal, ministers and the department may receive many enquiries about the prospective disposal, usually seeking advice about how a group or individual can secure an item. The DMO branch responsible for disposals noted an 'ever increasing Ministerial involvement in disposals' in mid-2011.

**6.3** During the period under consideration in this audit, the former FMA Act strictly controlled the gifting of public property. Section 43 of the Act expressly prohibited making a gift of public property except under certain defined circumstances. The clause reflected long-standing arrangements.<sup>251</sup> Moreover, these arrangements have more recently been reaffirmed by the adoption of very similar rules in the PGPA Act, which replaced the FMA Act.

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<sup>251</sup> The explanatory memorandum for the FMA Act stated: 'The inclusion of the clause [that became s. 43] is to put beyond doubt the basis on which the Commonwealth may give away its property. No equivalent provision exists in the Audit Act 1901, although it has long been interpreted that the Finance Minister's act of grace and waiver powers under that Act served to make the Minister the source of authority to approve gifts of stores. Finance Direction 26F reflected this view and [s. 43] is based on that Finance Direction. It also creates an offence of unauthorised gifting of public property by any minister or official, with a maximum penalty of seven years imprisonment. Gifting is allowed where the Finance Minister has given written approval under a specified set of conditions'.

#### 6.4 This chapter considers:

- the rules that apply to gifting of Defence assets and whether those rules are adequately reflected in Defence's internal instructions, guidelines, templates and associated material;
- whether gifting is adequately defined. In some cases, arrangements have been adopted that could be viewed as providing a gift but which did not invoke the gifting rules; and
- whether the gifting rules have generally been followed. Specifically, the audit sought to identify whether some prominent instances of gifting had been carried out with appropriate authority. Three case studies are considered:
  - the gifting of Navy ships as dive wrecks;
  - the gifting of the Leopard tanks to RSL clubs; and
  - gifting an F-111C aircraft to the Pacific Air Museum in Hawaii for display.

## The rules for gifting Defence assets

### Authority to gift Commonwealth assets

6.5 Section 43 of the FMA Act prohibited the gifting of public property except in defined circumstances, including where the Finance Minister had given written approval to the gift being made.<sup>252</sup> The Finance Minister delegated to Chief Executives the power to give written approval for gifts of public property, under the FMA (Finance Minister to Chief Executives) Delegation, Part 17. This instrument required delegates to observe specific conditions when considering making a decision to gift public property.

6.6 The Secretary of Defence (as the Defence chief executive) had, in turn, delegated this power to various Defence officials (both APS and ADF). The delegation was based on dollar values with the CDF having unlimited delegation and other Defence officials up to \$500 000. The limit of the delegation was based on the value of the gift.

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252 See also paragraph 2.9 and footnote 36.

## Conditions placed on gifting Commonwealth assets

**6.7** The Finance Minister's Delegation required, among other things, that 'property is generally to be disposed of at market price' and placed the following conditions on gifting:

(1) If a gift of property is being contemplated, the delegate must have regard to the requirement to adhere to the Commonwealth's general policy for the disposal of Commonwealth property, namely, that, wherever it is economical to do so, the property being disposed of should:

(a) be sold at market price, in order to maximise the return to the Commonwealth; or

(b) otherwise, should be transferred (with or without payment) to another Commonwealth Agency with a need for an asset of that kind.

(2) A departure from the Commonwealth's general policy, encompassing disposal by gift, is permitted if the Commonwealth property in question:

(a) is:

(i) genuinely surplus to the Agency's requirements; and

(ii) of historical or symbolic significance in relation to the proposed recipient; or

(b) holds other special significance for the proposed recipient, and there are compelling reasons to justify its gifting to that recipient.<sup>253</sup>

**6.8** Part (2) of the Minister's Delegation (above) covered any departure from sale at market price or transfer to another Australian Government entity. This explicitly encompassed disposal by gifting but also included disposal of an asset for a price less than the market price.

**6.9** The Finance Minister's Delegation also specifically prohibited the gifting of military firearms and gifts prohibited by law. This latter category included those items where sale was prohibited by intellectual property considerations or contractual obligations (such as those in arrangements with the US under ITAR).

**6.10** Where disposal of an asset by way of gifting was being considered, the delegate was required to obtain a reasonable estimate of the value of the

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253 FMA (Finance Minister to Chief Executives) Delegation 2013, Part 17.2 (2). This text is reproduced here in detail as a point of reference for later discussion and comparison.

Commonwealth property proposed to be gifted, and where this was not possible, the delegate had to use his or her discretion in assigning a notional value, and record the basis for determining the value of the property.<sup>254</sup>

**6.11** Additionally, where gifting was being contemplated the delegate was required to consider whether approval in a particular case would have created an onerous or undesirable precedent. If the gift would have created that precedent, it had to be refused.<sup>255</sup> For this reason, the delegate would need publicly defensible and objective grounds to justify favouring the person or organisation with the gift, ahead of other potential recipients.<sup>256</sup> In these circumstances, to achieve transparent and defensible decision-making, the delegate would need to set out their reasoning in any decision to make a gift of public property.<sup>257</sup>

#### *Gifting rules to be interpreted narrowly*

**6.12** The Department of Finance advised Defence (citing AGS advice) that, from a policy perspective, the gifting delegation should be read narrowly:

Finance regularly advises agencies that they should read the direction ‘historical or symbolic significance to the proposed recipient’ to have its natural meaning (i.e. the item relates to the past of an individual or organisation or has particular unique and identifiable meaning to that recipient).

For example, this delegation has been relied on to gift a particular desk to a retiring senior Defence official who had used that particular desk for over 30 years. Similarly, the direction that the item hold ‘other special significance for the proposed recipient, and there are compelling reasons to justify its gifting to that recipient’ should be read narrowly. We would advise agencies

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254 *ibid.* Part 17.4.

255 The directions within the Finance Minister's Delegation explained an undesirable precedent as one where ‘it would be difficult, in equity, for the Commonwealth not to approve other requests for such gifts and which would in that way lead to significant losses of Commonwealth revenues’.

256 FMA (Finance Minister to Chief Executives) Delegation 2013, Part 17.3.

257 The Public Governance, Performance and Accountability (Finance Minister to Accountable Authorities of Non-Corporate Commonwealth Entities) Delegation 2014 contains very similar requirements. The delegation (Part 10, Delegation under s. 66 of the Act—Gifts of relevant property) is slightly broader in scope in that it allows Accountable Authorities to gift low value, surplus items where it is either uneconomical to otherwise dispose of them or the gifting is consistent with Commonwealth policy objectives. However, it maintains the requirement for the delegate to consider whether approval to gift in a particular case would create an onerous or undesirable precedent, and if so, the gift must be refused. The delegation also maintains the requirement for the delegate to have publicly defensible and objective grounds to justify favouring the person or organisation with the gift, ahead of other potential recipients.



to consider this on a case by case basis, taking into account the personal unique meaning for the specific proposed recipient.<sup>258</sup>

## **Rules reflected with varying fidelity in Defence instructions and guidelines**

**6.13** The audit found that the gifting rules under the FMA Act were reflected in Defence's FINMAN 2 (Financial delegations manual). They also appeared in Defence's FINMAN 5 (Financial management manual), Chapter 6.2.

**6.14** The latter manual, FINMAN 5, also included a Defence requirement which was additional to the rules derived from FMA sources: that is, that 'Defence's policy for the disposal of public property is that the most economical means is to prevail, wherever practical.' This, on the face of it, imposes an obligation on those managing a disposal to take account of both the financial costs and the benefits of that disposal. This is a principle that accords with the requirement in s. 44 of the FMA Act to promote proper use of Commonwealth resources.

**6.15** However, the gifting rules are also reflected in a range of other Defence documents providing instruction or guidance to Defence staff, but with varying fidelity. The problematic aspects are explained below.

### ***Defence Chief Executive's Instructions***

**6.16** The gifting rules were reflected in the Defence Chief Executive's Instructions (CEI, 6.2.11). However, the CEIs also contained additional guidance purportedly on gifting in an another section (CEI 6.1, Asset Management):

Disposal by way of ... a gift, must be in accordance with DI(G) PERS 25-7 Gifts, Hospitality and Sponsorship.<sup>259</sup>

**6.17** The DI(G) referred to was not directed at the disposal of Defence assets and did not mention disposal. Rather, it provided instructions to staff on how to manage conflicts of interest and the provision of personal gifts and hospitality to parties with whom Defence staff may be dealing in the course of

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258 Advice from the Department of Finance to Defence, April 2014.

259 Defence, CEI 6.1 Asset Management (Non-Financial Assets), 6.1.1.4.

Defence business, such as suppliers and contractors.<sup>260</sup> The reference at s. 6.1 of the CEIs was potentially confusing.

### *DMO Chief Executive's Instructions*

**6.18** DMO's CEI concerning the gifting of Commonwealth assets included statements that were inconsistent with the Finance Minister's Delegation:

Proposals for public property to be presented as a gift must demonstrate that it is in the interests of the DMO and the wider community.<sup>261</sup>

**6.19** Whether a gift meets the interests of DMO or the wider community were not tests set out in the gifting rules (see paragraph 6.7, above). The source of these elements in the DMO CEI is not clear. Moreover, DMO is part of the Commonwealth and it is not clear how the reference to 'DMO's interests' is to be interpreted, as these cannot properly be separate from those of the Commonwealth.

### *DMO Disposal and Sales Directorate Disposal Guide*

**6.20** The DMO Disposals and Sales Directorate Disposal Guide included a table describing possible disposal methods. A note appended to the table read:

The authority to Gift or Transfer an Asset can only be exercised by persons holding appropriate financial delegations to be exercised after Ministerial Approval (Minister of Finance under FMA Act Sect 43) to proceed has been provided.<sup>262</sup>

**6.21** However, transfer of an asset can be done without the exercise of a gifting delegation and so should be treated separately from gifting. The wording is also confusing as it could give the impression that the delegate can make a decision only after ministerial approval, which would be contrary to the purpose of having a delegation arrangement and not consistent with the responsibilities of a delegate.<sup>263</sup>

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260 The DI(G) included a reference to FINMAN2 and CEI 6.2 in an appendix, but this is at the least an arduous path to the guidance.

261 DMO, CEI 6.2 Gifting Public Property, issued July 2010.

262 DMO, *Disposal Guide*, Disposals and Sales, AMSO, Table 5, pp. 14–16, May 2013.

263 Under s. 34A of the *Acts Interpretation Act*, a person exercising a delegated power acts in their own right and with their own discretion. They cannot generally be subject to direction by the party who delegated the power.

### *Other manuals*

**6.22** The ANAO examined other Defence material providing guidance on disposals, including:

- the DMO Standard Operating Procedure: Manage Major Disposals; and
- the Electronic Supply Chain Manual (ESCM) (various editions, including August 2013).

**6.23** Each of these contained errors in their accounts of the rules set out in the Finance Minister's Delegation (see paragraph 6.7).<sup>264</sup> The ANAO understands that Defence is seeking to correct these errors.<sup>265</sup>

## **Whether gifting is defined adequately**

**6.24** Casual use of the term 'gifting' is clearly a source of confusion within Defence. The term 'gifting' is sometimes used to encompass disposal options that have the appearance of a gift but may not technically be one. For example, Defence internal documents sometimes refer to assets being 'gifted' to Defence museums. This may seem functionally equivalent to gifting to a non-Commonwealth recipient, such as a private museum. However, from a legal perspective, the former options involve the Commonwealth retaining ownership of the asset and simply transferring the asset for another purpose either within Defence or to another entity within the Commonwealth.<sup>266</sup>

**6.25** Another disposal option that may have the appearance of gifting is where Defence makes items—such as the F-111 aircraft—available for loan. The recipients may perceive the loan as indefinite and broadly equivalent to a gifting arrangement, even though they are required to meet particular obligations to continue to have custody of, and display the asset. However, this too, is not gifting as the assets remain in Commonwealth ownership.

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264 For example, the ESCM introduces a condition that allows gifting where (subject to other conditions also being met) 'the charitable significance outweighs the financial return that would accrue to the Commonwealth by selling the items.' The origin of this condition is unclear. Details of these errors were provided to Defence in the course of the audit.

265 Errors in interpretation of the gifting rules are also encountered in disposal plans. For example, several disposal plans incorrectly state: 'The Minister for Finance and Deregulation has delegated the gifting of property to the Minister for Defence and the Minister for Defence Science and Personnel.' This appears to reflect an error in the Defence disposal plan template.

266 For example, the Caribou disposal strategy refers to 'gifting' of aircraft to Defence force museums.

## Providing a grant to assist with purchasing from Defence

**6.26** Questions about the adequacy of how gifting is defined arise where the asset is purchased with the assistance of a separate grant made to the recipient. Such grants are intended to help the recipient pay the Commonwealth for that asset, to help them take possession of it, and/or fund the use to which the recipient will put the item. This is a case where the arrangement does not invoke the gifting rules, but the effect is very similar to making a gift and the public may generally perceive it as such. An instance is the sale of the ex-HMAS *Otama*, an Oberon-class submarine, to a community group in 2001 (see text box below).

### Disposal of the ex-HMAS *Otama*

The HMAS *Otama* was an Oberon-class submarine in RAN service from April 1978 to December 2000. Defence disposed of the submarine in 2001.

A community group called the 'Western Port Oberon Association' developed a plan in 2001 for a Naval Memorial Park at Hastings, Victoria, which it envisaged would include the ex-HMAS *Otama*, if it could acquire the submarine from Defence. In a submission to Defence, the Association estimated the cost of the park at over \$2.3 million. The Association stated that the region of Hastings had a strong military history with particular links to submarines and submariners, with 3500 retired naval service personnel in area. The local member made three representations to the Minister for Defence in support of the plan.

By the time a decision was made on disposal, the local member had become the Minister for Defence. Executive authority for the disposal was exercised by the Parliamentary Secretary 'to avoid a conflict of interest'.

Defence invited the Greater City of Geelong and the Western Port Oberon Association to bid to acquire the submarine. Only the Association submitted a bid and, ultimately, it was successful and paid \$55 000 including GST. The Association's bid was for \$60 000 excluding GST. The sale price was reduced to \$50 000 (excluding GST) by the Parliamentary Secretary to the Minister for Defence.

The Western Port Oberon Association's submission of March 2001 estimated the cost of towing ex-HMAS *Otama* from HMAS *Stirling* in Western Australia to Victoria, in April 2002, to be \$250 000. When the Parliamentary Secretary approved the disposal of ex-HMAS *Otama*, he also announced the sale of the boat to the Association, and a Centenary of Federation Grant of \$500 000 to the Association for the Naval Memorial Park incorporating the submarine. Some of these funds were used to purchase ex-HMS *Otama* and to help with the cost of towing the submarine to Victoria.

Source: Hansard, 4 November 2003, pp. 22039–40, Question No. 2391 and Defence, Question Time Brief, December 2003, 'The Disposal of Ex-HMAS *Otama*'.

**6.27** The disposal of the ex-HMAS *Otama* to the Western Port Oberon Association was referred to by the local member of Parliament as ‘a gift from the Commonwealth’.<sup>267</sup> In fact, the transactions were more complex than that. The Association:

- had offered the Commonwealth \$60 000 for the submarine;
- but was charged \$50 000 by the Parliamentary Secretary to the Minister for Defence (to which \$5000 GST was added);
- faced fees of about \$250 000 for towing the submarine to its proposed Victorian location from Western Australia; and
- was granted \$500 000 to help meet the costs of acquiring the submarine, and moving it to its waterfront land-based display.

**6.28** A permanent location for the display had not been settled in advance of the transaction and the submarine has subsequently deteriorated. By 2011, Defence was concerned that this could become a reputational issue for Navy, even though Defence had sold the boat in 2002. A location was reportedly found in 2013 and, at the time of the audit, the proposed maritime centre to display the submarine was yet to be constructed.

**6.29** The case shows that, on occasions, a combination of decisions—in this case a sale accompanied by a simultaneous grant—may have the effect of gifting while not invoking the rules on gifting of Commonwealth assets.<sup>268</sup> In the circumstances there would have been benefit in Defence seeking Department of Finance advice on gifting policy and the application of the Finance Minister’s Delegation.

### Three case studies of gifting Defence equipment

**6.30** The ANAO examined three case studies to assess Defence’s application of the gifting delegation. The three case studies relate to:

- the gifting of ships as dive wrecks;
- the gifting of Leopard tanks to RSL clubs; and

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<sup>267</sup> The relevant media article is available at: <http://greghunt.com.au/Media/Speeches/tabid/87/articleType/ArticleView/articleId/57/Commending-the-Western-Port-Oberon-Association-for-their-efforts-to-establish-the-Otama-Sub-display.aspx>, [accessed 29 April 2014].

<sup>268</sup> The decisions in this case were made a decade and a half ago and the ANAO has not sought to retrieve advice provided to ministers on relevant matters.

- the gifting of an F-111C to a museum.

## Gift of ships as ‘dive wrecks’

**6.31** Defence has disposed of some half dozen major Navy ships over the last two decades by gifting them to state governments for sinking as ‘dive wrecks’ or artificial reefs.<sup>269</sup> The first was the ex-HMAS *Swan*, which was sunk on 18 October 1996 at Dunsborough, off the south-west coast of Western Australia. It is not known if any consideration was given at the time to whether this gifting would create a precedent. However, use of old and surplus ships as dive wrecks is an option that has been considered regularly since that time. The two most prominent and recent cases have been the ex-HMAS *Canberra* and ex-HMAS *Adelaide*.

### *Decommissioning of HMA Ships Canberra and Adelaide*

**6.32** In January 2004, the Chief of Navy notified the then Minister for Defence that HMA Ships *Canberra* and *Adelaide* would be decommissioned in November 2005 and September 2006.<sup>270</sup> Although HMAS *Canberra* was the newer ship, in the Chief of Navy’s view, its earlier decommissioning would be the most effective use of resources.

**6.33** For the HMAS *Canberra*, a detailed ministerial submission in August 2005 showed that Navy had considered a range of disposal options. It set aside most, with reasons, as impractical or inexpedient. It proposed selective inventory and system removal for re-use within Defence as the most cost-effective strategy. DMO had estimated that the financial benefit of this option was of the order of \$100 million. Only a limited range of options for the residual hulk would then remain, including gifting for a dive wreck or sale for scrap.

### *Disposing of ex-HMAS Canberra*

**6.34** In October 2005, DMO recommended to the Minister for Defence that he write to state premiers and territory chief ministers offering the ex-HMAS

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269 Before the disposal of the ex-HMAS *Canberra* and ex-HMAS *Adelaide* arose for consideration, respective Ministers for Defence gifted the ex-HMAS *Swan* (October 1996) and ex-HMAS *Perth* (August 1999) to the Western Australian Government; the ex-HMAS *Hobart* (June 2000) to the South Australian Government and the ex-HMAS *Brisbane* (September 2001) to the Queensland Government. All were gifted for use as dive wrecks.

270 In the event, the decommissioning of the HMAS *Adelaide* was delayed so as to mitigate the effect on Navy capability of delays in the FFG frigate upgrade program and so that sufficient platforms would be available to meet potential tasks.

*Canberra* as a gift for use as a dive wreck or artificial reef. If there was no interest from states or territories, the remainder of the ship would be sold for scrap. DMO advised the Minister that lobbying for the ship was already underway and that the value of the ship to state governments as a dive wreck could be 'significant in terms of tourism outcomes'. Further, the Queensland Government had estimated 'benefits in the order of \$22 million per year will accrue from the use of ex-HMAS *Brisbane* in this manner.'

**6.35** The Minister decided that the ship should be offered to states and a territory that had not been gifted a ship and wrote on 9 November 2005, offering the ship as a gift to Victoria, Tasmania, New South Wales (NSW) and the Northern Territory. The offer was noted in Parliament.<sup>271</sup> The Minister's letters stated that Defence would not help with costs once the ship had been handed over from its base in Western Australia. Defence estimated that the cost of towing the hull from Fleet Base West to one of the eastern states or Northern Territory was about \$500 000, excluding insurance.

**6.36** Responses from states were considered 'disappointing' as those that had responded would not accept the gift without an additional grant of funds to prepare it for sinking as a dive wreck.<sup>272</sup> DMO recommended and the Minister agreed (in May 2006) to write to the remaining states to gauge interest. Once again, DMO advised the Minister of the perceived benefits to states of dive wrecks:

State governments that have previously undertaken projects to establish dive wrecks of ex-HMA Ships *Brisbane*, *Hobart*, *Perth* and *Swan*, have variously reported annual revenue ranging from \$2.4 million to \$23 million, attributable to tourism prompted by these dive wrecks.

**6.37** All state leaders who replied referred to the precedent of the ex-HMAS *Brisbane*. The Commonwealth had provided no additional funding with earlier such gifts but it had made an exception for the ex-HMAS *Brisbane* and provided \$3 million. In that case, a decision to absorb costs of preparation had been reflected in a letter of 26 September 2001 from the then Minister for

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271 The Member for Flinders and Parliamentary Secretary to the Minister for the Environment and Heritage stated, on 8 December 2005: 'I take this opportunity to call on the Victorian Premier, in a spirit of bipartisanship, to make a bid for the HMAS *Canberra*. The HMAS *Canberra* is an Adelaide class guided missile frigate which has been recently decommissioned. It has been offered by the Minister for Defence, Robert Hill, to four states and territories—Victoria, New South Wales, Tasmania and the Northern Territory—as a vessel to be sunk so as to create an artificial reef and diving centre.'

272 By the time Defence received responses from states a new Defence minister had been appointed.



Defence to the Premier of Queensland. That commitment had only been capped at \$3 million by a subsequent Minister for Defence in another letter to the Queensland Premier, in April 2002.<sup>273</sup>

**6.38** In June 2006, the Minister decided to offer Commonwealth funding assistance with the ex-HMAS *Canberra* of up to \$3 million. After considering business cases put forward by Victoria and NSW, Defence recommended the selection of Victoria. After some further correspondence, the Victorian Premier confirmed his expectation of a Commonwealth contribution of \$2.8 million for his state's bid and the NSW Premier, a Commonwealth contribution of \$4.835 million. Defence again recommended that Victoria be selected. It also suggested that NSW Government interest could be directed to the HMAS *Adelaide*, then expected to be decommissioned towards the end of 2007.

**6.39** In July 2007, the Minister advised the Victorian Premier that management of the project would be passed to DMO, and he approved Commonwealth funding of up to \$7 million to complete the project. In October 2007, the Minister further agreed to a request from the Victorian Premier that the Commonwealth be responsible for all project costs beyond the Victorian contribution of \$1.5 million. Subsequently, the Deed of Gift was signed by the Victorian Premier and the Minister for Defence. At that point, DMO advised the Minister that preparing the ship for sinking off the Victorian coast would take 10 to 12 months and the total cost of the contract was not expected to exceed \$6.2 million (including \$1.1 million in towing costs).

**6.40** A lengthy process of discussion about the proposed site for sinking the ship ensued, involving Defence, the contractor, several Victorian Government agencies and the then Commonwealth Department of Environment, Water, Heritage and the Arts (DEWHA, responsible for administering the *Environment Protection (Sea Dumping) Act 1981*). DEWHA considered the site originally nominated by the Victorian Government to be too shallow, making the wreck prone to being unstable and broken up by wave action. The cost of holding the ship while awaiting Victorian Government nomination of a suitable site was estimated by DMO's contractor to be between \$120 000 and \$230 000 a month, and Defence began considering other options for disposing of the hulk.

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273 Towing, preparation and sinking of ex-HMAS *Brisbane* was reported as having cost the Queensland Government \$5 million, of which the Commonwealth contributed \$3 million.



**6.41** Finally, agreement was reached following receipt of DEWHA approval for sea dumping on 5 August 2009, and Victorian State 'Coastal Management Act Consent' approval, granted on 10 July 2009. The ex-HMAS *Canberra* was scuttled off Barwon Heads, Victoria, on 4 October 2009. Defence informed the ANAO that the ultimate cost of the project to the Commonwealth was \$7 million.

#### *Scuttling ex-HMAS Adelaide*

**6.42** In October 2006, the Minister for Defence wrote to the NSW Premier to let him know that the Victorian Government's bid for the ex-HMAS *Canberra* had been successful, and to draw the NSW Government's attention to the expected availability of the ex-HMAS *Adelaide* 'toward the end of 2007'. The Chief of Navy had agreed to move the ship to the east coast shortly after decommissioning. The Minister was advised that this would reduce significantly the cost to the NSW Government (or any other recipient).

**6.43** In December 2006, the NSW Premier's Department wrote to the Minister for Defence with a revised business plan, estimating the cost of preparing and scuttling the HMAS *Adelaide* at \$3.2 million. The proposal indicated that \$3 million would be sought from the Commonwealth.

**6.44** In February 2007, DMO obtained the Minister's approval to gift the ship to the NSW Government. The talking points provided to the Minister indicated that 'Commonwealth funding for a proportion of the projected costs was offered in pursuit of joint state and federal tourism outcomes.' The Minister then wrote to the NSW Premier, notifying him of the approval.

**6.45** A deed of gift was signed by the Minister for Defence and NSW Premier for ex-HMAS *Adelaide* in June and July 2008 identifying a Commonwealth contribution of \$3 million.

**6.46** In June 2009, the Minister for Defence responded to a request from the NSW Premier for a further contribution to the costs of scuttling the ex-HMAS *Adelaide* with an offer of Commonwealth funding of up to \$5.8 million. Court action by a community group opposed to the scuttling had led to delays in the project and substantial additional costs being incurred. A final payment by the Commonwealth of \$1.082 million was made in March 2011, bringing its contribution to \$5.8 million. A NSW request for further funds was refused.

**6.47** The ex-HMAS *Adelaide* was scuttled on 13 April 2011 off Avoca Beach near Terrigal, New South Wales.

### *Analysis of the gifting of HMA Ships Canberra and Adelaide*

**6.48** As indicated in paragraphs 6.35 and 6.44, the then Minister for Defence had offered ex-HMAS *Canberra* as a gift in November 2005 and a later Minister for Defence approved the gifting of HMAS *Adelaide* in February 2007. The earliest record provided to the ANAO that considers the question of the exercise of a delegation to gift the ex-HMA Ships *Canberra* and *Adelaide* is dated 31 January 2008, when Defence Disposals staff sought advice on the value of the ships so as to help determine who would exercise the gifting delegation. On 18 February 2008, the CEO DMO provided an instrument of delegation to the CDF as an ‘appropriate level at which the delegation may be exercised, given the level at which decisions have previously been made regarding the ships.’

**6.49** Approval was provided by the CDF on 21 February 2008 for the gifting of ex-HMAS *Canberra* to the Victorian Government and ex-HMAS *Adelaide* to the NSW Government. The approval document included an estimate of the market value of the items. Each would cost the Commonwealth \$3.5 million to scrap, including any revenue from selling the scrap.<sup>274</sup> It also noted the additional costs flowing from funds provided in the respective cases by the Commonwealth to the state governments:

- for the ex-HMAS *Canberra*, the approval noted a cost of \$6.2 million for the scuttling, of which \$1.5 million was being contributed by the Victorian Government. This meant that the disposal would cost the Commonwealth \$4.7 million, an estimated \$1.2 million above the cost of scrapping (\$3.5 million); and
- for the ex-HMAS *Adelaide*, the estimated contribution (at that stage) of \$3 million from the Commonwealth meant that the disposal would cost \$0.5 million less than scrapping (\$3.5 million). However, this calculation does not include the cost of bringing the ship from Fleet Base West to the east coast, which was done at Navy’s expense with the apparent intention of lowering the costs to be incurred by the recipient.

**6.50** To lawfully make a gift of public property requires either written approval by the Finance Minister or by that Minister’s delegate, subject to the directions in the Finance Minister’s Delegation. The exercise of the delegation

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274 The source and reliability of these estimates is not made clear in the relevant Defence documentation.

to gift the ex-HMA Ships *Canberra* and *Adelaide* occurred in February 2008. However, Defence had proposed gifting of the ships to the Minister for Defence in October 2005. The advice to ministers on making gifts of these ships did not refer to the legal requirements for such a decision. The ministerial submissions mentioned neither the FMA Act nor the Finance Minister's Delegation.

**6.51** The Minister for Defence offered the ex-HMAS *Canberra* as a gift well in advance of any decision by an authorised delegate to dispose of the ship this way. There is no record that Defence explained to the Minister that he did not hold the formal authority to make gifts of Commonwealth property, and that decision-making required the involvement of the Finance Minister or authorised delegates.

**6.52** In light of the progress of the gifting proposals by February 2008, the exercise of discretion by the delegate was severely constrained and the consideration of other options, for example, to scrap rather than gift the ship so as to maximise the return to the Commonwealth (or minimise the loss) was, for all practical purposes, closed to the delegate.

**6.53** The delegate's approval to make a gift did include an assessment of the market price and a view that each ship was worth minus \$3.5 million as scrap.<sup>275</sup> The cost of each gifting arrangement was also set out. In one case the known cost of gifting (and the eventual cost of gifting in the other) was greater than the cost of scrapping. Gifting was therefore unlikely to maximise the return to the Commonwealth. It is not clear how or whether the delegate took account of this.

**6.54** To make a gift, the Finance Minister's Delegation required that: the property in question be of historical or symbolic significance in relation to the proposed recipient; or hold other special significance for the proposed recipient, with compelling reasons to justify its gifting to that recipient (see paragraph 6.7). Based on the available evidence, it was not apparent that there was any historic or symbolic significance of the ships in relation to the proposed recipients, nor any special significance for the proposed recipients with compelling reasons to justify gifting the ships to those recipients. There is no reference in the approval document to any reasoning on these grounds. On

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<sup>275</sup> This is understood to be the net cost of scrapping, that is, the estimated expense of sending the ship to the scrapyard less the revenue from the sale value of the scrap.

the contrary, the explicit purpose of the gifting of both ships was for them to 'provide opportunities for tourism and revenue' as dive wrecks, as stated by the Minister for Defence in an answer to a Parliamentary question.<sup>276</sup>

**6.55** The decisions in the 1990s to gift surplus naval ships to the states were a clear precedent for subsequent gifting of ships. However, the more significant decision was that made by the then Minister for Defence in 2001 to provide \$3 million to the recipient state to help with the scuttling of ex-HMAS *Brisbane*. The potential public expectation of equitable treatment of states then led the Commonwealth to act similarly when subsequently gifting ships, by providing substantial funding on each occasion.

**6.56** An answer to a Parliamentary question on notice in 2012 shows that Defence is wary of future proposals to use surplus ships for dive wrecks. In answer to a question specifically enquiring about ships that will be decommissioned that may be available for use as an artificial reef, Defence stated:

Any proposal for a former [*Navy*] vessel to be sunk as a dive wreck would require a detailed analysis of technical, environmental, resourcing and licensing issues related to the application for a permit under the Sea Dumping Act. This would be required to be undertaken by the proposer or State Government managing that activity ...

For a proposal to allocate a decommissioned ship for sinking as an artificial reef to be considered for endorsement by Defence, the proponent must be able to demonstrate that they have the financial resources and managerial capabilities to successfully complete what is a complex and challenging preparation process ...

The full cost of a dive wreck is estimated to be around AUD \$10 million based on previous experience, but may vary depending on specific circumstances.<sup>277</sup>

**6.57** Ministers continue to receive representations about the possibility of using further surplus naval ships as dive wrecks.<sup>278</sup> Defence's advice in response to such representations has been cast in similar, cautionary terms.<sup>279</sup>

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276 Hansard, Senate, Wednesday, 21 March 2007, p. 72.

277 Senate Standing Committee on Foreign Affairs, Defence and Trade, Questions on Notice, Senate Budget Estimates 28–29 May 2012, Answer to Question 50, 'De-commissioning of ships'.

278 Correspondence seeking advice on the availability of a decommissioned ship was received by the Parliamentary Secretary to the Minister for Defence from a Member of Parliament in May 2014.

### *Gifting of ships as dive wrecks—conclusion*

**6.58** The delegate's decisions to gift the ex-HMA Ships *Canberra* and *Adelaide* as dive wrecks to Victoria and New South Wales were made after the offer of a gift was made to the states by the Defence Minister. The delegate's decision was therefore constrained by preceding events and ministerial decisions made without the benefit of departmental advice on the requirements of the gifting delegation. It also did not meet in full the requirements of the Finance Minister's Delegation for gifting of Commonwealth assets; particularly the requirement that the items have historic or symbolic significance to the proposed recipients or special significance with compelling reasons to justify gifting to those recipients. The gifting of ex-HMA Ships *Canberra* and *Adelaide* has also resulted in significant Australian Government costs to support the states in preparing and scuttling the ships. The experience serves to reinforce the long-standing advice in the Finance Minister's Delegation to have careful regard to precedents which may be established through gifting.

### **Gifting of Leopard tanks to RSL clubs**

**6.59** In September 2005, Defence advised the then Minister for Defence that a disposal strategy for its 103-vehicle Leopard tank fleet was being finalised. The strategy:

proposes to donate a small number of vehicles to museums for heritage preservation and to seek to sell the remainder. Vehicles which cannot be sold would be converted to scrap.

**6.60** The advice also stated that it was likely that Australia would be unable to sell its Leopard main battle tanks (the bulk of the fleet) as other countries were also disposing of similar vehicles. In the meantime, Defence was withdrawing its Armoured Vehicle Launch Bridge (AVLB) Leopard vehicles from service with a view to exploit the then present demand for those vehicles before the market declined further.

**6.61** In April 2007, Defence advised its Minister that although there was growing interest from the public and organisations in acquiring a surplus

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279 Defence informed the ANAO in January 2015 that it had recently advised the Parliamentary Secretary of the potential work health and safety (WHS) liabilities applicable to the disposal of decommissioned ex-Navy vessels as dive wrecks. In summary, Defence is required to do all that is possible and reasonable to ensure the creation and use of dive wrecks is without risk to the health and safety of both workers and members of the public.

Leopard tank, there had been no interest in the AVLB vehicles from any current users. It was thought unlikely that it would find a single buyer for the fleet and proposed now to sell the Leopards by public tender or as scrap. A small quantity would be 'gifted to domestic Defence and related organisations for historical and instructional purposes.'

**6.62** By July 2007, Defence's disposal plan proposed that Defence retain 66 Leopard vehicles for museums, displays and target practice, leaving 37 available for sale or gifting.

*Request to Finance Minister for gifting approval*

**6.63** On 21 August 2007, Defence submitted its disposal plan (in synopsis) for the Leopard tanks to the Minister for Defence for his approval. Defence advised the Minister that 'Defence's priorities for disposal are to meet its internal needs, followed by gifting to veterans' organisations and finally to sell any remaining vehicles at public auction.' It also stated that Defence was able to gift surplus equipment to approved organisations subject to approval in writing from the then Minister for Finance and Administration.

**6.64** On 14 September 2007, the Minister for Defence wrote to the Finance Minister, in the terms recommended by Defence, requesting approval to gift Leopard tanks to veterans' organisations. The Minister for Defence also issued a press release on that day, entitled 'Get Yourself a Leopard' in advance of receiving approval from the Finance Minister. This invited relevant organisations to express interest provided they could demonstrate some historical or cultural significance of the tank to them.

**6.65** The Defence Minister's letter to the Finance Minister sought approval to gift a number of Leopard tanks to veterans' organisations for display purposes. The letter set out the basis on which the gifting was proposed to take place:

policy provides that public property may be gifted if the property has cultural, historical or environmental significance to the proposed recipient, and that the charitable significance outweighs the financial return which would accrue to the Commonwealth through the sale of the items.<sup>280</sup>

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280 Letter from the Minister for Defence to the Minister for Finance and Administration, 14 September 2007.

**6.66** This requires two comments: first, gifting of public property has its basis in law. Second, the basis for gifting reflected the errors discussed earlier in this chapter (paragraph 6.13 forward), in internal Defence documentation.

**6.67** The then Department of Finance and Administration provided a brief and a draft reply to its Minister but that reply was not sent.<sup>281</sup> The brief pointed out that the Finance Minister had delegated the ability to gift public property. However, the sponsoring organisation within Defence was unaware of this delegated authority. The brief also stated that:

The pre-empting of your approval by the [*Defence Minister's*] press release of 14 September 2007 would have provided scope for embarrassment should any issues within your responsibilities have arisen which compromised the proposal. Needless to say, the release should have been withheld until you had advised Defence on the request.

*Announcement of the allocation of gifted tanks*

**6.68** Although no reply had been received granting approval for the proposed gifting, the Minister for Defence issued a further press release on 13 November 2007, entitled 'New Homes for Retired Tanks'. This announced that 'a re-elected Coalition Government [would] provide thirty decommissioned Leopard tanks to RSLs and veterans' associations around Australia.' The press release included a list of thirty successful organisations, selected (according to the release itself) on the order in which applications were received, with state allocations based on relative population size.

**6.69** Following the change of government in November 2007, an internationally-based initiative arose to have a range of countries, including Australia, gift Leopard tanks to a particular overseas country. Defence advised the new Minister (in February 2008) that it intended to defer disposal of the Leopard tanks until a decision was made on this initiative.

**6.70** The Defence submission also obtained the new Minister's approval to gift the surplus Leopard tanks to the organisations selected by the previous Minister. It repeated the advice that the gifting would require approval from the Finance Minister.

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281 The brief was received in the Minister's office on 11 October 2007. The 2007 federal election was called on 14 October 2007.



### *Approval to gift the surplus Leopard tanks*

**6.71** In the event, the CDF approved the gifting of 30 decommissioned Leopard tanks on 21 April 2008. The sequence of events leading to this decision is not clear from Defence records.

**6.72** The approval document noted that the tanks had a 'book value of zero', were genuinely surplus to Defence's requirements and were of historical or symbolic significance to the recipients.

**6.73** The approval broadly followed the required form for gifting but warrants two comments:

- As pointed out above, approval for gifting should have been given before the Minister invited expressions of interest, and certainly before announcing an allocation, albeit contingent. Further, this approach suffered from the same problem raised earlier in relation to gifting ships for dive wrecks (see paragraph 6.52): once the Minister had made a decision, the delegate was effectively constrained in his decision-making and capacity to have full regard to the expectations set out in the Finance Minister's Delegation.
- The relevant value to take account of is not the book value, but the market value. This would have been greater than zero, even as scrap.

### **Gifting an F-111C aircraft to the Pacific Air Museum**

**6.74** The possibility of US interest in receiving a gift of an F-111 was noted in the Chief of Air Force's statement of RAAF preferences for F-111C preservation, in February 2010. In April 2011, and again in July that year, the US Commander Pacific Air Forces wrote to the CAF requesting a decommissioned RAAF F-111 for the Pacific Aviation Museum (PAM), Hawaii.<sup>282</sup> Defence was inclined to favour the request because the US had a number of its military aircraft on loan or gifted to Australian museums. Defence, which was seeking to maintain strong bilateral relationships, could help by providing the F-111 to the PAM.

**6.75** In November 2012, the then Minister for Defence agreed. The approved proposal involved offering the aircraft on an 'as is, where is' basis, leaving the US to fund any disassembly, transport and reassembly in Hawaii. However,

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282 Earlier informal enquiries on behalf of the PAM had been received in late 2010.



upon receipt of the offer, the US Air Force advised that it could not take legal ownership of the aircraft to transfer it to the PAM. The RAAF subsequently agreed in-principle to disassemble, deliver and reassemble the aircraft in Hawaii at Defence expense. It proposed this to the Minister for Defence, in June 2013, and the Minister approved the gifting.<sup>283</sup>

**6.76** Defence has represented a document entitled ‘DATO Disposal Authority 114/2013’ signed by the F-111 Disposal Project Manager on 30 August 2013 as the gifting decision document. The document lacks any consideration of the issues required by the Finance Minister’s Delegation and provides no reasoning for making the gift.<sup>284</sup> Moreover, the substantive decision had clearly already been made by the Defence Minister, raising further doubt as to whether the actions recorded in this document could be considered a proper exercise of the relevant delegation.

## Conclusion—gifting Defence specialist military equipment

**6.77** Gifting of public property was prohibited under the FMA Act except in certain defined circumstances, including where the Finance Minister had given written approval to the gift being made. The Finance Minister had sole ministerial authority over gifting, and had delegated that power to Chief Executives under the FMA (Finance Minister to Chief Executives) Delegation, Part 17.<sup>285</sup> This instrument required delegates to observe specific conditions when considering making such a decision. These long-standing arrangements have largely continued under the PGPA Act.

**6.78** The gifting rules have not been reflected accurately nor consistently in many instructions and guidelines for Defence staff. This may be due, in part, to the proliferation of such sets of instructions and guidelines. Defence should give prompt attention to the drafting of Defence instructions and guidelines to bring its documentation into alignment with the Australian Government’s resource management framework.

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283 Defence stated to the Minister that the staff costs for the trip to Hawaii would be \$35 000. Delivery would be effected by up to three C-17 Globemaster aircraft movements and could be done through a combination of programmed and ‘opportunity’ tasking. This is taken to imply that Defence would incur minimal additional costs.

284 It may have been possible, for example, to set out an argument that the asset held special significance to the recipient and that there were compelling reasons to justify its gifting to that recipient.

285 The Finance Minister’s delegation was to officials, not ministers.

**6.79** The audit identified instances when Defence did not approve gifting of SME in accordance with applicable Commonwealth legislative and policy requirements. For example, when DMO recommended to the then Minister for Defence in 2005 that he write to state premiers and territory chief ministers offering the ex-HMAS *Canberra* as a gift for use as a dive wreck, DMO did not advise the Minister that he did not have the authority to make such a gift under long-standing legal arrangements<sup>286</sup>, nor of the requirements set out in the gifting delegation. Similarly, the ADF's Leopard tanks were offered by the Minister for Defence as a gift to RSL branches in 2007, before a request was made to the Finance Minister seeking formal approval of the gifting.

**6.80** Invariably, when items of SME are to be withdrawn from service, Defence will offer early advice to the Minister for Defence on proposed disposal arrangements. In that context, where any options for gifting are to be contemplated, Defence should advise the Minister that the Minister does not have authority to approve a gift, and of the specific requirements of the Finance Minister's gifting delegation, including the requirement placed on the Finance Minister's delegate to adhere to the Commonwealth's general policy for the disposal of Commonwealth property, and to avoid establishing an undesirable precedent.

**6.81** Further, experience has shown that gifting items of SME can involve substantial costs for Defence. For example, the disposal of the two RAN ships, ex-HMA Ships *Canberra* and *Adelaide* by gifting them to Victoria and New South Wales cost Defence at least \$13 million.

## **Recommendation No.4**

**6.82** To bring its instructions and guidelines that address gifting of Defence assets into alignment with the requirements of the resource management framework, the ANAO recommends that Defence promptly review all such material. This could be undertaken as part of the review recommended in Recommendation No. 1.

**Defence response:** *Agreed*

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<sup>286</sup> Authority to gift Commonwealth assets lies with the Finance Minister, who has delegated it to the Defence Secretary. The Secretary has sub-delegated his authority to the Chief of the Defence Force and other members of the Defence Organisation.

## 7. Managing Other Risks

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*This chapter considers Defence's treatment of specific risks in managing certain disposals, including restrictions imposed on arms purchased from the US, conflict of interest risks, and disposal of non-ADF equipment.*

### Risks in specialist military equipment disposals

**7.1** During the course of the audit, a range of specific risks in managing disposals became apparent, other than those considered in detail in earlier chapters. The audit considered a selection of these risks:

- *management of trailing obligations.* Most specifically, disposal of Defence military equipment is affected by US International Traffic in Arms Regulations (ITAR), which limit how Defence can dispose of this equipment when it has been obtained from the US<sup>287</sup>;
- *conflicts of interest.* This is the risk of placing private before public interest, which can arise in the management of Defence disposals; and
- *disposal of non-ADF equipment.* In a small number of cases, a need to dispose of SME has arisen where that equipment is not ex-ADF equipment, but nevertheless is to be disposed of by Defence. This introduces additional challenges to the disposal function including identifying a source of funding for the disposal.

### Managing trailing obligations

#### International Traffic in Arms Regulations

**7.2** The US Government controls access to its defence technology (including data) through the US *Arms Export Control Act* (AECA). It administers this access through its ITAR.<sup>288</sup> Defence's access to US defence technology is provided on the condition that Defence uses such material only

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287 A similar issue can arise with equipment sourced from other countries. For example, Defence's Leopard tanks could not be sold, gifted or released to a third party without the written approval of the German Government. This agreement was included in the 1975 Leopard Tank acquisition contract between the Commonwealth of Australia and the West German Government. German Government approval was given in February 2009.

288 ITAR controls cover physical equipment, services and related technical data. ITAR restrictions also apply when ITAR-controlled items have been incorporated into a product manufactured outside the US.

for the purpose authorised under the original agreement and does not transfer it to a third party without prior approval of the US Government.<sup>289</sup> Disposal of military equipment that is, or contains, ITAR-controlled material requires prior approval of the US Government, as it involves a change in the authorised end-use and/or end-user.<sup>290</sup>

**7.3** Obtaining ITAR approval from the US Government for disposal has taken as long as 18 months or several years, and sometimes approval is not granted. If these issues are not properly anticipated and managed, there can be adverse consequences for the outcome of a disposal. For example, delays may result in Defence incurring additional storage or mooring costs. On the other hand, breaches of ITAR may cause embarrassment to the Australian Government and to Defence, and may restrict future access to foreign technology and equipment.

**7.4** The ANAO sought Defence advice that it had obtained US Government approval for 12 major equipment disposals undertaken in recent years (see Table 7.1).

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289 A transfer can be temporary or permanent and includes a transfer for the purposes of repair, loan, maintenance, demilitarisation, or disposal by destruction, scrapping, sale or gifting. A third party means any entity or individual who is not an employee of the Commonwealth, APS or ADF.

290 For example, transferring a Defence helicopter from operational service to a static display item in an Australian Government-operated museum is a change in end-use.

**Table 7.1: Selected SME disposals and ITAR requirements**

Equipment		Year of disposal	ITAR approval obtained where applicable
1	Lighter, amphibious resupply, cargo (LARC)	2005 and 2008	Defence able to provide evidence of approval for the 2008 case. <sup>a</sup>
2	Fremantle Class Patrol Boat	2008	ITAR do not apply. <sup>b</sup>
3	Ex-HMAS <i>Canberra</i>	2009	Yes, in 2008.
4	Caribou aircraft	Ongoing from 2011	Canadian origin. ITAR do not apply. <sup>b</sup>
5	Boeing 707 aircraft	2011	Yes, in 2008.
6	Leopard tanks	2011	ITAR do not apply. German Government approval required and obtained. <sup>b</sup>
7	Ex-HMAS <i>Adelaide</i>	2011	Yes, in 2009.
8	F-111 fighter jets	2011 to 2014	Approvals (x 8) for various components and aircraft loans and destruction from 2011 to 2014.
9	Army B Vehicles	Ongoing from 2012	ITAR do not apply. <sup>b</sup>
10	Landing Craft Mechanised (LCM2000) watercraft vessels	2012	ITAR do not apply. <sup>b</sup>
11	Ex-HMAS <i>Manoora</i>	2013	Yes, in 2013.
12	Ex-HMAS <i>Kanimbla</i>	2013	Yes, in 2013.

Source: Compiled by the ANAO from Defence documentation. This table relies on Defence assurances about the completeness of ITAR approval for any individual disposal. In some cases, an item of equipment comprising major sub-components may require ITAR approval for each sub-component. The ANAO has not sought to verify that all ITAR-controlled items associated with these disposals were correctly identified by Defence.

Note a: Defence was unable to locate the approval letter for the 2005 disposal. However, two further LARCs were disposed of to the same recipient in 2008 and the approval letter for that disposal has been identified. Further vessels have been disposed of since 2005 by scrapping. Defence provided approval letters for vessels destroyed in 2013.

Note b: Based on Defence advice to the ANAO.

7.5 Defence advised the ANAO that ITAR did not apply to five disposals. Defence provided the ANAO with copies of the US Government approval letters for six disposals. It was not able to supply a copy of approval for the gifting of a LARC to a NSW High School in 2005. However, it did supply a copy of an approval for the later supply (2008) of two further LARCs to the same recipient and other documentation surrounding the 2005 disposal. In this light, Defence's inability to locate the specific approval for the 2005 disposal is not considered a significant omission.

7.6 With effect from March 2014, Defence transferred the responsibility for managing ITAR applications from the Defence Export Control Office in Defence to AMSO. While AMSO now coordinates the ITAR approval process, the responsibility for identifying the relevant items to which ITAR apply rests with the relevant DMO SPO. In November 2012, AMSO released a standard procedure to provide guidance on the ITAR approval process.<sup>291</sup>

## **Managing ITAR**

7.7 Trailing obligations such as ITAR can be difficult for Defence to manage during the disposals process as the equipment may have been purchased many years—even decades—earlier. Defence does not have a centralised or systematic record of these obligations and relies on the relevant area in Defence to retain appropriate records.

7.8 A step that could help Defence manage ITAR arrangements in future would be to establish a centralised record of relevant obligations, provided this can be done cost-effectively.

## **Blanket Demilitarisation and Disposal Agreement**

7.9 A large proportion of Australian military equipment is of US origin and Defence has to seek case-by-case approval before a change in ownership or end use. As at mid-2009, DMO stated that the average time taken for ITAR approvals was 145 days (having reportedly declined from an earlier average of 200-plus days).<sup>292</sup> However, the time taken in individual cases was highly

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291 Defence Materiel Standard Procedure, 'DMSP (IND) 05-0-002 Re-transfer & re-export of United States Defence Technology and Equipment to Third Parties', November 2012.

292 Defence informed the ANAO that it currently expects ITAR re-transfer approval from the US Government to be granted within 90 calendar days.

variable. The age of equipment or currency of technology has not been grounds for a relaxation of the rules by the US Government.

**7.10** The lengthy ITAR approval processes led to work on a proposed Blanket Demilitarisation and Disposal Agreement (BDDA) with the US Government as an element of reform in the disposals function. Defence intended the BDDA to satisfy the ITAR on military equipment of US origin in a more streamlined way and, thereby, expedite disposals and save costs.

**7.11** Primarily, the BDDA would allow Defence to dispose of equipment under previously agreed, standard conditions, rather than considering each case separately.<sup>293</sup> This would save Defence the cost of storing equipment while awaiting each individual approval.

**7.12** The BDDA proposal was put to the US Government in December 2009, and it required the approval of the US Congress.

**7.13** Defence subsequently gained assurance letters from industry and state and territory governments, and made personal representations on the proposal to the US State Department in Washington and to its representatives in Australia. In particular, it provided advice to the US State Department in 2011 on the avoidable costs it was incurring under the existing arrangement while awaiting ITAR approval. Among the examples cited by Defence were its estimates that:

- the cost of storing the Iroquois helicopters while awaiting approval of the BDDA was up to \$225 000 a year; and
- the cost of awaiting approval for the F-111 aircraft was up to \$1.07 million a year.

**7.14** Defence's BDDA proposal did not succeed. Discussions in April 2014 between representatives from the Australian Embassy in Washington D.C. and officials at the US Office of Regional Security and Arms Transfers resulted in a recommendation that Defence's BDDA application be withdrawn. In June 2014, Defence wrote to the US State Department, formally seeking to withdraw its proposal of December 2009 for a BDDA.

**7.15** Following the April 2014 discussions, Defence was to consider development of a number of separate, smaller applications to address ITAR

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<sup>293</sup> The aim of the BDDA was fast-tracking disposal and demilitarisation. No other scenarios (such as sale of ITAR equipment to foreign governments) were included.



requirements. Defence informed the ANAO that, in conjunction with the US State Department, Defence was attempting to establish a reduced scope submission that would cover disposal by destruction.

## Conflict of interest

**7.16** A conflict of private (personal) interest is a situation in which the impartiality of an officer in discharging their public duties could be called into question because of the influence of personal considerations, financial or other. The conflict in question is between official duties and obligations, on the one hand, and private interests on the other. Conflicts of interest may be:

- Actual: a real conflict between an officer's public duties and their private interests or other professional responsibilities.
- Potential: a situation in which an officer has a private or professional interest that, in the future, could conflict with their public duties.
- Perceived: exists where a third party has the view that an officer's private interests could improperly influence the performance of their duties.<sup>294</sup>

**7.17** The audit observed a number of situations in the disposals it examined where a conflict of interest could arise. Generally, these involved individuals working for Defence subsequently taking up positions with external organisations doing business with Defence.

**7.18** Conflicts of interest can be difficult to deal with. For example, it is not possible to prohibit an employee from resigning and taking up employment with another organisation where the knowledge they have gained may be of commercial value. Where an employee is contemplating such an offer it is appropriate for them to declare that interest and be precluded from participation in any further decision-making or activity that could be seen to advantage their future employment with the other organisation. However, this strategy relies on the employee declaring their potential conflict of interest.

**7.19** Defence's post-separation employment policy requires ADF members and Defence APS employees wishing to take up employment with private

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294 ANAO Audit Report No.47 2013–14, *Managing Conflicts of Interest in FMA Agencies*. Conflicts of interest can also arise when an officer is required to fulfil multiple roles that may be in conflict with each other to some degree. That circumstance was not identified during the current audit.

sector organisations to consider whether there might be potential for a perceived or actual conflict of interest. Where a conflict exists or is perceived to exist, the member or employee must fully inform Defence of the situation before accepting employment. The CDF, Secretary of Defence or CEO DMO will then consider what measures, if any, should be put in place to manage any perceived or actual conflict of interest.<sup>295</sup>

## **Ex-ADF personnel and disposal projects**

### **Case 1**

**7.20** In the case of one disposal project that came to attention during the audit, an ADF member who had been the director of a major Defence acquisition project joined a private company as its director of Australian operations soon after retiring from full time service duty but while remaining a Reservist.

**7.21** Some six months after separating from Defence the former ADF member approached Defence, as the private company's local director of operations, offering to buy surplus equipment and related items. The former ADF member subsequently signed a contract with Defence on behalf of the company.

**7.22** As the former director of the Defence project, it is very likely that the former ADF member would have developed expertise highly relevant to his new role working for the private company. Such expertise would have been of value to a company specialising in that field.

**7.23** The ADF member, having left Defence to join the company, remained a Reservist, which provided a range of access privileges to Defence, including physical and electronic, while he was working as the company's representative.

**7.24** The ADF member's access appears to have been common knowledge in relevant circles in Defence. For several years after leaving full-time employment in Defence, the ADF member had access to and was using his

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<sup>295</sup> These measures could include allocating alternative duties, the restriction of the flow of information to the Defence member/employee, a review or audit of access that the Defence employee/member has, or has had, to specific information with relevance to their future employment; and restrictions on access by the Defence employee/member to information systems.

Defence email account to conduct private business with Defence, generally concerning the company's acquisition of the surplus equipment.

**7.25** Moreover, the problem was drawn to the attention of the DGDAIM (the branch head responsible for major equipment disposals) by Defence's legal advisers. They recommended that the ADF member's access to a particular Defence base be withdrawn.<sup>296</sup> Defence has no record of whether it took any action on this recommendation.

**7.26** Defence can find no record of the ADF member having declared any perceived or actual conflict of interest relating to employment with the private company at any stage during employment with Defence or as a Reservist.

## **Case 2**

**7.27** Defence's review of a separate disposal determined that some of the content of the successful tender submission had been influenced by information obtained through former ADF members. The former ADF members were part of the loose consortium of organisations involved in the successful tender for the purchase of the equipment and were to play key roles in the successful tenderer's future plans. Defence's internal review of the disposal identified three ex-ADF members, all former members of the ADF unit that had operated the equipment, who were assisting the private company which became the successful tenderer with the purchase of the equipment.

**7.28** A potential conflict of interest was identified by DMO. A former ADF member performed the role of chief engineer for the successful tenderer and as such, represented that company on a number of occasions during the sale process.

**7.29** The ADF member was, apparently, discharged from the Reserves before Defence's RFT for the sale of the equipment was released. However, this was well after the disposal planning work and ministerial approval of the disposal strategy and subsequent RFT preparation. As a Reservist in the ADF unit responsible for the equipment during this time, the member would have had substantial knowledge of Defence's plans, and the state of the equipment and related items.

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<sup>296</sup> The legal adviser believed that the ADF member had been using his access to the base, gained by virtue of his reservist status, to perform maintenance work on the equipment on behalf of his private employer.

**7.30** Around this time, Defence Disposals staff were dealing with the ADF member as a current Reservist who was going to be employed by the company. There is no evidence that, at the time, any Defence staff identified this as potentially problematic, on the grounds of a perceived or actual conflict of interest.

## **Requests for favours**

**7.31** Another way in which conflicts of interests can arise is where a party external to Defence (possibly a former ADF member) seeks favours or other consideration from currently serving members personally known to them. An instance that came to light in the course of the audit was a request from a successful recipient of surplus Defence equipment to a (then) serving three-star officer. The request sought Defence assistance with the transport of equipment and related items that the recipient had purchased, to bring the materiel closer, at least, to its destination and save the recipient transport costs.

**7.32** The original request was handed down the ADF chain of command for further investigation into Defence's capacity to assist. There was no suggestion in this communication that such assistance might not be an appropriate use of Defence—that is, public—resources. There is a risk, in circumstances such as these, that the more junior personnel might interpret such a communication as an implied instruction.

**7.33** In the event, the request was denied. A condition of the disposal contract between the external party and Defence was that the equipment was provided on an 'as-is-where-is' basis.<sup>297</sup> Defence denied the request because of this condition.

**7.34** Another instance that came to light during the course of the audit was a request from a Defence contractor involved with the maintenance of the Caribou aircraft to staff at the relevant RAAF Base, to buy two Caribou propeller blades and barrels.

**7.35** A formal request and bid was made in September 2010 following an informal request earlier that year. The formal request was made the month before the Caribou sale RFT was released in October 2010. A staff member

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<sup>297</sup> The point is that, if assistance with transport had been offered to all tenderers for the equipment, other parties might then have bid who had not in fact done so because of the stated conditions including the need to collect the materiel from its 'where is' location.

from the RAAF Base forwarded the request to Defence Disposals staff in Sydney, stating that the contractor had 'provided exceptional service to Defence' and supported the sale 'as a gesture of goodwill'. The sale was eventually authorised by the Defence Disposals staff member in November 2010, before the closing date of the Caribou sale RFT in March 2011.

**7.36** As an open RFT was underway during this period to sell Caribou spares, which included propellers, it is not clear why Defence staff did not direct the contractor to the formal RFT process. Granting requests for items outside of an open RFT process undermines public confidence in the way Defence undertakes business and is at odds with Defence's own requirement to manage disposal activities, including the tender process, openly, fairly and equitably, and in a manner that will withstand government, public and international scrutiny (see paragraph 2.25).

**7.37** The cases observed indicate that, although Defence has a post-separation policy, there is a need for increased alertness to the potential for conflicts of interest to arise, particularly where ADF members join private companies which are likely to do business with Defence. Another matter for consideration by Defence is the access rights of Reservists working for a company on Defence business. It would also be desirable that senior Defence officers, in particular, exercise great care in responding to external requests for assistance.

**7.38** In addition to reinforcing the conflict of interest and post-separation policies with ADF members and APS staff, Defence should establish measures to strengthen adherence to the policies. For example, periodic internal audit reviews could be used to assess whether departing personnel informed Defence about potential conflicts of interest before accepting private sector employment offers.

## **Recommendation No.5**

**7.39** The ANAO recommends that Defence:

- (a) reinforce its conflict of interest and post-separation policies to all ADF and APS staff, particularly in relation to future private sector and Defence Reservist employment; and
- (b) introduce practical measures to achieve consistent application of the policies across the Defence Organisation.

### **Defence response**

**7.40** *Agreed.*

## Disposal of non-ADF SME

**7.41** Most SME that Defence must dispose of has been part of an Australian Defence capability and used by Navy, Army or Air Force. However, instances may arise of a need to dispose of other military equipment. While unusual and unpredictable, these impose a workload on Defence, and require planning and funding, in common with more conventional disposals.

**7.42** Two instances of non-standard disposals came to light during the audit:

- The first was the disposal of patrol boats that had been provided some years ago to Pacific countries but which were approaching the end of their useful working life.
- Second was the disposal of two Russian-made Mi-24 attack helicopters which have been at the Air Force's Tindal base since 1997.

### Pacific Patrol Boats disposal

**7.43** Australia's Pacific Patrol Boat Program provided 22 patrol boats to 12 Pacific countries. It was announced in August 1983, with the first patrol boat delivered to Papua New Guinea (PNG) in 1987 under the auspices of Australia's Defence Capability Plan.

**7.44** The program has been considered successful in providing Pacific island nations with a means of patrolling their own exclusive economic zones. It has provided a means of countering illegal fishing, improving regional security cooperation and contributing to South Pacific nation-building in general.

**7.45** The patrol boats were gifted to the Pacific countries, are owned by the recipient countries and do not form part of any Australian Defence capability. However, in April 2012, Defence's International Policy Division drew Defence Disposals' attention to the Pacific Patrol Boat Program and a possible need to help dispose of the original 22 patrol boats. With a few years remaining before the end of the boats' service life, there would be merit in planning for any disposal action.

**7.46** The 2013 Defence White Paper confirmed Australia's commitment to replace the current patrol boats as they progressively reach their end of service life from 2018–26. In June 2014, Ministers announced a new Pacific Patrol Boat Program, with a capital cost of \$594 million and through life sustainment and personnel costs estimated at \$1.38 billion over 30 years.

## Russian-made military attack helicopters

**7.47** Two Russian-made military attack helicopters (Mi-24, code-named ‘Hind’) formed the most unusual item on the forward work program for Defence military equipment disposals at the commencement of the audit. An explanation for the presence of these helicopters is set out in the text box below.

### Disposal of the Sandline Mi-24 ‘Hind’ attack helicopters

Two Russian-made Mi-24 ‘Hind’ attack helicopters came to Australia as part of a shipment of military equipment in 1997. A United Kingdom-based private military company, Sandline International (Sandline), had assembled the equipment for use under contract to the PNG Government. However, changed circumstances led to the equipment being brought to Australia aboard a Russian Antonov transport aircraft, which landed at Tindal RAAF base, near Katherine, in the Northern Territory in March 1997. There its contents were unloaded and the transport aircraft and crew left.

The nature of the equipment was not disclosed by government at that time but it was stored at Tindal and originally regarded by Air Force as ‘a matter for Customs’. It included four helicopters, two of which were regarded as civilian and later sold, and two Mi-24 attack helicopters.

About five years later, in February 2002, the attention of Parliament was brought to the continued presence of the two Mi-24 helicopters. The then Minister for Defence advised a Senate Estimates hearing that they were ‘in limbo’ but, when pressed on how long they would remain so, he indicated that he was not contemplating a period of 10 or 20 years.

In 2014, seventeen years after their arrival, the helicopters remained at Tindal.

Primary source: Defence records.

**7.48** Questions as to how Defence would dispose of the Mi-24 helicopters were raised within Defence in January 2010. A JLC ‘tiger team’ visited the Northern Territory with a view to identifying and disposing of materiel that was obsolete or surplus to operational requirements. That team drew to the attention of the then Director of Defence Disposals the continued presence of the helicopters at RAAF Base Tindal. The Director of Defence Disposals promptly checked with Defence’s International Policy Division, which advised that the ex-Sandline materiel should not be disposed of as its status was ‘still under investigation’. The implication from the records is that the question of ownership was at issue. The Director of Defence Disposals indicated that,



when ownership was resolved, an approach to disposal would be required along with consideration of the storage impact on ADF warehousing.

**7.49** In April 2010, an infrastructure project at RAAF Base Tindal was expected to lead to the demolition of the hangar housing the helicopters, after which they would be stored in the open. An Air Force officer expressed concern that ‘although the helicopters have kept fairly well to date, any length of time in the open is likely to accelerate any deterioration.’<sup>298</sup> The helicopters were moved into an open storage area later in 2010.

**7.50** Parties outside Defence were also aware of the continued presence of the helicopters at RAAF Base Tindal and that they had been moved to an open area. For example, the Minister for Defence Materiel received representations from the Aviation Historical Society of the Northern Territory in October 2011, offering an arrangement to store and display the helicopters at its museum on behalf of Defence. The offer was declined.

**7.51** Nevertheless, this offer helped stimulate action from the Director-General Logistics—Air Force, who, in October 2011, wrote to superiors seeking assistance in removing the helicopters. He explained that ‘last year we had to move the airframes from their then storage area (old aircraft hangar) to a hard stand area out in the elements so that the hangar could be demolished as part of the RAAF Base TDL ongoing works program ... the climate in the NT will quickly impact the condition of the airframes now that they are out in the elements.’<sup>299</sup> Further, he took the view that:

Defence needs to take a stand and reach agreement with Sandline that we will dispose of them. I am of the view that as long as we are storing the airframes for zero cost Sandline has no pressure to move quickly to dispose of them, the complicating factor being that it was Australia that confiscated them in the first place.<sup>300</sup>

**7.52** Eight months later, an Assistant Secretary from Defence’s International Policy Division wrote to a Sandline representative notifying the company that Defence would terminate the bailment of the helicopters and remove the helicopters in the most cost-effective way it could identify. The letter stated that, whereas it was originally envisaged by Defence and Sandline that

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298 Defence, internal correspondence, 23 April 2010.

299 Defence, internal correspondence, 20 October 2011.

300 *ibid.*

Defence would store them for twelve months, 'Defence had now stored the helicopters at its expense for fifteen years.' Further:

Defence also has concerns about the potential risk of contamination from hazardous materials, given the age of the helicopters and their deterioration as a result of exposure to environmental conditions at RAAF Base Tindal.

For these reasons, Defence has determined that it is not an efficient, effective economical and ethical use of Commonwealth resources, and poses unacceptable risk in light of its duties under the *Workplace Health and Safety Act 2011* (Cth), for Defence to continue to store the helicopters.<sup>301</sup>

**7.53** The Sandline representative responded immediately, stating among other things, that the course that Defence had outlined in its letter was reasonable. International Policy Division then advised others in Defence that Defence could dispose of the helicopters (from 21 October 2012).<sup>302</sup>

**7.54** In the light of these developments, the Director-General Logistics—Air Force then sought DMO help to identify disposal options and costs. Air Force Logistics Branch identified a need for an engineering assessment and to identify hazardous materials (particularly as a Russian design of the era of the Mi-24 was expected to contain many hazardous materials). Discussion between various parties in Air Force and DMO ensued, which found that it was difficult to identify a source of funding for the disposal, partly because these had never been Defence assets:

The key problem for us all is that the items are not a Defence asset as such ... As no one in Defence owns [*them*] they have no funding attached and a brief discussion with [*the Defence CFO*] last week assured me that there was no money [*to*] spare.

**7.55** The intended technical assessment of the helicopters was then planned for January–February 2013, subject to a funding source being found. Defence informed the ANAO that the technical assessment has been performed and the helicopters were found to be in good order. Defence further informed the ANAO that Air Force has received a request which will result in the disposal of the helicopters during 2015.

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301 Defence, letter to a representative of Sandline from Assistant Secretary, Pacific and East Timor, International Policy Division, 23 July 2012.

302 Defence, internal correspondence, 13 August 2012.

**7.56** At the conclusion of this audit Defence had not yet advised the Minister for Defence about the Mi-24 helicopters at Tindal. Defence informed the ANAO that it expected to advise the Minister in January 2015.

## Conclusion—other risks

**7.57** In addition to the matters considered above, a range of specific risks add to the complexity of managing SME disposals. The audit considered the following additional sources of risk:

- management of trailing obligations, specifically adherence to US International Trade in Arms Regulations (ITAR), which limit how Defence can dispose of US-sourced SME;
- perceived and actual conflicts of interest, which can arise for Defence personnel involved in disposals; and
- disposal of non-ADF SME, which has arisen in a small number of cases.

**7.58** The US controls access to its defence technology through ITAR, making this a major consideration in many disposals because a large proportion of ADF SME is of US origin. Obtaining ITAR approval can take time and might not be granted. This can have cost or other consequences for a disposal. Defence has generally obtained ITAR approval where relevant for SME disposals over recent years. However, Defence has no centralised register of ITAR obligations in relation to existing SME, and could consider the cost-benefit of compiling a register to help manage its obligations.

**7.59** A conflict of interest involves a conflict, which can be actual, potential or perceived, between a public official's duties and responsibilities in serving the public interest, and the public official's personal interests. The audit observed a number of instances involving individuals working for Defence subsequently taking up related positions with external organisations doing business with Defence. In some cases, the individual had remained a Reservist with continued access to Defence resources.

**7.60** Defence's post-separation employment policy requires ADF members and Defence APS employees wishing to take up employment with private sector organisations to fully inform Defence of the situation. However, this does not always take place and has limited Defence's capacity to manage

potential conflicts of interest.<sup>303</sup> Defence should reinforce its conflict of interest and post-separation policies to its ADF members and APS staff, particularly the need for transparency concerning any future private sector and Defence Reservist employment, and introduce practical measures to achieve consistent application of policy across the Defence Organisation. Defence could also provide illustrative examples of certain situations or behaviours requiring close management, including: related post-separation employment, Reservists undertaking private business with Defence, personal business interests and requests for favours.

**7.61** From time-to-time Defence needs to dispose of non-ADF SME. While unusual and unpredictable, these instances impose a workload on Defence, and require planning and funding, in common with more conventional disposals. In the case of the Russian-made military helicopters flown to Australia in 1997<sup>304</sup>, Defence has been incurring some unquantified cost in storing them at Tindal for the better part of two decades. Greater awareness of such costs and the assignment of responsibility within Defence for disposal of SME that currently lacks a clear internal 'owner' would assist in effective disposal of such equipment.

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Ian McPhee  
Auditor-General

Canberra ACT  
5 February 2015

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303 Measures to manage conflicts of interest could include: allocating alternative duties; the restriction of the flow of information to the Defence member/employee; a review or audit of access that the Defence employee/member has, or has had, to specific information with relevance to their future employment; and restrictions on access by the Defence employee/member to information systems.

304 The helicopters were part of a shipment of equipment diverted to the Northern Territory in 1997. A United Kingdom-based private military company, Sandline International, had assembled the equipment for use under contract to the Papua New Guinea Government.

# Appendices



## Appendix 1: Entity response



**Australian Government**

**Department of Defence**

**Mr Dennis Richardson  
Secretary**

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

SEC/OUT/2015/1  
CDF/OUT/2015/6

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

Dear Dr Ioannou,

### **Proposed Audit Report: Defence's Management of the Disposal of Specialist Military Equipment**

Thank you for the opportunity to review and comment on the Section 19 (Proposed) Audit Report for the audit into Defence's Management of the Disposal of Specialist Military Equipment (SME) provided to Defence on 5 December 2014. The full Defence response is contained at the Enclosures.

We appreciate the responsiveness of the ANAO to our concerns as notified to the Auditor-General in April 2013. Defence welcomes the report and agrees to its recommendations.

Defence agrees that the proposed report reasonably reflects the organisational history of disposals in Defence and recent reforms in this area. Defence considers that the proposed report will provide significant impetus to the recent reforms of disposals and further remedial action has already commenced. Defence has provided comments regarding the recommendations which can be found in Enclosure 3.

Defence acknowledges the findings identified in this report, particularly in relation to the treatment of asbestos containing materials (ACM) prior to disposal and has already initiated remediation action.

Defence undertakes to implement all recommendations and expects considerable improvement to the management of SME disposal as a direct result of this audit.


PO Box 7900 Canberra BC ACT 2610 Telephone 02 626 52851 - Facsimile 02 6265 2375

*Defending Australia and its National Interests*



We would also welcome the opportunity to more fully explain the Defence response at your convenience, and would encourage your audit team to review the actions undertaken to reduce the asbestos risks that were identified in the current draft.

Yours sincerely

  
**Dennis Richardson**  
Secretary  
Department of Defence

9 January 2015

  
**MARK BINSKIN, AC**  
Air Chief Marshal  
Chief of the Defence Force

12 January 2015


**Enclosures:**

1. Proposed Amendments
2. Requests for Information
3. Defence response to Recommendations
4. Agency Response

## Appendix 2: Responses by other parties to extracts from the proposed report

The following comments on an extract from the proposed report were provided by the Department of Finance:

60  
22 JAN 2015  
11.00

  
**Australian Government**  
**Department of Finance**

Rosemary Huxtable PSM  
Acting Secretary

Our Ref: SEC0011277

Mr Ian McPhee PSM  
Auditor-General  
Australian National Audit Office  
GPO Box 707  
CANBERRA ACT 2617

22/1

Dear Mr McPhee

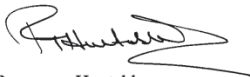
I am writing in response to Dr Tom Ioannou's correspondence of 8 December 2014, inviting the Department of Finance (Finance) to comment on extracts of the ANAO's proposed report on *Defence's Management of the Disposal of Specialist Military Equipment*, provided under section 19 of the *Auditor-General Act 1997*.

I note that the objective of the audit is to assess the effectiveness of Defence's management of the disposal of specialist military equipment and that all the proposed audit recommendations were not included in the extracts supplied. Accordingly, the following comments are limited to the material provided.

In relation to Recommendation No. 1(c), Finance supports the recommendation that Defence consult Finance during a review of its guidance to ensure alignment with the resource management framework.

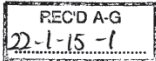
I look forward to receiving the final draft copy of the report. Should your officers wish to discuss these comments, my contact officer for this matter is Neil Robertson (Assistant Secretary, Governance and Public Management Reform Taskforce) on 6215 2110.

Yours sincerely

  
Rosemary Huxtable  
Acting Secretary

14 January 2015

Sensitive



John Gorton Building, King Edward Terrace, Parkes ACT 2600 • Telephone 02 6215 3445 • Facsimile 02 6273 1925  
Internet [www.finance.gov.au](http://www.finance.gov.au)

*The following comments on an extract from the proposed report were provided by Omega Air:*



**Dr. Tom Ioannou,**  
Group Executive Director,  
Australian National Audit Office,  
Canberra, Australia.

**Dear Dr Ioannou,**

Reference: ANOA Letter dated 8 Dec, 2014 (received via unregistered mail 24 Dec 2014)

Thank you for providing us with your reference audit report extract on the Omega purchase of the RAAF B707 Weapon System and ancillary equipment.

The report on the financial issues for Omega is factual and I wish to provide you with background as to how the deal came to be done in the first instance.

We offered to re-engine the RAAF fleet of B707 Tankers with the more fuel efficient P&W JT8D-219 at a cost of 180 million USD. We had surveyed the B707 fleet together with Northrup Grumman who had partnered with Omega to re-engine JOINT STARS and any other B707 fleets. We were unsuccessful in persuading the RAAF that re-engining was a more cost effective solution than spending 2.2 Billion USD to acquire new tankers. We also were unsuccessful in persuading the RAAF that this product was not yet tested and that the boom design was flawed due to the mass of the boom being too great for the underside of the aircraft and that the Ruddevators would not deliver sufficient command authority to control the boom at high speed. The Department of Defence decided to purchase the A330 MRTT instead of keeping the B707 tankers in service.

We were aware that the Commonwealth had offered the B707 aircraft to allied nations through the offices of Air Attaches globally and that no one seemed interested. We had a contract with the US Navy to provide AAR services globally. It seemed to Omega that we were the only possible customer for the retiring B707 fleet as nobody else would buy them. We tried to establish a fair value based on our possible capacity to use the aircraft for USN support. Omega is the only company in the world that provides civil AAR. We approached Anglo Irish Bank who were our long term bankers who agreed to provide 75% of the funding up to a limit of 10 million dollars.

We tried to get valuations on the package from professional valuers, but none would value them and stated that they could only rely on our own judgement as the market was zero, except for Omega. We spoke with Stephen Bucholtz who had recently retired from the RAAF and he suggested that we would need to offer more than 10 million to get approval from the DMO Disposal Agency. We did despite the fact that B707's were selling for 2/400,000 USD for scrap for spare parts for the remaining fleet. Omega believed that the value was greater to us than the scrap value as they could be FAA certified as CASA had a joint certification agreement with the US FAA. This was a mistake as we discovered after the contract was agreed that the certification was completed by the Israel CAA and not by CASA. We had not had this knowledge when we agreed the deal and only came to our attention once we received/reviewed the extensive documentation that came with the aircraft. It was thus, our mistake and had no blame to the DMO as we simply assumed in good faith and never asked the question.

In late 2007 Anglo Irish Bank was in difficulty and terminated their offer to support the purchase of the RAAF B707 fleet and weapons system, shortly after Omega had signed the contract and paid the deposit. We approached many banks including some in Australia without success to try to replace Anglo finance.

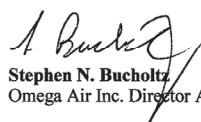
By this time the RAAF had approached the USN and the USAF to try to get support for the now very much delayed A330-MRTT. They could only provide periodic Air to Air Refuelling so we were asked by the USN if we could provide the needed support. We could not at that time as we could not afford to buy the RAAF aircraft that would allow us to release our existing aircraft used by the USN and we could not get FAA certification for the RAAF aircraft as they would not recognise the Israeli clearances. We also knew from the RAAF personnel we met at AAR conferences that they expected a 2/3 year delay in the A330 delivery. We met with DMO on a number of occasions to see if we could offset the purchase price against the service we would provide. This was not possible as the money was from and too different account "pots" within Defence.

The USN finally decided to give us an Interim Flight Clearance (IFC) on the ex-RAAF tankers based on their own history of using the aircraft while in RAAF service. This IFC only applied for 6 months and would only be renewed based on evaluation. We decided to proceed on this basis and restructured our agreement with DMO and proceeded to try to honour our commitments. Clearly Omega had paid much too much for the aircraft and spares package but we were stuck with the problem and needed to honour our contractual commitment.

We supported the RAAF for 3/4 years while they awaited the delivery of their own new tankers and as they struggled to get an Operational Capability. This support was provided through the US Navy who in some cases sacrificed their own training to allow Omega to deploy in support of the RAAF. Although by this stage we had paid a significant percentage of the aircraft purchase price theoretically, we did not own them. However, when operating with the RAAF we provided very experience crews plus global operational and logistic support which meant occasionally we operated at a loss but were committed to meet the support requests, which from the feedback we received the RAAF staff were most satisfied. Thus, we were very disappointed when Defence stopped us flying for the RAAF until the aircraft were fully paid for. This short notice cancellation placed considerable financial difficulties on the company, severely limiting our ability to trade through the contractual difficulties faced at the time.

Now that the situation has been resolved we trust there is no long time detriment and we look forward, if required, to provide the RAAF with the cost effective and efficient AAR support that the company is known globally for.

Yours Truly,



**Stephen N. Bucholtz**  
Omega Air Inc. Director Australian Operations

For:

**Ulick McEvaddy**  
Omega Air Owner/Director  
Tel no.+353 1 8376622 office  
[ulick@omegaair.ie](mailto:ulick@omegaair.ie)

12 January, 2014

## Appendix 3: Disposals Review Recommendations

These six recommendations were made by the DMO Disposals Review (October 2013). All have been accepted by Defence.

### Recommendation 1: Legislation and policy review

- That a detailed review of the legislation and policy applicable to Disposals' activities be conducted. This should include a review of procurement and contracting policy to confirm where this policy is appropriate for disposal activities and where any departures from existing procurement policies are warranted in the disposals context.
- The review should adopt a holistic approach involving consultation with all necessary stakeholders to consider all key compliance obligations, including financial management and accountability, management of dangerous/hazardous substances and international arrangements.
- That the review produces a single guidance document/instruction which clearly sets out the legislative and policy framework applicable to disposals.
- That the guidance document/instruction produced is developed and agreed with relevant stakeholder organisations to resolve current inconsistencies and lack of clarity in available guidance.

### Recommendation 2: Delegation framework clarification

- That the delegation structure applicable to disposal activities be clarified so that it is clear which stakeholder organisations hold particular delegations, and what delegations must be exercised in relation to disposal activities.
- That the risk analysis process referred to in recommendation 4 be used to establish appropriate delegate approval processes at key "risk points" in the disposal process.
- That processes are established to ensure delegates have visibility of the stakeholders that have been consulted, and the advice of those stakeholders, when delegate endorsement is sought.
- That the Minister be engaged more appropriately in Disposals' operations, including through the use of noting briefs at key points, rather than approvals.

### Recommendation 3: Governance framework

- That, based on the clarified delegation structure referred to in recommendation 2, a clear governance framework be developed to apply to all disposal activities. This framework should articulate:

- each relevant delegate and when delegate consultation / approval is required;
- the role and responsibility of each stakeholder organisation and when stakeholder consultation / advice is required; and
- mandatory requirements applicable to all disposals (for example if probity or DMO Legal advice is to be mandatory for all disposals).
- That Disposals consider introducing a “light touch” independent review process at key points for each of its major, or politically sensitive, disposal processes.

### **Recommendation 4: Risk analysis**

- That an overarching risk analysis be undertaken to identify key risk areas for disposal activities and key risk points throughout the disposal process – this analysis should cover all relevant perspectives including commercial, financial, contracting, legal and project management (among others).
- That the risk analysis considers how the risk profiles of disposals and procurements differ.
- That a risk analysis framework be established to guide the development of risk analysis for individual disposals projects.

### **Recommendation 5: Templates, processes and instructions**

- That the template documentation which has recently been produced by Disposals be:
  - reviewed for completeness;
  - reviewed against the outputs of the recommendations above;
  - reviewed against the resources (both within Disposals and from stakeholder organisations) that are available to support the implementation of the processes and templates; and
  - subject to stakeholder feedback.
- That based on the activity referred to above, the template suite developed by Disposals be refined and completed so that it provides a useful suite of documentation for Disposals personnel (and relevant stakeholders).
- That detailed guidance be produced for all template documents to inform users of why and how the templates must be used.
- That Disposals’ existing template tender and contract suite be reviewed for completeness and currency. This should include a review alongside the

outputs of the recommendations above to confirm that there is appropriate alignment.

- That detailed instructions and guidance be produced which is applicable to disposals (such as a disposals policy manual) to provide standardised guidance to individuals performing disposal activities. These instructions and guidance materials should include details of key risks and the stakeholders that should be consulted at key points, or on key issues, in the disposal process.
- That business rules be established to support the use of templates, instructions and guidance materials and the retention of appropriate records.

### **Recommendation 6: Training and resourcing**

- That a training needs analysis be conducted in the context of the Disposals function to confirm required skill sets and training requirements for personnel involved in Disposals (whether as stakeholders or Disposals personnel).
- That Disposals' personnel and relevant stakeholders be offered training on legislative and policy obligations, disposal risks, procurement and contracting, templates and guidance and on records management, particularly electronic records creation and storage.
- That Disposals' resourcing model be reviewed to ensure that it has sufficient, skilled, personnel with the necessary contracting, commercial, logistics, inventory management, project and contract management and finance skills to effectively identify and manage risk, and to manage disposal projects in accordance with legislative obligations and applicable policies.
- That DMO/Disposals consider whether additional appropriately skilled and experienced resources are required to properly support the disposal function.
- If the extant resourcing profile for Disposals is inadequate to properly support the process and governance models established in response to this review, then Disposals/DMO should consider alternative approaches to the performance of the Disposals function if adequate numbers of trained resources are not made available to support the Disposal function.



## Appendix 4: Revenues and Costs Associated with Disposals

- Defence is aware of the revenues it obtains from disposal sales and these are reflected, in aggregate, in its financial statements (Table A.1).

**Table A.1: Sales of specialist military equipment**

(As at 30 June)	2009 \$000 <sup>A</sup>	2010 \$000	2011 \$000 <sup>B</sup>	2012 \$000 <sup>C</sup>	2013 \$000 <sup>D</sup>	2014 \$000 <sup>E</sup>
Proceeds from sale	41 816	0	3 400	598	12 489	49,425
Less: Carrying value <sup>F</sup>	124 500	0	0	108	18 508	35,026
Less: Selling expense	320	0	0	0	2 280	9,949
<b>Net gain (loss) from sale</b>	<b>(83 004)</b>	<b>0</b>	<b>3 400</b>	<b>490</b>	<b>(8 299)</b>	<b>4,450</b>

Source: Defence Annual Reports, Financial Statements.

### Notes to Table A.1

- Comprises part-payment for the B707 aircraft disposal (\$2.3 million); net loss on the sale of the Super Seasprite helicopters (\$85.3 million).
- Comprises part-payment for the B707 aircraft disposal.
- Comprises net gain on the sale of the Caribou aircraft and associated spares.
- Comprises net gain on sale of approximately 330 B Vehicles (\$0.763 million); net gain on the sale of a number of Penguin Missiles (\$1.970 million); net loss on the sale of Sea King Helicopters (\$11 million); and a net loss on the sale of FA-18 centre barrels (\$0.032 million).
- Comprises net gain on the sale of Collins related items (\$0.140 million); net gain on sale of a number of Penguin Missiles (\$2.849 million); net gain on the sale of various military support items (\$4.578 million); net loss on the sale of FA-18 centre barrels (\$2.814 million); net loss on the sale of 3 Bushmaster Protected Mobility Vehicles (\$0.064 million); net loss on the sale of approximately 2 000 B Vehicles (\$0.188 million); net loss on the sale of ex-RAN tug boats *Bandicoot* and *Wallaroo* (\$0.040 million); and net loss on the sale of tentage (\$0.013 million).
- Carrying value of specialist military equipment is carried at cost less any accumulated depreciation and accumulated impairment losses. For further information on asset values for Defence specialist military equipment refer to Defence's financial statements and notes to and forming part of the financial statements in Defence Annual Reports.

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