

Performance Audit No. 19 (2014-15)

Disposal of Specialist Military Equipment

Introduction

- 3.1 Chapter 3 discusses the Joint Committee of Public Accounts and Audit (JCPAA) review of the Australian National Audit Office ANAO Report No. 19 (2014–15), *Management of the Disposal of Specialist Military Equipment*. The chapter comprises:
- an overview of the report, including the audit objective, scope and audit conclusion
 - Committee review
 - Committee comment

Report overview

- 3.2 Defence manages Commonwealth assets worth some \$75 billion, 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, including 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. 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 Army's fleet of Leopard 1AS tanks, most of which were retained or gifted for display
 - the Royal Australian Air Force's (RAAF's) F-111C/G long-range strike aircraft, a few of which were retained for display but most of which were destroyed because of asbestos content.¹
- 3.3 Proceeds from SME disposals can vary significantly. Proceeds were \$12.5m in 2012–13 and \$49.4m 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.²
- 3.4 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;
 - Australian obligations relating to the management of hazardous substances, such as asbestos;
 - environmental protection; and
 - the resource management framework applying to government entities.³
- 3.5 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.⁴
- 3.6 Under this audit, the primary legislation governing disposal of Commonwealth assets was the *Financial Management and Accountability Act 1997 (FMA Act)*⁵. 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, having regard to:
- legal, contractual, government and international requirements;
 - ensuring that actions would withstand scrutiny;
 - being fair, open and honest; and

1 ANAO Report No. 19 (2014–15), *Management of the Disposal of Specialist Military Equipment*, p. 11.

2 ANAO Report No. 19 (2014–15), p. 11.

3 ANAO Report No. 19 (2014–15), p. 11.

4 ANAO Report No. 19 (2014–15), p. 11.

5 On 1 July 2014, the *Public Governance, Performance and Accountability Act 2013* replaced the FMA Act

- considering the cultural, historical and environmental significance of providing the item to appropriate organisations.⁶
- 3.7 The Defence Materiel Organisation (DMO)⁷ 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. However, many parts of Defence may have an interest in any particular disposal.⁸

ANAO Audit objective and scope

- 3.8 The Secretary of Defence and Chief of the Defence Force (CDF) wrote to the Auditor-General in April 2013 and requested a performance audit of Defence's management of SME disposals. In May 2013, the Auditor-General agreed. The audit objective was to assess the effectiveness of Defence's management of the disposal of SME. The audit considered:
- whether Defence has conducted disposals in accordance with applicable Commonwealth legislative and policy requirements and Defence policies, guidelines and instructions; and
 - where relevant rules have been 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.⁹
- 3.9 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.¹⁰

6 ANAO Report No. 19 (2014–15), p. 12.

7 In April 2015, the Minister for Defence, the Hon Kevin Andrews, announced a series of reforms for the Department of Defence. One of the reforms announced through the *First Principles Review: Creating One Defence* policy paper was the abolition of the DMO and the return of its functions to the broader Department of Defence.

8 ANAO Report No. 19 (2014–15), p. 12.

9 ANAO Report No. 19 (2014–15), p. 13.

10 ANAO Report No. 19 (2014–15), p. 13.

ANAO overall conclusion

- 3.10 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, SME disposals require a balanced assessment of risks and potential benefits with appropriate senior leadership attention within Defence. The ANAO found that 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
- 3.11 The ANAO found that the major disposals examined had been largely disappointing as they have generally taken a long time, incurred substantial and unanticipated costs, and incurred risks to Defence's reputation. This includes:
- 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 Vehicles¹² 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 is ongoing after five years following a flawed tender process and uncertainty as to the identity and business of the major purchaser.¹³
- 3.12 Boeing 707 and Caribou aircraft disposal problems were already known to Defence and led the Secretary and CDF to request this audit. The audit highlighted a number of consistent underlying themes in the difficulties in managing SME disposals. The key issues were:
- a disproportionate focus on revenue without full regard to costs;
 - insufficient attention to risk management;
 - the quality of internal guidance;
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11 ANAO Report No. 19 (2014-15), p. 13.

12 B Vehicles comprise about 12,000 Army trucks, trailers and four and six-wheel drives, which are beyond their expected operating life. ANAO Report No. 19 (2014-15), p. 21.

13 ANAO Report No. 19 (2014-15), p. 14.

- fragmented responsibilities; and
 - limited senior management engagement.¹⁴
- 3.13 The ANAO found that Defence's rules were not clear or fully developed for SME disposals, despite many internal sources of guidance. In particular, Defence lacked a set of operational procedures for SME disposals and clearly identify roles and responsibilities across the large number of Defence stakeholders. Thus, Defence staff had limited guidance on key issues such as the potential costs of disposal activity, and there was no requirement to check on the capacity of the entities with whom Defence was dealing.¹⁵
- 3.14 The ANAO commented that shortcomings in Defence guidance relating to establishing the bona fides of third parties 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 which introduced risks of inappropriate or incorrect gifting of surplus Defence SME.¹⁶
- 3.15 While the reform of SME disposals has been attempted in recent years, it had not consistently held the attention of Defence's senior leadership. The ANAO concluded that reforms that commenced in 2011 had good intentions but were not supported by sufficient analysis and were based on a flawed assessment of the prospect for making SME disposals into a net revenue-generating program.
- [Defence] 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.¹⁷
- 3.16 The ANAO found that history indicates that Defence staff tend to focus on the apparent revenue available from equipment sales without full regard to the risks taken in pursuit of that revenue. Risks included reputational risks and risks of further costs being incurred during the disposal process. As discussed in the audit report, reforms in 2011 highlighted the gaining of revenue as an objective for SME disposals.

14 ANAO Report No. 19 (2014–15), p. 14.

15 ANAO Report No. 19 (2014–15), p. 14.

16 ANAO Report No. 19 (2014–15), p. 14.

17 ANAO Report No. 19 (2014–15), p. 15.

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. As the audit shows, the costs to Defence can exceed the potential revenue available.¹⁸

- 3.17 A major challenge had been the presence of asbestos in SME. Defence set about a vigorous remediation program to remove asbestos from its workplaces. Defence also resolved in late 2009, through a 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 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 have contained accessible asbestos without full regard to the management of the risks or transparent declaration of those risks to potential purchasers.¹⁹
- 3.18 The ANAO reported that the Defence Minister does not hold the formal decision-making authority for gifting Commonwealth assets. The Australian Government's resource management framework states that the Finance Minister has that authority and has delegated it to the Secretary of Defence. The ANAO commented that a challenge remained for Defence to develop early advice to ministers about the requirements and operation of the gifting delegation where any options for gifting are to be contemplated.²⁰
- 3.19 The audit's key message was that decision-making should be based on a broader understanding of the benefits, risks and costs of each disposal. 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. The ANAO stated:

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

18 ANAO Report No. 19 (2014-15), p. 15.

19 ANAO Report No. 19 (2014-15), pp. 15-16.

20 ANAO Report No. 19 (2014-15), p. 16

of understanding and be well placed to complete the disposal efficiently, effectively and properly.²¹

Audit recommendations and agency response

3.20 The ANAO made five recommendations aimed at strengthening Defence's SME disposals framework and practice. Table 3.1 sets out the recommendations for ANAO Report No. 19 and Defence's response.²²

Table 3.1 ANAO recommendations, Report No. 19 (2014-15)

1	<p>To rationalise and simplify its existing framework of rules and guidelines for disposal of specialist military equipment, the ANAO recommends that Defence:</p> <ul style="list-style-type: none"> (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. <p>Defence response: <i>Agreed.</i></p> <p>Finance response: <i>Supported</i></p>
2	<p>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.</p> <p>Defence response: <i>Agreed</i></p>
3	<p>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.</p> <p>Defence response: <i>Agreed</i></p>
4	<p>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.</p> <p>Defence response: <i>Agreed</i></p>
5	<p>The ANAO recommends that Defence:</p> <ul style="list-style-type: none"> (a) reinforce its conflict of interest and post-separation policies to all ADF members and APS staff, particularly in relation

21 ANAO Report No. 19 (2014-15), p. 16.

22 ANAO Report No. 19 (2014-15), pp. 29-30.

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

3.21 Defence provided the following response to the 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 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. 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.²³

- 3.22 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.²⁴

Committee review

- 3.23 Representatives of the following agencies gave evidence at the Committee's public hearing on 14 May 2015:
- Defence Materiel Organisation (DMO)
 - Department of Defence
 - Australian National Audit Office (ANAO)
- 3.24 As discussed below, the Committee focussed on the following issues during its review of the ANAO's report:
- Redress of issues raised in the ANAO report
 - Disposal of decommissioned warships
 - Disposal of specialist military equipment in operational areas
 - Caribou aircraft
 - Disposal of Sandline helicopters
 - Financial delegations
 - Conflicts of interest
 - Staff training and corporate knowledge

Redress of issues raised in the ANAO report

- 3.25 The Department of Defence, having itself requested the audit of SME disposals, has already begun to institute reforms that address the issues

23 ANAO Report No. 19 (2014–15), pp. 27–28.

24 ANAO Report No. 19 (2014–15), p. 28.

raised in the ANAO report. Defence responded that senior management oversight and attention is now firmly placed on the area of disposals, and they are systematically working through all the issues identified by the Auditor-General's report.²⁵

- 3.26 First, major disposals are now being led by a single area in Defence, which is the Australian Military Sales Office (AMSO). Defence claim they are also developing a consolidated, streamlined and simplified policy framework, and are undertaking a whole of Defence review of disposals policy.²⁶ Defence explained:

We have gone through the [ANAO] audit report and identified many, many other areas that we need to address. It is probably fair to say, and as the ANAO report also identifies, that we had conducted an independent review at the end of 2013 which had identified a number of gaps in terms of policies and procedures. We were working through a number of those gaps while the audit was ongoing and we have now systematically categorised them. We have categorised it into governance, which is the level of oversight the organisation has. We have also categorised it into policies and procedures, which includes new templates. We have also categorised it into checklists, which include for example the risk relating to *bona fides* and getting our inspector-general organisation to do an assessment. We have also categorised it into education and training for staff, and so on and so on. In addition to the management response to the five recommendations internally, we have a suite of recommendations and initiatives under each of those headings that we are working through.²⁷

- 3.27 Second, Defence has also initiated its own audit processes to complement those of the ANAO:

The audit area within Defence has also done a review on disposals as well and we have some recommendations we are working through with them. To close the actual recommendations the area needs to submit to my area a detailed explanation of what has been done and we will then go and inspect that to see if not just the finding itself, the recommendation, has been closed but the

25 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, p. 2.

26 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, p. 2.

27 Ms Michelle Kelly, Head, Defence Industry, Department of Defence, *Committee Hansard*, 14 May 2015, p. 10.

intent of the issue has also been met. This builds a high level of confidence that whatever has been done will become enduring.²⁸

- 3.28 Finally, in terms of some of the specific issues raised in the ANAO report, such as disposal of assets contaminated with asbestos and B type vehicles, some particular initiatives have been developed:

The ANAO report identified that Defence has not always adhered to the internal guidance on disposal of assets containing asbestos. We have reviewed the guidance and a new framework has been implemented, and I worked with the Vice Chief of the Defence Force to issue an updated instruction on disposal of assets containing asbestos... We are now also undertaking a comprehensive work health and safety risk assessment for each disposal, and that is being used to determine the most practicable remediation action – it is not only for asbestos but all hazardous material.

[I]n relation to the B vehicles, we had already taken a number of steps... to suspend the supply of B vehicles to the sales contractor and at our request the contractor, Australian National Disposals, cancelled the auctions planned for January and February while we put in place updated measures. We have disclosed all relevant safety related information to the contractor, who has in turn passed those onto past and future purchasers. We have got a dedicated website set up, to allow easy public access to safety and hazardous substance documentation. We have also asked the contractor, and they have done this, to produce a number of warning labels regarding potential asbestos content; those labels have been posted to all past purchasers. For vehicles not sold, the warning labels are now being affixed to the vehicles before they are on-sold... [T]he company has now restarted the public auctions, and those started in March 2015.²⁹

Disposal of decommissioned warships

- 3.29 The disposal of decommissioned Australian warships featured in the ANAO report, notably the *HMAS Adelaide* and *HMAS Canberra* – both Adelaide class frigates. *HMAS Sydney* – also an Adelaide class frigate – is

28 Mr Geoffrey Brown, Chief Audit Executive, Department of Defence, *Committee Hansard*, 14 May 2015, p 10.

29 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, p. 2.

also scheduled to be decommissioned at the end of 2015.³⁰ Given the issues with the earlier two warships, the Committee was interested in what had been learned and how this would apply to the decommissioning of *HMAS Sydney*. Defence responded that the ANAO's recommendations had resulted in changes to disposal process and gave the upcoming decommissioning of *HMAS Tobruk* as an example of the new approach Defence is taking:

HMAS Tobruk is a good example because it is being decommissioned about the middle of this year. Already we have received... a number of representations from various areas around Australia for a range of things, including sinking it as a dive wreck, and parts going to various heritage organisations. So for this one we have reinstated a governance framework which goes to what the ANAO identified, which was that disposal is managed in a whole range of different areas in Defence and not consolidated under one governance framework, and there is not a clear accountability in terms of responsibility.

We have readjusted that accountability framework so there is one area that brings in all stakeholders, who discuss and make recommendations in terms of disposal strategies. That area also has responsibility for ticking-off on a range of WHS [Work Health and Safety] risks, hazardous substances, security, probity – all of the issues that are in our checklist that are similar to our acquisition processes that need to be cleared. This was in direct response to another ANAO concern, which was that there was not sufficient senior level oversight not only in terms of disposal decisions, but also to make sure that there was sufficient compliance in terms of the process. It also now has sufficient oversight within the Defence Materiel Organisation before it goes to the relevant capability manager, who is the delegate, and before it goes to the minister for his review.³¹

3.30 New workplace health and safety laws have made disposing of decommissioned warships as dive-wrecks increasingly complicated and difficult. Defence explained:

The legislation has changed quite significantly. In terms of the states, as you are aware and as is outlined in the report quite

30 "Final entry into Sydney for city's namesake warship", *Media Release*, Department of Defence, 27 February 2015, <<http://news.defence.gov.au/2015/02/27/final-entry-into-sydney-for-citys-namesake-warship/>> accessed 25 May 2015.

31 Ms Michelle Kelly, Head, Defence Industry, Department of Defence, *Committee Hansard*, 14 May 2015, p. 3.

extensively, there were issues associated with the states being able to pay the full amount of the cost. Defence ended up incurring quite significant costs over and above what was expected. In terms of the state issue, we have certainly looked at thinking about how, going forward, should we ever do a dive wreck, we can put in place arrangements to ensure that the states can pay and can comply with WHS and hazardous material requirements.

Having said that, the bigger issue for us at the moment is really the constraints that WHS puts on agreeing to a dive wreck at all. That in the case of [HMAS] *Tobruk* is something that we are working through in terms of expert WHS advisers and with ministers' offices and other stakeholders to work out how we can manage it. Once we cross that threshold – if we can – we will need to put in place much more rigorous arrangements with states. Now not only is the cost an issue for them; but WHS is even more so an issue for them not only now but years down the track.³²

- 3.31 Defence was asked if effective processes had been established to ensure that commitments from state governments were being followed through. Defence explained that the difficulties were more to do with the Work Health and Safety risks and the increased costs those risks entailed:

We had agreements in place with the states at the time. Once the additional cost became apparent, the states were not willing to fund those costs. But we cannot outsource our obligations to ensure that, if a ship is used as a dive wreck, it is sunk safely, that all work health and safety issues are taken into account. So, ultimately, we still have a residual liability to ensure that it is done safely. While we can certainly deal with the financial consequences through revisions to the agreement and requiring money to be paid up-front.... I think the greater challenge for us is to ensure that, if a state does take it and we have agreed for a ship to be used as a dive wreck, it is actually sunk safely and all the work health and safety issues are dealt with. I think the advice we have received is that we would always have some level of residual liability to an individual should they suffer harm as a result of a matter relating to that dive wreck.³³

32 Ms Michelle Kelly, Head, Defence Industry, Department of Defence, *Committee Hansard*, 14 May 2015, pp. 4-5.

33 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, p. 5.

Disposal of specialist military equipment in operational areas

- 3.32 By coincidence members of the JCPAA visited Afghanistan in 2014 and witnessed the Mine-Resistant Ambush Protected (MRAP) vehicles being compacted and destroyed. Although the MRAPs were not at 'end-of-life' and still serviceable, they were surplus to requirements and the costs of return to Australia were deemed prohibitive following a cost-benefit analysis of that disposal option.³⁴ Defence explained the process for disposal of assets in theatre and/or overseas:

An assessment is taken of the costs, benefits and risks of the various disposal strategies – for example, we would look at whether we want to repatriate the equipment to Australia, whether it can continue to be used, whether it has a life, and then the ongoing sustainment costs of those and the cost to remediate. We would have a look at requests by the relevant country for retention of particular capability, and then we would also assess the risks around doing that, depending on the nature of the capability. We would have a look at what the best method of disposal is, whether that is sale or gift to the country. We would normally seek assurances around how that equipment would be maintained. We would do an assessment. Does the country have the capacity to support that equipment? What will be the expectation on spares and supply chain and our ongoing liability? Those are issues we would look at – either sale or gift to the country, bringing back to Australia for either retention remediation and further use, or some other disposal activity. Another option would be simply to dispose of it where it is in theatre. All those considerations are taken into account before we make a decision about what the best disposal action is.³⁵

Caribou aircraft

- 3.33 Although it was known the Caribou aircraft contained asbestos, the decision was made to gift some of them to historical societies and museums. Defence was asked to provide further explanation as to why and how this occurred and the current status of the aircraft and any possible remediation work:

The asbestos is in situ. A number of old military platforms contain asbestos. For example, the Leopard tanks, which were also gifted,

34 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, pp. 3-4.

35 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, p. 3.

contain asbestos. This is part of our assessment when we are looking at a disposal strategy.³⁶

It is a slightly different case for those particular Caribou. There is an ongoing monitoring program for those particular ones. It is slightly different to the tanks, for example, which we have welded up so that they are not accessible³⁷...What we normally do is have a program in place to make sure that, in the case of Leopard tanks, they were welded up so that the asbestos is not accessible.³⁸

[W]e have two [Caribou] aircraft in flying condition that are being maintained by the heritage organisations concerned. We have a detailed plan in place to ensure they are maintained in an appropriate way to ensure they are safe... But obviously we would not be allowing those to be flying if the asbestos was not being safely managed.³⁹

Disposal of Sandline helicopters

- 3.34 The ANAO report identified the case of two Russian-made Mi-24 'Hind' attack helicopters that 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 Papua New Guinea Government. However, changed circumstances led to the equipment being brought to Australia aboard a Russian Antonov transport aircraft, which landed at Tindal RAAF base.
- 3.35 Originally regarded by Air Force as 'a matter for Customs', the equipment included four helicopters, two of which were regarded as civilian and later sold, and two Mi-24 attack helicopters. 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 asked 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.⁴⁰

36 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, p. 6.

37 Ms Michelle Kelly, Head, Defence Industry, Department of Defence, *Committee Hansard*, 14 May 2015, p. 6.

38 Ms Michelle Kelly, Head, Defence Industry, Department of Defence, *Committee Hansard*, 14 May 2015, p. 6.

39 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, pp. 6-7.

40 ANAO Report No. 19 (2014-15), p. 198

- 3.36 The continued storage at Tindal of these military attack helicopters has resulted in Defence incurring an unquantified cost for the better part of two decades.⁴¹ When asked for an update, Defence explained that while the aircraft are still expected to be disposed of within 12 months, there have been further delays:

The particular equipment in question is not ours but...we are going through that process and I expect that to be complete inside the next 12 months. We have had some trip-ups along the way, particularly related to disposal and access during the wet season. But I expect that to be complete in the next 12 months. The [ANAO] audit report talks about specific dates and briefs to the minister. That has not occurred. It did not occur in January because the particular request that was made, as referred to in the report, was withdrawn. So advice to the minister at that time would have been incomplete. I expect that advice to be updated later this year.⁴²

Financial delegations

- 3.37 The issue of who has the financial delegation to gift former military assets as evidenced by the report engaged the Committee's interest, especially as the items gifted are usually of high-dollar value. Committee members asked for clarification on the process and lines of responsibility.
- 3.38 Regarding the dive-wrecks, and the advice given by DMO to the Defence Minister, Defence responded:

I think it is partially a semantic issue, partially not a semantic issue. For disposals of those kinds of assets we would always seek a ministerial view around what the disposal options would be. I think that from a timing perspective we could have been better at advising the minister up-front around what the rules around gifting were and that it is actually an internal delegates decision, then having the minister approach the finance minister for confirmation of the strategy prior to them making the offer. So I think it is a timing issue. We probably could have been better at advising the minister up-front about what the actual process was and who the delegates were.⁴³

41 ANAO Report No. 19 (2014–15), p. 27.

42 Air Commodore Peter Yates, Director, General Logistics – Air Force, Department of Defence, *Committee Hansard*, 14 May 2015, p. 9.

43 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, p. 3.

- 3.39 Defence made it clear that the Minister for Finance has the delegation in terms of gifting of Commonwealth property, but that this was further delegated to chief executives which was then again delegated to service chiefs with the caveat that such delegations were limited to certain dollar values. Nonetheless, the Defence Minister is consulted on the various proposals.

The Minister for Finance has the delegation in terms of gifting of Commonwealth property. As I understand it, he has delegated that to chief executives, which are effectively the secretaries of departments. In our case it is the secretary and the CDF. It has been further devolved within the department down to the service chiefs as well, and I think their threshold is \$500,000. Anything above that in terms of value of the asset and the delegate is either the secretary or CDF.

While the finance minister has delegated it to the department that does not necessarily mean that we consult the finance minister because he has delegated that authority. But what we do quite properly do is engage with our ministers as the case is throughout the process, quite properly, to talk about the issues, the options, preferences, other aspects the delegate may need to take into account in exercising their delegation. So we consult with the minister and advise him... So we just need to be clear – and we will certainly be in the future – about where the delegation lies and what information and consultation it is we are actually seeking or having with ministers...

If it is a major disposal then the [Defence] minister might want to have a conversation with colleagues and take a broader government view. But, ultimately, the final decision is not the minister's; it is the delegate's.⁴⁴

- 3.40 Defence noted the ANAO report's conclusion with regard to financial delegation and advised they had altered their processes accordingly.

Conflicts of interest

- 3.41 Potential conflicts of interest were identified by the ANAO report which was of interest to the Committee – particularly as in one example 'there is no evidence that, at the time, any Defence staff identified...a perceived or

44 Ms Michelle Kelly, Head, Defence Industry, Department of Defence and Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, p. 4.

actual conflict of interest.’⁴⁵ Defence explained what steps were being taken to address this issue:

[W]hen we do major procurements we have really strict processes. We have strict rules in our request for tenders and our evaluation plans. We appoint probity advisors. We seek conflict of interest declarations. As I was saying before, as part of our revised processes, what we are now applying to our disposal activity is the similar level of rigor to that we apply to our procurement processes – so, using consistent processes. Obviously, one is a procurement of something and one is a disposal, but to some extent there is commonality – similar request for tender, conditions of tender; similar provisions in contracts; similar requirements for an evaluation plan, for probity requirements in that plan; and so on... The other thing I would observe is that we paid a lot of attention in the DMO to post-separation employment and management of conflicts of interests... I think part of the problem with the post-separation is the inconsistent application across the broader defence organisation.

There is now a much more consistent approach across the defence organisation to managing, in particular, the post-separation issue, and also the use of reservists, because even in our major procurement processes we have come across some examples where people are coming in and doing reserve work, but who also work in their normal jobs for Defence contractors. There are challenges around managing that, because as a reservist they have access to the Defence network. They might have access to information that could be of assistance to that company in tender processes that are ongoing or forthcoming. So we have done a lot of work with each of the headquarters to make sure that they are adopting a similar approach to what we do in DMO in managing that post-separation conflict of interest.⁴⁶

3.42 A representative for the RAAF gave a practical example of how their service approached the issue:

Last year a member of my staff was resigning from Air Force and was seeking employment with a major contractor. We actually went through a formal investigation and declaration of conflict of interest. The policy requires me to send that to deputy chiefs. I sent it to the deputy chief. The deputy chief agreed with my

45 ANAO Report No. 19 (2014–15), p. 195.

46 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, pp. 8-9.

assessment that there was no real or perceived conflict of interest, and we have actually stored that advice. My view is that the revised procedures are in place. They are far better than they used to be, and we are able to use them to good effect. I cannot speak for all of Air Force – I only control one part of it – but certainly we are using those instructions.⁴⁷

Staff training and corporate knowledge

3.43 Failings by employees in the conduct of disposal of Defence SME, such as the inadequate advice regarding financial delegations, can in part be traced back to factors such as skills, experience, training and organisational structure. Defence provided an overview of the section now charged with disposals and its staffing arrangements:

We set up the Australian Military Sales Office a few years ago... The Australian Military Sales Office was set up from within the existing staffing that I had from both Defence Industry Division and Defence Disposal Agency. I merged some people from the Defence Industry Division with the Defence Disposal Agency to try to build a capability... We have also bolstered the commercial acumen; we also have a number of contracting folk in our organisation and our legal folk. We are paying a lot greater attention to the way we go about doing disposals by using the same skill sets, processes and templates as we do for a major procurement. I think the ANAO report identified that our focus has tended to be on the procurement of new capability, and disposals has been kind of the poor cousin. We are now trying to apply the same level of rigour, skill sets, process and best practice to the disposals operation that we do for procurement.⁴⁸

3.44 Staff turnover has been significant. When the Australian Military Sales Office (AMSO) was established in July 2012, it incorporated the existing Defence Disposals Agency which had 11 staff members. Seven of these staff members, including the director, have since left the AMSO.⁴⁹ Such a high staff turnover can undermine the retention of corporate knowledge and the execution of competent experience based risk analysis. Defence explained the manner in which it is addressing these issues:

47 Air Commodore Peter Yates, Director, General Logistics – Air Force, Department of Defence, *Committee Hansard*, 14 May 2015, p. 9.

48 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, p. 5.

49 *Submission 3*, Department of Defence, p. 3.

We have lots of training courses that we put our staff through. I think I mentioned before we have a significant contracting workforce that we apply to our procurements as well as in-house legal function and we have now mandated that disposals and military sales make use of that highly-skilled workforce in undertaking this work. They will identify the need for a risk assessment and we might then get external support to come in and help us with the risk assessment or we bring in other expertise from across the organisation to support us in that activity.⁵⁰

We have a quite well-matured risk assessment processes. We have a project risk management manual. We have a lot of guidance about how to undertake risk assessment in terms of project risk, capability risk and liability risk. I think one of the things that was identified by the ANAO report was that we had not been applying those mature processes and procedures and templates that we had from our procurement work to the disposals work. Again, that is something that we have brought across that we are now applying more rigorously when we are doing disposals and sales of military equipment.⁵¹

Committee comment

- 3.45 The Committee is encouraged by the fact that it was Defence itself that requested this ANAO audit having recognised that problems existed regarding disposal of SME.
- 3.46 Defence provided an enthusiastic overview of the reforms the department has instituted to address the concerns raised in the ANAO report. The Committee commends the ANAO recommendation that Defence rationalise and simplify the framework of rules and guidelines for disposal of SME. The Committee notes Defence's assurances it is developing a consolidated, streamlined and simplified framework on Defence disposals.
- 3.47 The conflicts of interests highlighted in the report are of concern to the Committee. Although Defence has outlined its reformed approach, the opportunity for such conflicts, either perceived or real, to occur, remains particularly when there are large dollar values involved. Reputational

50 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, p. 10.

51 Mr Harry Dunstall, Acting Chief Executive Officer, Defence Materiel Organisation, Department of Defence, *Committee Hansard*, 14 May 2015, p. 9.

issues for both Defence and the Australian Government may arise if cases such as those reviewed in the report continue and Defence must ensure that its internal processes eliminate such occurrences.

- 3.48 Although the Committee is encouraged by Defence's initiatives, one of the challenges will be that the enthusiasm currently being shown and the reforms currently being instituted result in long-term reform in the procedures and policies of SME disposal. However, the Committee is concerned that the *One Defence* reforms, that will result in DMO being folded back into the Department of Defence, may in some way undermine the improvements being made to the disposal of SME given that DMO has oversight of this function. To ensure that the current momentum and reform in this area is maintained, an initial follow-up audit should be considered within 12 months following the tabling of this report with the possibility of further audits in the future.

Recommendation 5

- 3.49 **The Committee recommends that the Australian National Audit Office (ANAO) consider a follow up audit 12 months following the tabling of this report to provide an update on the progress of Department of Defence's reforms with regard to the disposal of Specialist Military Equipment. Further audits in this area could be considered by the ANAO.**
- 3.50 The Committee notes with interest the continued storage of and delay in disposing of the former Sandline Mi-24 'Hind' attack helicopters. That they have been in storage for almost two decades at cost to the Australian taxpayer is not a desirable situation nor is it one that should ever be repeated.
- 3.51 With the establishment of the Australian Military Sales Office in July 2012 and the reforms that have been introduced there appears to be a positive development in contributing to the resolution of SME disposals. However, the Committee notes the high staff turnover and expresses its concern that through that turnover significant expertise and experience will be lost to the organisation. To ensure that this expertise is maintained, training for new staff is essential but so too is the necessity for departing staff to ensure that their corporate knowledge is preserved and transmitted to incoming staff.

Recommendation 6

- 3.52 **The Committee recommends that the Department of Defence develop comprehensive training programs, instruction procedures and handover briefs for all new Australian Military Sales Office staff.**