

Chapter 6

External reviews of the 2010 tender process

6.1 The AFCD and PwC reviews did not dispel some of the disquiet surrounding the probity of the 2010 tender process. Indeed, Defence felt the need to commission two external reviews, one by Deloitte and the other by the Australian Government Solicitor, concerning matters of probity and legal process compliance. This chapter outlines the reasons for commissioning these reviews, their approach and key findings. It also outlines the limitations in scope and methodology under which the reviews operated. The chapter further identifies the events of September 2010 that prompted the current AFP investigation into the 2005 tender process.

Correspondence with Strategic on completion of the internal review

6.2 Following the completion of the AFCD and PwC reviews, Mr Brown, the Chief Audit Executive, wrote to Mr Aisen on 26 August 2010 to inform him of the outcome of the AFCD review. Mr Aisen responded on 28 August 2010, expressing some 'very serious concerns' about the outcome and process.¹

6.3 Mr Aisen disputed the finding that the tender process was compliant with Commonwealth and Defence procurement policy. He stated that Mr Charlton's employment within 1JMOVGP while providing services to Adagold amounted to at least a perceived conflict of interest that should have disqualified Adagold's tender response.² Mr Aisen also raised concerns about other matters including:

- the financial circumstances of Major Charlton's business, Sky Air World, which he submitted should have been assessed as relevant to Adagold's suitability to contract with the Commonwealth;
- the limited scope of AFCD reviews of telephone records and email correspondence between Major Charlton, Adagold and any member of 1JMOVGP in the lead-up to, and following the release of, the tender; and
- the conduct of interviews with, and information sought from, Major Charlton and Adagold.³

6.4 In the interests of transparency, Mr Aisen requested the public release of the AFCD report and 'all relevant Defence-held records'. On 28 August 2010, he forwarded a copy of his correspondence to the Shadow Minister for Defence and to the Chair of the Senate Foreign Affairs, Defence and Trade Legislation Committee

1 Mr Shaun Aisen, email correspondence to Mr Geoffrey Brown, 28 August 2010.

2 Mr Shaun Aisen, email correspondence to Mr Geoffrey Brown, 28 August 2010.

3 Mr Shaun Aisen, email correspondence to Mr Geoffrey Brown, 28 August 2010.

seeking 'a full, independent inquiry into all matters associated with this tainted tender'.⁴

Consideration of internal review findings

6.5 On 26 August 2010, Defence also provided a submission to the (then) Minister for Defence, Senator the Hon John Faulkner, detailing the outcome of the tender process and noting its intention to proceed to contract with Adagold.⁵

6.6 On the request of the Minister and in accordance with caretaker provisions, a copy of the submission was provided to the Shadow Minister for Defence, Senator the Hon David Johnston, on 27 August 2010.⁶ Senator Johnston raised concerns at a meeting on 31 August 2010 and, on the same day, documented them in a letter to the Secretary of the Department of Defence, Dr Watt.⁷ Senator Johnston indicated that he was 'primarily concerned with Defence's reputation and image, in entering a contract in all of the circumstances of this matter'.⁸ In particular, he stated that:

Quite apart from questions around [Major Charlton's] involvement pre-RFT, post-RFT and currently, the fact that he has a long and substantial relationship with Defence Logistics and particularly the Joint Movement Group whilst providing professional advice to tenderers, successful or otherwise is frankly, not a good look.⁹

6.7 Promptly, Dr Watt convened an internal meeting to discuss and develop terms of reference for external probity reviews before making any decision to proceed to contract with Adagold.¹⁰ Defence stated that the terms of reference for the external reviews were 'specifically drafted to address the concerns raised by Senator Johnston'.¹¹

6.8 The 2010 procurement process was suspended for the duration of these external reviews. To minimise operational disruptions, and notwithstanding the urgency, Defence entered into a short-term contract with Strategic to provide air sustainment services to the MEAO from 23 October to 22 November 2010.¹²

4 Mr Shaun Aisen, email correspondence to Mr Geoffrey Brown, 28 August 2010.

5 Department of Defence, *Submission 5*, Attachment A, pp. 7–8.

6 Department of Defence, *Submission 5*, Attachment A, p. 8.

7 Department of Defence, *Submission 5*, Attachment A, p. 8 and Annexure B.

8 Senator the Hon David Johnston, Shadow Minister for Defence, letter to Dr Ian Watt, 31 August 2010, p. 1.

9 Senator the Hon David Johnston, Shadow Minister for Defence, letter to Dr Ian Watt, 31 August 2010, p. 1.

10 Department of Defence, *Submission 5*, Attachment A, p. 8.

11 Department of Defence, *Submission 5*, Attachment A, p. 8.

12 Department of Defence, *Submission 5*, Attachment A, p. 11; Dr Ian Watt, *Proof Committee Hansard*, 29 March 2011, p. 49.

Commissioning external reviews

6.9 Defence engaged the external reviewers, Deloitte and the Australian Government Solicitor (AGS), through its professional services panel arrangements.¹³ In respect of its engagement of Deloitte, Defence acknowledged that it had considerable pre-existing contractual arrangements with the firm. Defence considered, however, that these prior arrangements did not affect the independence of Deloitte's review due to the strength of the firm's brand. Dr Watt stated:

One issue about Defence is that no matter where you go...lots of people have contracts with us. In the case of a major accounting firm, their business is their brand not their contracts with us. If they felt there was a conflict of interest because of the contracts they had with us, they would have said so. They did not because their brand is worth much more than whatever current contracts they have. I think there is a point where there are only a limited number of service providers around Canberra or any other town. All users of services rely on the brand.¹⁴

6.10 It should be noted that an article again raising concerns about the probity of the tender process including the 2005 tender appeared in the *Age* on 2 September. The article reported that the newspaper had obtained emails revealing that two Department officers working in the unit responsible for the 2005 contract—David Charlton and John Davies—'were providing information during the tender process to the company later declared the winner'.¹⁵

Deloitte review

Terms of engagement

6.11 Deloitte was engaged on 2 September 2010 to undertake a review of certain aspects of the tender process. These were:

- the governance framework and process of the tender, addressing confidentiality and conflicts of interest in the lead-up to tender and during the tender evaluation process;
- the decision to tender and whether it was based on achieving value for money and was not structured to disadvantage certain potential tenderers;
- the governance of the tender, including adherence to the TEP;
- the financial and commercial capacity of the two top-ranked respondents, and their capacity to meet the quality and standards required by Defence; and

13 Department of Defence, *Submission 5*, Attachment A, p. 8.

14 Dr Ian Watt, *Proof Committee Hansard*, 29 March 2011, p. 84. Defence also noted the depth of resources available to large firms and their rapid response capacity—including, for example, through AFCD's outsource co-partner arrangement with PwC: Mr Geoffrey Brown, *Proof Committee Hansard*, 9 March 2011, pp. 83–84.

15 Richard Baker, 'Defence bidders got inside help', the *Age*, 2 September 2010.

- the fitness and propriety of the two top-ranked tender respondents to contract with the Commonwealth, including any reputational concerns and issues arising from media reports.¹⁶

6.12 Deloitte was engaged from the Defence Management consultation panel, following consultation with other panel members Ernst & Young and KPMG who were excluded due to other engagements with Defence.¹⁷ The total cost of the review was \$591,820 (GST inclusive). The timeframe to perform the work was seven business days (extended from an initial five business days). Deloitte engaged 23 staff on the inquiry, comprising seven partners, seven directors and nine other senior staff members. Their total time worked on the assignment was 996 hours.¹⁸

6.13 Defence provided Deloitte with the terms of reference. Deloitte indicated that there were some 'minor modifications' to the terms of reference, which it attempted to incorporate in outlining the scope of its work. One of the partners leading the inquiry, Mr Peter Bars, characterised the process of defining and scoping the terms of reference in the following terms: 'Defence gave us terms of reference and then we said, "given that we have terms of reference what does that actually mean in terms of work that we can execute to meet those terms of reference?" That sort of feedback loop came in some fine-tuning around the scope of what we would do'.¹⁹

Methodology

6.14 Deloitte undertook the following tasks in performing the engagement:

- interviewed certain members of the TEB and relevant Defence stakeholders;
- read aspects of Defence documents and policies;
- read the draft AFCD report and working papers;
- examined the transcripts of AFCD interviews;
- read aspects of the shortlisted tender responses;
- supplemented the financial evaluation for the two top-ranked tenderers with information obtained from additional searches; and
- conducted searches of public records and online media for agreed individuals and companies.²⁰

16 The full terms of reference are set out at pp. 3–4 of the Deloitte Review.

17 Department of Defence, *Submission 5*, Attachment A, p. 8.

18 Department of Defence, *Submission 5*, Attachment A, p. 8.

19 Mr Peter Bars, *Proof Committee Hansard*, 28 March 2011, p. 16.

20 Deloitte Review, p. 2.

Key findings

6.15 Deloitte reported to Defence on 15 September 2010. It found that nothing had come to its attention to indicate that the tender should not proceed.²¹ Its key findings in respect of individual terms of reference are summarised below.

Decision to tender

6.16 Based on its review of the RFT and SER, and its interviews with Group Captain Barnes and Squadron Leader Cole, Deloitte found that:

- the services detailed in the RFT were reasonable from an operational perspective and did not disadvantage any of the tenderers;
- the tender response period of eight weeks provided sufficient time for all parties to provide tender responses that could meet the airworthiness certification requirements in the request; and
- the decision to tender was based on a reasonable expectation of achieving a better value for money outcome for the Commonwealth.²²

6.17 According to Deloitte, there was sufficient evidence to indicate that the volumetric specifications were supported by operational need, based on departure reports from Strategic Aviation indicating full use of cargo capacity and historical and forecast analyses undertaken by Defence. Deloitte noted that the RFT did not preclude separate passenger and cargo flight options.²³

6.18 Deloitte cited AFCD interview records with successful and unsuccessful tenderers indicating acknowledgement of the tight but achievable nature of the tender response timeframe. Further, Deloitte noted that the global financial crisis and the significant number of amendments to the 2008 contract suggested that the decision to proceed to tender was based on an expectation of achieving greater value for money.²⁴

Governance around the development of the RFT and tender evaluation process

6.19 Following its review of the supporting documentation and AFCD interview records, Deloitte concluded that nothing had come to its attention to indicate that:

- there was not an adequate plan in place covering the governance of the tender; and
- the plan was not adhered to in all material respects.²⁵

21 Deloitte Review, p. 2.

22 Deloitte Review, p. 11.

23 Deloitte Review, pp. 11–12.

24 Deloitte Review, p. 12.

25 Deloitte Review, p. 16.

6.20 However, Deloitte identified three shortcomings in the implementation of governance arrangements. Firstly, while the majority of risk management actions in the procurement strategy were implemented, three were not—conducting market research, involving an aviation consultant and providing advance notice to standing offer panel members prior to the release of the request.²⁶

6.21 Secondly, Deloitte found that probity risks were not documented in the risk management plan, and a specific probity plan was not documented.²⁷ Thirdly, it found that there was no documentation indicating that tender evaluation team members had received a briefing on ethics, probity and fair dealing.²⁸

Governance in relation to conflicts of interest

6.22 Deloitte was satisfied that nothing had come to its attention to indicate that:

- the governance process did not address adequately potential or perceived conflicts of interest in the lead up to tender and during the evaluation; or
- any perceived or real conflicts of interest that were identified had not been appropriately dealt with.²⁹

6.23 In addition to the absence of a specific probity briefing to tender evaluation team members addressing conflicts of interest, Deloitte also identified shortcomings in the original conflict of interest declarations signed by evaluation team members. These included an absence of a declaration about possible conflicts arising from employment, prior employment or financial interests in potential suppliers or relationships with persons who have interests in these organisations.³⁰

6.24 In respect of the management of conflicts of interest pertaining to Major Charlton, Deloitte noted the steps taken to identify his background and manage risk identified in AFCD interviews with Major Charlton, his statutory declaration and interviews with other ADF personnel.³¹ It noted that, in reaching its conclusion, it had relied on the transcripts of interviews undertaken by AFCD. Defence had prepared these documents.

Governance in relation to confidentiality

6.25 Deloitte found that nothing had come to its attention to indicate that:

26 Deloitte Review, p. 15.

27 Deloitte Review, p. 15.

28 Deloitte Review, p. 15.

29 Deloitte Review, p. 18.

30 Deloitte Review, pp. 17–18.

31 Deloitte Review, pp. 19–20.

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- governance processes for the procurement did not adequately address confidentiality in the lead-up to the tender process; and
 - any confidentiality issues were identified.³²

6.26 Deloitte based its findings on:

- the remote geographical location at which tender planning and evaluation was undertaken;
- the access controls applied to electronic files pertaining to the tender and access logs indicating that no unauthorised access had occurred;
- Major Charlton's statement that he did not have access to the files or provide Adagold with any tender-related information prior to the release of the RFT;
- Adagold's statement that it did not have any knowledge of the decision to re-tender or the tender specifications until the release of the RFT; and
- the statements of key personnel involved in the tender planning process that they did not have a personal or social relationship with Charlton and nor did the staff within their areas of supervision.³³

6.27 In relation to the last point, in his oral evidence to the committee, Mr Dennis Krallis, Partner, Deloitte Touche Tohmatsu, stated that to his knowledge Deloitte did not ask these persons whether they or the staff they supervised had any contact with Major Charlton, Warrant Officer Davies or Adagold.³⁴

Respondents' fitness and propriety to contract with the Commonwealth

6.28 Deloitte examined an agreed list of companies and persons with Defence, in respect of the top two ranked respondents.³⁵ On the basis of searches of the public record—using an array of online commercial databases and regulatory agency websites—it concluded that nothing had come to its attention to identify that these persons and entities were not fit and proper to contract with the Commonwealth.³⁶

6.29 Deloitte noted that it had not identified any Commonwealth or Defence criteria setting out requirements for being 'fit and proper' for the purposes of contracting with the Commonwealth. In making its assessment, Deloitte considered

32 Deloitte Review, p. 10.

33 Deloitte Review, p. 8.

34 Mr Dennis Krallis, *Proof Committee Hansard*, 28 March 2011, p. 12.

35 These were Adagold (subsidiaries, related companies and key members or employees); Alltrans (parent company and key members or employees); AIS (parent companies and key members or employees): Deloitte Review, p. 21.

36 Deloitte Review, p. 24.

'whether any information identified in the searches...could cause the Commonwealth reputational damage'.³⁷

Respondents' financial and commercial capacity to deliver the requested services

6.30 Deloitte did not identify any evidence suggesting that the potential risks associated with the financial and commercial capacity of the preferred tenderer had not been recognised.³⁸ It reviewed the RFT and evaluation documentation, interviewed members of the tender evaluation team, undertook supplementary financial evaluation, and made the following observations:

- it appears reasonable that Adagold and Hi Fly were assessed by the TEWG as viable but high-risk, such that a performance guarantee should be obtained from Adagold;³⁹
- the risk classification adopted by the financial TEWG appears to be 'relatively subjective', in particular the requirement for certain proponents considered to be at the higher level of risk to be subject to a financial performance guarantee';⁴⁰ and
- Adagold demonstrated commercial capacity to perform the services through:
 - its demonstrated understanding of the Australian operating and regulatory environments, in both its tender response and previous experience in performing air sustainment services in the MEAO; and
 - its exclusive, informal agreement with Hi Fly.⁴¹

Adagold's capacity to deliver services to the required quality and standard

6.31 Deloitte found that nothing had come to its attention to indicate that Adagold lacked the capacity to meet the quality and standards required by the Commonwealth to provide the contracted services.⁴² It adopted the following measures of quality and standard:

- technical and operational capacity;
- financial capacity;
- operational capability;
- aircraft availability; and

37 Deloitte Review, p. 23.

38 Deloitte Review, p. 27.

39 Deloitte Review, p. 26.

40 Deloitte Review, p. 27.

41 Deloitte Review, p. 27.

42 Deloitte Review, p. 29.

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- aircraft certification and regulatory requirements.⁴³

6.32 Deloitte examined the RFT documentation, Adagold's response and working papers prepared by AFCD in the evaluation process. It based its conclusions on the following:

- Adagold's evaluation score 56.3 out of 70 on the seven technical and operational criteria, which made it the highest ranked proponent;
- the demonstration of Adagold's operational capability through the information provided in its tender response, its demonstrated experience (including performing ADF and Danish defence force contracts to the MEAO), the previous experience of Hi Fly, and Adagold's operational awareness activities including a site visit to the Al Minhad airbase;
- the existence of an exclusive agreement between Adagold and Hi Fly giving Adagold access to a compliant aircraft, and the provision for a replacement aircraft; and
- Hi Fly's airworthiness certification.⁴⁴

6.33 In reaching its conclusion, Deloitte noted that, 'as would be expected our work does not seek to comment on the likelihood that the respondent will be successfully able to carry out operations as this will be subject to a range of future events and circumstances which are outside the scope of this report'. It also noted that it had not verified the representations made in Adagold's tender response.⁴⁵

Adagold's alleged interests in South Africa

6.34 Deloitte reviewed allegations made in media articles from Australian, South African and Danish media in relation to Adagold contracts in South Africa. It concluded that the allegations did not raise matters of sufficient substance to warrant excluding Adagold from consideration in the 2010 tender process.⁴⁶ In particular, its searches did not locate official records of alleged complaints—including court decisions or records of tender defaults.⁴⁷ It also noted the outcome of the Danish Complaints Board for Public Procurement, in which all complaints were dismissed wholly or partially, and that no action was taken to change the award of the contract.⁴⁸

Other findings

6.35 Deloitte also found that:

43 Deloitte Review, p. 28.

44 Deloitte Review, pp. 28–29.

45 Deloitte Review, p. 29.

46 Deloitte Review, p. 33.

47 Deloitte Review, pp. 31–32.

48 Deloitte Review, p. 33.

- the governance process around the choice of potential suppliers from the standing offer panel was adequate, noting that Defence invited all panel members to participate in the tender for the 2010 contract;⁴⁹ and
- nothing further had come to its attention that could improve the probity of the procurement process.⁵⁰

6.36 In addition to its terms of reference above, Deloitte further considered matters raised in the Shadow Minister's letter to the Secretary dated 31 August 2010. These matters were:

- (a) Major Charlton's 'long and substantial' relationship with 1JMOVGP while providing professional advice to tenderers;
- (b) Major Charlton's recent financial history;
- (c) the financial and corporate integrity of the South African company, Adajet; and
- (d) Hi Fly's performance and quality of service in supporting previous MEAO contracts.

6.37 Deloitte considered that issues (a) and (c) were addressed in its existing terms of reference. Following consultation with the Chief Audit Executive, it determined that issue (b) was not pertinent to the 2010 tender process. In respect of Hi Fly's previous performance in issue (d), Deloitte noted 2007 media reports of allegations of non-compliance with aviation safety standards. It further noted that subsequent inspections undertaken by CASA and ADF did not identify any breaches of regulatory requirements of other or operational concerns.⁵¹

AGS Review

Terms of engagement

6.38 On 2 September 2010—concurrently with the Deloitte review—Defence engaged AGS to undertake an urgent legal and legal process review of the tender.⁵² AGS was instructed to provide advice on the following issues:

- whether the procurement process complied with the Deed of Standing Offer under which the process was let;
- whether the procurement process complied with Commonwealth and Defence procurement policy;

49 Deloitte Review, p. 7.

50 Deloitte Review, p. 34.

51 Deloitte Review, p. 35.

52 AGS Review, p. 1.

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- whether the procurement process and the selection of the preferred respondent was fair and defensible; and
 - in light of the above answers, what were the legal risks of not proceeding to contract with the preferred respondent, and what options were there for contracting with a different provider.⁵³

6.39 The AGS review was led by the Chief Counsel, Commercial Practice Group and assisted by a Senior Lawyer. The total cost of the review was \$74,203 (GST inclusive).⁵⁴

Methodology

6.40 AGS engaged the following methodology:⁵⁵

- received an initial background briefing by Defence;
- identified, requested and received documentation relating to the conduct of the procurement and the establishment of the standing offer panel;⁵⁶
- conducted interviews with Defence personnel involved in the conduct of the procurement.⁵⁷

Key findings

6.41 AGS reported to Defence on 15 September 2010. In short, it found that the procurement process was conducted in accordance with the standing offer and was compliant with Commonwealth and Defence policy.⁵⁸ It also found that the process and the selection of Adagold as the preferred tenderer was fair and defensible, in that it had not identified any evidence of impropriety.⁵⁹ AGS concluded that—subject to the outcome of the Deloitte probity review—there did not appear to be any reason for Defence not to proceed to contract.⁶⁰ These findings are discussed in detail below.

Compliance with deed

6.42 AGS advised that, in its view, the procurement process complied with the deed of standing offer under which the process was let. However, it identified two

53 AGS Review, p. 1. See also *Proof Committee Hansard*, 28 June 2011, p. 2.

54 Department of Defence, *Submission 5*, Attachment A, p. 8.

55 AGS Review, p. 5.

56 See AGS Review, Annexure A.

57 AGS Review, Annexure B.

58 AGS Review, p. 2.

59 AGS Review, p. 2.

60 AGS Review, p. 2.

issues—the treatment of non-compliant completed requests, and post-separation employment issues.⁶¹

6.43 AGS identified that the deed did not specify how the Commonwealth would treat a completed request that did not comply with requirements expressed in mandatory language (for example, 'must' or 'shall'). It noted that this issue had been raised by potential tenderers and during the evaluation.⁶² AGS concluded, however, that it was open to the Commonwealth to accept a request that did not comply with 'mandatory' requirements, and that this was stated expressly in the terms of the request issued under the deed.⁶³ Interestingly, the other reviews did not mention this issue of the treatment of non-compliance with 'mandatory' requirements.

6.44 In relation to post-separation employment issues, AGS noted the provisions in clause 22 of the deed, requiring contractors to:

- ensure that any former Defence employees engaged by them complied with the relevant Defence Instruction on post-separation employment, DI(G) PERS 25-4; and
- seek written approval to engage certain former Defence employees.

6.45 In AGS's view, it was apparent that Major Charlton 'did not adequately comply with DI(G) PERS 25-4 as he did not submit a specific letter of notification identifying the employing parties (other than a very general email)'.⁶⁴ AGS stated further that it was unclear whether Adagold was aware of Major Charlton's Reservist employment and therefore required to seek Commonwealth approval prior to obtaining his assistance in the preparation of its tender response.⁶⁵ Once again, the other reviews did not refer to this important area of non-compliance with the deed of standing order.

6.46 AGS concluded, however, that this issue did not support a finding of non-compliance with the deed for two reasons. First, although clause 22 was phrased in mandatory terms, it was not specifically identified in the deed or the request as a condition of participation, a minimum form and content requirement or an essential requirement, meaning that non-compliance would lead to automatic exclusion from the tender.⁶⁶

6.47 Secondly, AGS considered that if Adagold had sought approval under the deed to obtain Major Charlton's assistance via AIS, it was unlikely that the

61 AGS Review, p. 7.

62 AGS Review, p. 7.

63 AGS Review, p. 7.

64 AGS Review, p. 7.

65 AGS Review, p. 7.

66 AGS Review, p. 7.

Commonwealth would have withheld approval.⁶⁷ AGS based its assessment on the fact that Major Charlton's work in 1JMOVGP was unrelated to the 2010 tender process and, consequently, 'the potential for real or perceived conflicts of interest or probity objections at that time would in any event probably have been assessed [by Defence] as being low'.⁶⁸

6.48 The committee is of the view that this was a rash and highly speculative assumption in light of the doubts surrounding the probity of the 2005 tender process, chaired by Major Charlton. Defence was aware of these reservations at the time of the 2010 tender, which is now the subject of an AFP investigation. The committee considers the matter of conflicts of interest and post-separation employment in chapter 10.

Compliance with Commonwealth and Defence procurement policy

6.49 AGS advised that, in its view, the procurement process complied with Commonwealth and Defence procurement policies, subject to three matters.⁶⁹ Firstly, it proceeded on the assumption that the standing offer panel was established in accordance with the requirements of the CPGs. It did not review the relevant tender process to establish the panel conducted in 2009.⁷⁰

6.50 Secondly, it noted that as a procurement under a panel arrangement, the 2010 tender process was not subject to the Mandatory Procurement Procedures in the CPGs.⁷¹ It constituted a procurement-related task, meaning that it was still governed by the other elements in the procurement policy framework—in particular the requirement to achieve value for money. AGS stated that provided Defence is able to establish that Adagold represented value for money, then it would be compliant with the CPGs. It returned to the issue of value for money in its advice on whether the process was fair and defensible.⁷²

6.51 Thirdly, AGS noted that Defence did not appoint an independent probity advisor. While acknowledging that this was not a mandatory policy requirement, AGS noted the Department of Finance and Deregulation recommended that consideration be given to the appointment of probity advisors in light of size, complexity, sensitivity and potential risk of individual procurements.⁷³

67 AGS Review, pp. 7–8.

68 AGS Review, p. 7.

69 AGS Review, p. 8.

70 AGS Review, p. 8.

71 AGS Review, p. 8. See further, Department of Finance and Deregulation, *Guidance on the Mandatory Procurement Procedures*, Financial Management Guidance 13, Appendix B—Panels.

72 AGS Review, p. 8.

73 AGS Review, p. 8.

Whether the procurement process and selection of Adagold was fair and defensible

6.52 AGS stated that it had not identified any impropriety in the way in which the procurement process was conducted or in the selection of Adagold as preferred tenderer. However, it identified five areas for improvement in future.

6.53 Firstly, AGS identified that no overarching probity framework for the conduct of the procurement was established. It stated:

The need for the possible engagement of a probity advisor was not identified in the initial risk assessment, and legal advice was not sought on this matter until mid-way through the process. As a result no probity plan for the project was developed. In addition we have identified that there were no specific probity arrangements established to cover the process relating to the development of the Request documentation (although we have been advised that all drafts of the Request were stored on a secure Defence server.⁷⁴

6.54 The review also observed that:

- Defence personnel who assisted in developing the Request documentation were not asked to sign a conflict of interest declaration unless they also participated in the evaluation of tender responses;
- members of the tender evaluation team did not sign conflict of interest declarations until after the evaluation commenced; and
- no specific probity protocols were developed to cover the industry briefing.⁷⁵

6.55 Secondly, AGS identified some instances in which the SER and the supporting TEWG reports could more accurately and transparently reflect the assessment of tender responses. It noted that it held discussions with Defence about these matters, which led to the refinement of the SER and the TEWGs to address these matters.⁷⁶

6.56 Thirdly, AGS noted that the scoring methodology adopted by the TEB and the TEWGs was not referenced in the TEP. It noted that best practice is to set out the evaluation methodology in full in the TEP.⁷⁷

6.57 Fourthly, AGS identified overlap in some of the tender evaluation criteria—particularly in terms of assessing compliance with the request. It further considered that there was a lack of clear guidance in the TEP as to how each of the criteria were to be assessed. It stated that without such guidance, 'there was a possibility that the

74 AGS Review, p. 9.

75 AGS Review, p. 9.

76 AGS Review, pp. 9–10.

77 AGS Review, p. 10.

same issue could be double or even triple counted' in the evaluation.⁷⁸ While acknowledging that all tenderers would have been affected equally in this regard, it recommended the inclusion of more detailed evaluation guidance in future TEPs.⁷⁹

6.58 Finally, AGS noted a disparity between the TEP and the request documentation, in respect of minimum form and content requirements, conditions of participation and essential requirements.⁸⁰ It observed that the TEP referred to initial screening being undertaken to check tenders against these matters. However, the request documentation did not expressly classify provisions in this way. This meant that no screening report was prepared.⁸¹ Similar to its observations on the deed, AGS noted that several requirements in the request were expressed in mandatory language but it was unclear whether non-compliance would result in exclusion from the process.⁸² Mr Scala, AGS, explained:

...although we had things identified as 'must' in the various request documentation, and indeed a standing offer, none of those were actually expressly identified as conditions of participation or essential requirements and the like and none of them specifically had any sanction attached to them—that is 'If you fail to meet this requirement you will automatically be excluded' or 'we reserve the right to exclude'.⁸³

6.59 AGS recommended that future request documentations clearly identify minimum form and content requirements, conditions of participation and essential requirements to avoid potential confusion.⁸⁴

Consistency with advice from Clayton Utz

6.60 In chapter 3, the committee considered Clayton Utz's advice to Defence on the SER and areas identified for improvement. These included providing more complete information and detail, especially on the extent to which each tender had met the evaluation criteria; the need to substantiate some statements and the use of imprecise language such as the term 'compliant' when 'having no deficiencies' would be more accurate.⁸⁵ The AGS review identified similar areas of weakness such as the opaque scoring system and the use in some places of inappropriate language—in this case the use of terminology that was mandatory in nature.

78 AGS Review, p. 10.

79 AGS Review, p. 10.

80 AGS Review, p. 10.

81 AGS Review, p. 10.

82 AGS Review, p. 10.

83 *Proof Committee Hansard*, 28 June 2011, p. 5.

84 AGS Review, pp. 10–11.

85 Clayton Utz, Advice to Tender Evaluation Board re Source Evaluation Report, 9 July in camera evidence.

6.61 Also, the committee took in camera evidence from Clayton Utz on a comment made in its advice to Defence that the SER did 'not appear to have treated tenderers equally on the leasing arrangements with the respective aircraft owners'.⁸⁶ This observation on 'unequal treatment' was of particular interest to the committee and was subjected to further consideration when the committee was taking evidence from AGS. Mr Scala informed the committee that the review team identified this as a matter of concern where:

...there appeared to be a failure to equitably assess the risk associated with tenderers not having entered into formal leasing arrangements with aircraft owners. That was an issue where it appeared to us that one tenderer who did not have a formal lease in place but more a letter of comfort seemed to be assessed as if, effectively, the lease was in place, not as if the alternative was the case, as other tenderers were.⁸⁷

6.62 According to Mr Brown:

...it was not that people were scored down—the issue was taken evenly across all of them—but the grading of the outcomes there was not a specific score of five out of 10 if they were graded through the process. If we take the leasing as an example, no-one was disadvantaged by that. It would be extremely unusual to have a broker come into the process with a signed lease.⁸⁸

6.63 Mr Scala understood that the issue was 'then rectified in the final source evaluation report'.⁸⁹ The committee returns to this matter in chapter 11.

Legal risks of not proceeding to contract with Adagold

6.64 AGS concluded that—subject to the outcome of the Deloitte Review—there would appear to be no reason preventing Defence from proceeding to contract with Adagold. It considered that, unless there were evidence to indicate that Adagold was in some way implicated in causing the procurement process to fail, cancelling the request or not proceeding to contract would result in a claim for damages or costs from Adagold. AGS understood these expenses to be in the vicinity of \$500,000.⁹⁰

6.65 AGS stated further that if the request process were cancelled, it would be necessary to undertake a new procurement process.⁹¹ It stated that if not cancelled but a valid reason existed for excluding Adagold from consideration, it would be possible

86 *Proof Committee Hansard*, 28 June 2011, p. 16 and in camera Hansard, 28 June 2011.

87 *Proof Committee Hansard*, 28 June 2011, p. 4.

88 *Proof Committee Hansard*, 28 June 2011, p. 17.

89 *Proof Committee Hansard*, 28 June 2011, p. 4.

90 AGS Review, p. 11.

91 AGS Review, p. 11.

for Defence to enter into contract negotiations with the second ranked tenderer, however this would have to be assessed against value for money requirements.⁹²

Allegations concerning the 2005 tender and AFP investigation

6.66 As noted earlier, on 2 September 2010, while the external reviews were under way, an article published in the *Age* newspaper reported allegations of impropriety in the 2005 tender process, which resulted in the awarding of the contract to Strategic.⁹³ The allegations concerned the 'leaking' of tender specifications to Strategic prior to the release of the RFT. The article reported that it had uncovered email correspondence between Strategic directors which suggested that two members of 1JMOVGP—identified as Major Charlton and Warrant Officer John Davies—had 'fed' this information to Strategic.⁹⁴ This matter was not taken up by the reviews of the 2010 tender process, on the basis that the Phillips Fox (DLA Piper) review of the 2005 tender process did not identify any probity related compliance issues that would require the process to be set aside.⁹⁵

6.67 On 10 September 2010, Defence referred the allegations concerning the 2005 tender to the AFP. Defence stated that it had not previously been aware of any allegations that Strategic had received inside information in 2005. It noted that, 'if proven, these allegations would give rise to a range of possible criminal offences'.⁹⁶ At the time of writing, the matter remained under investigation by the AFP.⁹⁷

Defence responses to the external review findings

6.68 Following receipt of the external review reports and consideration of their findings, Defence formed the view that it should proceed to contract with Adagold. It also took action to remedy several issues identified in the reviews—in some cases before the reviews had reported, in response to issues raised progressively by the reviewers. These included:

- requiring TEB members to sign revised conflicts of interest and probity declarations, subsequent to the tender evaluation process, addressing the deficiencies identified by Deloitte;⁹⁸

92 AGS Review, p. 11.

93 Richard Barker, 'The sky's the limit', *Age*, 2 September 2010, p. 13.

94 Richard Barker, 'The sky's the limit', *Age*, 2 September 2010, p. 13.

95 AFCD Review, pp. 5, 25.

96 Department of Defence, *Submission 5*, Attachment A, p. 13.

97 Department of Defence, *Submission 5*, Attachment A, p. 13; Dr Ian Watt, *Proof Committee Hansard*, 29 March 2011, p. 46. See further, Department of Defence 'Referral of matters regarding the 2005 Defence contract for air support services to the Middle East Area of Operations to the Australian Federal Police' Media Release MECC 428/10, 13 September 2010.

98 Deloitte Review, pp. 15, 18.

- revising the SER and the supporting TEWG reports to reflect more accurately and transparently the assessments of tenders which were carried out;⁹⁹
- reconvening the TEB to re-validate the SER. The re-validated SER confirmed Adagold as the preferred tenderer but reversed the order of the second and third preferred tenderers in order to correct a mathematical error in the totalling of evaluation scores;¹⁰⁰ and
- requiring Adagold to provide a performance guarantee to the value of \$2 million, and negotiating a novation agreement between Defence, Adagold and Hi Fly.¹⁰¹

6.69 Defence stated that it was also developing and implementing broader process and policy reforms in respect of non-equipment procurement and the management of conflicts of interest.¹⁰² These initiatives are outlined in chapter 7.

6.70 The committee looks more closely at the re-validation of the SER which resulted in a re-ordering of the second and third ranked preferred tenderers in chapter 11.

Limitations of the external reviews

6.71 In the previous chapter, the committee drew attention to the limits placed on the two earlier reviews. The external reviews conducted by Deloitte and AGS were also subject to significant limitations in time, scope and methodology.¹⁰³ They also seemed to be designed to support the argument for proceeding with the preferred tenderer. In other words, their efforts were really focused on defending the integrity of the process, rather than genuinely testing it.

6.72 Deloitte noted that its work was confined to reading documents, interviews and listening to interviews performed by others. Deloitte also noted the following limitations on its engagement:

- it relied on transcripts from interviews undertaken by others (it should be noted that Major Charlton and Mr Clark's Statutory Declarations were drafted for them by a member of the AFCD team);¹⁰⁴
- it did not interview any of the tenderers or Major Charlton;
- it did not verify the information obtained through interviews or tender responses, or from online media sources;

99 AGS Review, pp. 9–10. See further, AFCD Review, p. 11.

100 Department of Defence, *Submission 5*, Attachment A, pp. 10–11.

101 Department of Defence, *Submission 5*, Attachment A, pp. 26–27.

102 Department of Defence, *Submission 5*, Attachment A, pp. 32–35.

103 Deloitte review, p. 2; AGS review, p. 5.

104 Mr Bromwich, *Proof Committee Hansard*, 29 March 2011, p. 81.

- it did not check the integrity or accuracy of the information contained in the financial viability spreadsheets produced by Defence as part of the tender evaluation;
- while believing that the statements made in its report are accurate, it did not give any warranty of completeness, accuracy or reliability in relation to the statements and representations made by, and the information provided by, Defence personnel. It did not attempt to independently verify these sources; and
- the scope of its engagement did not include examination of the 2005 contract, the extension in 2008 or the establishment of the standing offer panel in 2009.¹⁰⁵

6.73 Deloitte stated that the limitations of its work were due to the following:

- the limited timeframe of seven business days;
- the fact that Defence had conducted interviews and obtained statutory declarations from Adagold representatives and Major Charlton. Deloitte stated that 'given the scope of our engagement, the timeframes involved and the information contained in the interviews and statutory declarations, we did not believe further interviews were required';
- the fact that Deloitte was not engaged to re-perform the tender evaluation; and
- the scope of the work was not an audit, hence Deloitte did not perform audit procedures to verify the accuracy of information.¹⁰⁶

6.74 It should be noted that with regard to its schedule, Defence conveyed to Deloitte 'the importance of completing its review expeditiously'. Defence stated:

Timeframes were set in order to avoid disruption to the critical air sustainment services, to take advantage of greater load requirements, and to minimise the additional costs associated with the interim solution...a short term contract was estimated to cost an additional \$1 million for each week of delay.¹⁰⁷

6.75 Even so, measures were taken to enable the review team to conduct its work effectively and to ensure that its findings were understood in the context of the review's limitations. As required by the Accounting Professional and Ethical

105 Deloitte Review, p. 2.

106 Deloitte Touche Tohmatsu, *Submission 3*, p. 1. See further, Department of Defence, *Submission 5*, Attachment A, p. 9.

107 Department of Defence, *Submission 5*, Attachment A, pp. 8–9. See also Mr Brown, *Proof Committee Hansard*, 29 March 2011, p. 75.

Standards Board, Deloitte was 'obliged to set out the scope of work as well as any limitations on that scope'.¹⁰⁸ In addition:

- the review was undertaken by senior staff who worked intensively within the limited timeframes;¹⁰⁹
- limitations of scope in respect of reliance on secondary evidence were identified largely by the reviewers themselves, on the basis of need.¹¹⁰
- they were 'given complete and unfettered access at all times to all tender and probity review documentation and personnel who participated in the Request for Tender';¹¹¹ and
- reviewers were informed by Defence that their work 'should not be compromised in any respect by artificial constraints, time or otherwise', and were able to undertake any additional work that they identified as necessary in the course of the assignment.¹¹²

6.76 Deloitte stated that no restrictions were placed on it by Defence in the conduct of its engagement.¹¹³ It acknowledged that although Defence was its client, its view was that 'we were carrying out an independent examination'.¹¹⁴ Indeed, the evidence of one of the partners leading the review, Mr Dennis Krallis, was that Deloitte received instructions from the Chief Audit Executive to the effect that 'if there is something to be found, if there are issues, we want you to find them'.¹¹⁵

108 Department of Defence, *Submission 5*, Attachment A, p. 9; Mr Peter Bars, *Proof Committee Hansard*, Sydney, 28 March 2011, p. 2; Mr Geoffrey Brown, *Proof Committee Hansard*, 29 March 2011, pp. 84–85.

109 Department of Defence, *Submission 5*, Attachment A, pp. 8–9; Deloitte, *Submission 3*, p. 1.

110 Mr Geoffrey Brown, *Proof Committee Hansard*, 29 March 2011, pp. 86–87; Mr Peter Bars, *Proof Committee Hansard*, 28 March 2011, p. 2. See also the evidence of PwC in respect of the development of terms of reference, which were prepared by PwC and approved by Defence: Mr Steven Baker, *Proof Committee Hansard*, 29 March 2011, p. 20.

111 Department of Defence, *Submission 5*, Attachment A, p. 10. See further, Mr Geoffrey Brown, *Proof Committee Hansard*, 29 March 2011, p. 87; Deloitte, *Submission 3*, p. 1, but compare the oral evidence of Deloitte, that their request to access the AGS Review was denied by Defence on the basis of privilege: Mr Dennis Krallis, *Proof Committee Hansard*, 28 March 2011, p. 4.

112 Dr Ian Watt, *Proof Committee Hansard*, 29 March 2011, pp. 47–48. See further, Deloitte, *Submission 3*, p. 2; Mr Dennis Krallis, *Proof Committee Hansard*, 28 March 2011, p. 13.

113 Deloitte Touche Tohmatsu, *Submission 3*, p. 2; Mr Dennis Krallis, *Proof Committee Hansard*, 28 March 2011, p. 2. See further, Department of Defence, *Submission 5*, Attachment A, pp. 9–10. Mr Geoffrey Brown, *Proof Committee Hansard*, 29 March 2011, pp. 84–87.

114 Mr Dennis Krallis, *Proof Committee Hansard*, 28 March 2011, p. 13.

115 Mr Dennis Krallis, *Proof Committee Hansard*, 28 March 2011, p. 13.

Limitations on the AGS Review

6.77 AGS was similarly aware of 'the importance of completing its review expeditiously'. In addition, it identified the following limitations to the scope of its review:

- its instructions from Defence not to address probity related issues under consideration by Deloitte;¹¹⁶
- its full reliance upon 'the accuracy and completeness of information provided...by Defence';¹¹⁷ and
- its assumption that the underlying working papers of the TEB and the TEWGs—which it did not examine—supported the assessments contained in the high-level summary TEB and TEWG reports that it examined.¹¹⁸

6.78 Mr John Scala, Chief Counsel, AGS, also made clear that their legal process review was 'not asked to look into whether or not it was appropriate to use the deed of standing offer as the starting point for the procurement'. Thus, although the terms of reference explicitly asked for advice on 'whether the procurement process complied with the Deed of Standing Offer', it did not go to the suitability of this arrangement for this specific procurement process. Notably in this regard, he observed that 'it would be arguable to say that the deed of standing offer appeared to us to be designed more for ad hoc types of service provision as opposed to this type of service'.¹¹⁹ The AFCD review made a similar observation that the deed 'may not have been suitable for the more complex air sustainment procurement activity'.¹²⁰

6.79 Also, the review team was not required to consider issues of alleged impropriety involving Mr Charlton or allegations concerning any previous tender process in which Adagold may have participated.¹²¹ In the committee's view, the findings of the reviews should be viewed in light of the limits placed on them.

Conclusion

6.80 Numerous allegations have been raised about the integrity of the 2010 tendering process for the delivery of air sustainment services to MEAO. There have been four reviews of the tender process, which focused broadly on the identification of any reasons that should impede Defence from proceeding to contract. The total cost of these reviews was in the vicinity of \$700,000. Additional costs were incurred in the

116 However, AGS consulted with Deloitte in the preparation of its advice and shared thoughts and findings on a progressive basis AGS Review, pp. 1, 5.

117 AGS Review, p. 5.

118 AGS Review, p. 5.

119 *Proof Committee Hansard*, 28 June 2011, p. 7.

120 See paragraph 5.14.

121 *Proof Committee Hansard*, 28 June 2011, p. 2.

awarding of an interim air sustainment services contract, pending finalisation of the 2010 tender process.

6.81 While concluding that the procurement process was not fatally flawed from a technical compliance perspective, the relevant reviews identified several opportunities for improvements to Defence practices and procedures.

6.82 Both the external reviews acknowledged that there were limitations on their work, particularly severe time constraints which meant that they relied heavily on the work done by the AFCD team including transcripts of interviews and on the accuracy and completeness of working documents provided by Defence. Also, the reviews specifically excluded consideration of the 2005 tender whilst allegations concerning serious impropriety in the conduct of that procurement emerged during the course of the inquiries. The allegations were referred to the AFP and were under investigation at the time of writing.

6.83 Given the limitations of, and directions imposed on, the reviews as outlined in this chapter, the committee is aware of lingering concerns about some of their conclusions, and about the overall reputation and image of Defence's procurement processes and practices. In the next chapter, the committee outlines Defence's decision to proceed to contract with Adagold and its performance to date. The committee also outlines several procurement reforms being implemented by Defence, some of which have been prompted by identified weaknesses in the 2010 tender process. Suffice to say, there is an inference that the process was the issue not the outcome.