

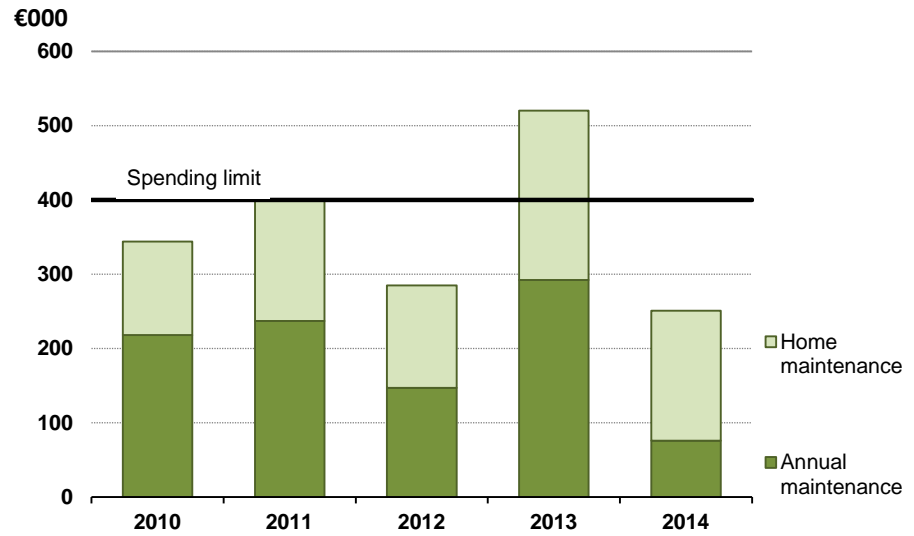
8 Disposal of Government Jet

- 8.1** The Air Corps in the Defence Forces provides air transport for the Government and for the President for official engagements at home and abroad. This is known as the Ministerial Air Transport Service. The service is primarily provided by a seven-seater Learjet 45 aircraft. Up to July 2014, a 14-seater Gulfstream IV jet, which went into service in 1992, was also used.
- 8.2** An inter-departmental group was established, following a Government decision in July 2014, to review the options for the future provision of the service.
- 8.3** The Gulfstream IV jet was flown to the manufacturer in the United States of America (USA) for its annual planned maintenance inspection and service in July 2014. During the inspection, it became apparent that the servicing and repair cost would be significantly higher than originally anticipated. Following discussions with the Taoiseach, the Minister for Defence (the Minister) directed in August 2014 that all work on the aircraft should cease and that the jet should be disposed of. The Gulfstream jet was sold in January 2015.
- 8.4** This report examines
- the circumstances that gave rise to the decision to sell the aircraft
 - the process used to sell the aircraft and spare parts
 - the progress on the review of ministerial air transport services.

Maintenance costs

- 8.5** Like all aircraft in the Air Corps fleet, the Gulfstream jet was maintained in accordance with the original manufacturer's recommended maintenance and overhaul cycle. This involved routine maintenance carried out by Air Corps personnel (home maintenance) and an annual maintenance inspection by Gulfstream in the USA (annual maintenance).
- 8.6** The Department of Defence (the Department) has stated that in 2010, the Minister decided that if any costly non-routine maintenance or major structural repair was required, the jet should be grounded and the Government would decide, at such time, on its future. A total maintenance cost of €400,000 in any year was deemed by the Department to represent the upper limit that should be incurred.
- 8.7** Costs significantly in excess of the €400,000 threshold were incurred in 2013, (see Figure 8.1), due to the repair of a fire detection system and the overhaul of a brake unit, and to treat corrosion. The corrosion was identified during the course of the annual maintenance inspection.

Figure 8.1 Maintenance costs of Air Corps Gulfstream jet, 2010 to 2014



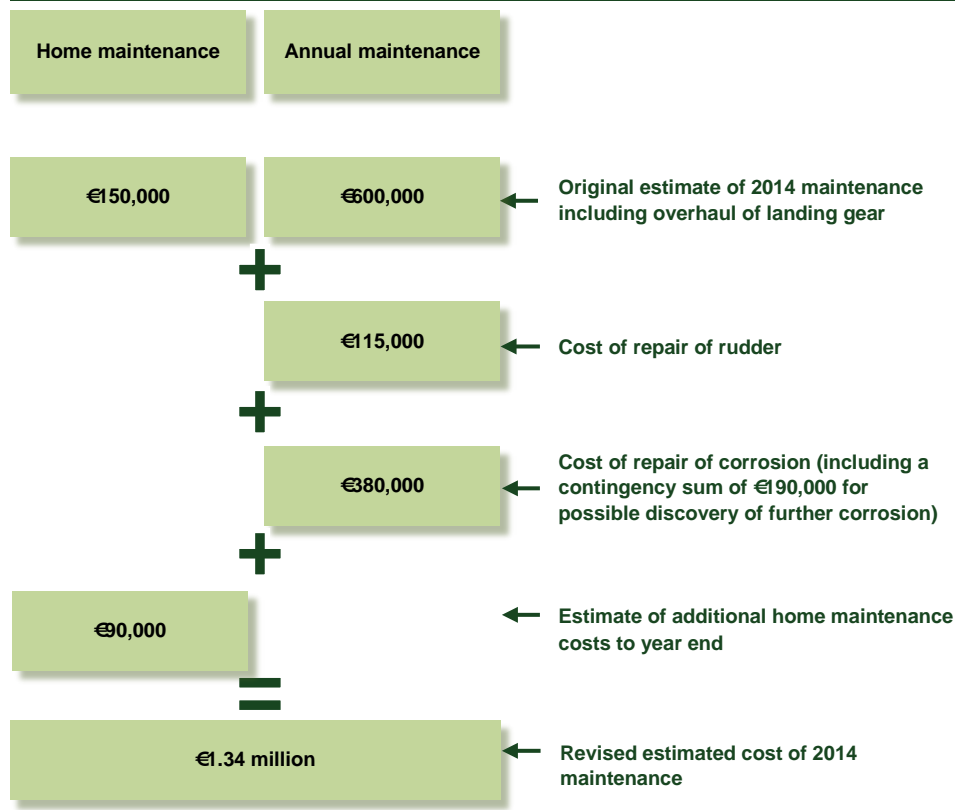
Source: Department of Defence

2014 maintenance and repair costs

- 8.8 Prior to the 2014 annual maintenance inspection, it was known that an overhaul of the aircraft's landing gear was necessary. Therefore, Government approval was obtained for increased expenditure up to a total of €750,000 to cover home maintenance (€150,000), annual maintenance (€350,000), and the required overhaul of the landing gear (€250,000).
- 8.9 A memorandum to Government in July 2014 noted that the aircraft would require an overhaul of both engines by 2018/2019 at an estimated cost of €2.5 million and therefore retention of the aircraft beyond that date would be unsustainable given its age.

8.10 The 2014 annual maintenance inspection identified additional necessary repairs. The original estimated cost for home maintenance also increased by €90,000. Overall, the estimate for repairs and maintenance in 2014 increased to €1.34 million (see Figure 8.2).

Figure 8.2 Increase in estimated cost of 2014 maintenance and repairs



Source: Department of Defence

- 8.11** The Department did not conduct a formal analysis of the projected 'remaining life' costs and benefits associated with the operation of the jet in either 2013 or 2014, when faced with costs exceeding the €400,000 threshold. Such an analysis would estimate expected future economic costs and benefits associated with the jet, and discount these in order to recognise the 'time value' of money. This would allow the Department to assess quickly whether incurring unforeseen additional costs was economical. An illustrative framework for such a cash flow analysis is shown in Figure 8.3 below.

Figure 8.3 Illustrative framework for discounted cash flow analysis of aircraft life cycle

	Year 0	Year 1	Year 2	Final year
Costs				
Home maintenance	€	€	€	€
Annual maintenance	€	€	€	€
Operational expenses	€	€	€	€
Scheduled repairs	€	€	€	€
Contingency for repairs	€	€	€	€
Benefits				
Disposal value (aircraft and parts)				€
Net cash flow	€	€	€	€
<i>Discount rate x%</i>				
Net present value (NPV) of cash flow	€	€	€	€
Projected NPV of alternative service	€	€	€	€

Source: Office of the Comptroller and Auditor General

- 8.12** The Department is of the view that it would have been highly speculative to produce contingency cost projections that might arise from unidentified or unforeseen problems. It stated that the only maintenance and repair figures that could be relied upon were the minimalist projections referred to in the memorandum to Government in 2014 when increased expenditure amounting to €750,000 was sought.
- 8.13** The Department also commented that there would have been no basis for calculating a projected cost of an undetermined alternative service in the absence of a Government decision on what that would be, for example, the acquisition of a replacement aircraft or some other service model.

Disposal decision

- 8.14** On foot of the escalating costs, the Department sought the recommendation of the General Officer Commanding the Air Corps as to whether the additional expense to repair the aircraft should be incurred. In his response dated 8 August 2014, he noted that in considering whether to conduct the repair, due cognisance must be taken of the age of the aircraft and the likelihood that other corrosion or fatigue issues may arise. The maintenance programme takes into consideration the high number of flights and flying hours, and calls for deeper and more extensive investigative maintenance processes annually. He recommended that the aircraft should be repaired. The Deputy Chief of Staff (Operations) also recommended that the aircraft be returned to service. No formal discounted cash flow analysis underpinning the recommendation was conducted.
- 8.15** The Department made informal contact with an Irish aviation consultant company in August 2014 who advised that
- the necessary repairs could be carried out and the aircraft kept for another few years but it seems to 'have had its day'
 - an immediate sale would likely be to a parts dealer, in which case it would be worth in the 'sub \$1 million range' – i.e. less than €750,000 at the prevailing exchange rates
 - the jet could be used as a deposit against another aircraft.
- 8.16** Department officials prepared briefing notes for the Minister outlining the sequence of events, the accumulating costs and the options. The Department has stated that a formal analysis of the costs and benefits of repairing and retaining the aircraft compared to those arising from a disposal had not been prepared as an immediate decision was demanded. This was because
- the aircraft was in a stripped down state blocking a busy scheduled production line
 - any further delays were likely to incur substantial charges and the full cost of the contracted maintenance inspection.
- 8.17** On 15 August 2014, the Minister directed that no further work should be carried out on the aircraft and it should be disposed of for the best possible price.

Disposal of the aircraft

- 8.18** Officials from the Department and Air Corps officers travelled to the Gulfstream facility in the USA in August 2014 to finalise the maintenance costs already incurred and any further liabilities accruing. The options for sale were also discussed.
- 8.19** The Department has stated that the costs for the contracted maintenance inspection could have been up to €425,000. Following negotiation, the costs were agreed at labour costs already incurred and a small element of costs relating to parts that had been removed and sent for refurbishment. The amount agreed was €76,000.
- 8.20** Additional costs to put the aircraft into a serviceable condition prior to a sale were estimated by Gulfstream at a further €710,000. This comprised an estimated €600,000 to transfer the aircraft to the civil register and a further €110,000 in contingency for possible further corrosion. Together with the previous estimate of repairs, this would bring the maintenance bill with Gulfstream to €1.8 million.

- 8.21** The Department has stated that it considered the most viable option was to dispose of the aircraft for salvage and that this decision was based on
- the costs involved in repairing it to a serviceable condition
 - the depressed market conditions for executive jets
 - charges for its continued retention in the USA
 - the absence of any guarantee as to the future serviceability of the aircraft.
- 8.22** The Department has stated that, despite its best efforts, Gulfstream declined an invitation to submit an offer to acquire the jet for salvage and to buy back spare parts held in Baldonnell. The original manufacturer of the engines was not willing to make an offer for the engines and this contributed to Gulfstream's decision.
- 8.23** The Department decided not to use a USA-based broker to handle the disposal. This was considered to be a time consuming and difficult process especially as the aircraft was in a stripped down state. In the event, Gulfstream agreed that it would use its knowledge of the market to see if there was any interest from potential purchasers.
- 8.24** The Department has stated that while the normal process for the disposal of major assets is to conduct a public tender competition or a public auction, it would have been impossible to do so in the case of the jet as
- the aircraft was in a stripped down state in a facility where very high standards of security apply
 - Gulfstream would not have allowed prospective buyers, responding to a public sale or auction process, to view the aircraft on its premises and
 - boxing the aircraft up in parts for sale elsewhere would have been completely untenable.
- Therefore, it considered that it had no choice other than to execute a sale in the circumstances that occurred.
- 8.25** In early December 2014, the Department received a letter of intent through Gulfstream from a USA based company (Journey Aviation) who offered to buy the aircraft for €836,000 on condition that it was brought back into a serviceable state. The Department declined this offer as the aircraft was for sale on an 'as seen' basis and it had no ministerial or Government sanction for any further expenditure on the aircraft. The company then offered €418,000 to purchase the aircraft 'as seen'. This offer was accepted by the Department in January 2015.
- 8.26** The Department has stated that Journey Aviation arranged for the aircraft to be repaired, through the use of the company's own resources and stock of spare parts, registered on the civil register and brought back into use.

Disposal of spare parts

- 8.27** The Air Corps had 87 spare parts for the jet in stock with an original acquisition cost of €1.4 million. This was the value at which they were recorded on the stock management and control system, and in the appropriation account. Just over half of the parts held were used parts, and some of those could only be used as a trade in for a replacement. At 30 October 2014, the Air Corps estimated that the value of the parts was €405,000.

- 8.28** The Department has stated that its normal practice is to include any aircraft spare parts as part of the sale of an aircraft and this is usually done by way of a public tender competition. However, given the status of the aircraft in the USA and the complexities involved, it decided to complete the sale of the aircraft in the first instance and to deal with the issue of the spare parts, with the buyer of the aircraft, at a later date.
- 8.29** Journey Aviation was invited to make an offer for the spare parts. The parts were sold to Journey Aviation 'as seen' in February 2015 for €53,000 and dispatched in July 2015. The Department considers that the sales price was reasonable given the nature of the spares, their age and the 'as seen' sales condition.
- 8.30** Journey Aviation informed the Department in October 2015 that 55 of the 87 spare parts did not have certification documentation attached. Such documentation validates the parts as being in conformance with the design specification for the aircraft, serviceable and fit for use. The documentation was not available. The Department has stated that it relied on the 'sold as seen' condition in the sales agreement, under which no warranties or guarantees were given to the purchaser, and consequently, certification was not an issue.

Accounting treatment

- 8.31** The Gulfstream jet entered service in 1992. The total cost of acquiring the aircraft was approximately €45 million. This included lease payments for the first ten years.
- 8.32** The aircraft was recorded on the Department's asset register in 2005 at an historical cost of €19 million. The Department has stated that this was an estimate applied for accounting purposes when it was implementing a new management information system, and did not necessarily represent an accurate market valuation of the aircraft at the time.
- 8.33** The Department's accounting policy is to depreciate military assets over their planned useful lives to projected residual values. The Department has stated that the projected residual value of a military asset is a nominal amount, used to show that the asset may still have a value in use, rather than an intention to reflect the market value of the asset at the end of its planned life.
- 8.34** In this case, the depreciated value of the jet had been its residual value of €952,000 since 2012. As the sales proceeds amounted to €418,000, a loss on disposal of €534,000 is reflected in the Department's operating cost statement in the 2015 appropriation account.
- 8.35** The cost of the spare parts disposed of (€1.4 million) is included in stock write-offs in the 2015 appropriation account (note 2.5). The disposal proceeds (€53,000) are included in appropriations-in-aid.

Review of ministerial air transport services

- 8.36** In July 2014, prior to the emergence of the problems with the jet, the Government decided to establish an inter-departmental group, chaired by the Department, to review the options for the future provision of ministerial air transport services in the medium to long term. The group includes representatives from the Departments of the Taoiseach, Public Expenditure and Reform, and Transport, Tourism and Sport.

- 8.37** The group's review includes an examination of how other countries, particularly island nations, arrange ministerial air transport. The option of seeking independent aviation expert advice on operational and cost implications is currently under consideration.
- 8.38** To support the work of the inter-departmental group, an internal working group within the Department was established including representatives from the Air Corps.
- 8.39** The inter-departmental group is currently in the process of preparing a report for submission to Government.

Conclusions and recommendation

- 8.40** Formal analysis of costs and benefits associated with different potential courses of action is a key aid to decision making. In the case of the Gulfstream jet, the Department did not formally appraise the economic case for increased maintenance costs in 2013 or 2014, nor did it formally appraise the costs of returning the jet to a serviceable condition against the benefits that would accrue from its use.

Recommendation 8.1

The Department should ensure that discounted cash flow analysis of life cycle costs is undertaken for all major items of equipment, as a framework to assist decision making. Decisions for retention or disposal of major assets should be informed by such assessment of continued versus alternative service delivery options to ensure the maximisation of net benefits to the State.

Accounting Officer's response

Not agreed in this case. Notwithstanding the recommended approach to decision making for major equipment items, particular and extenuating circumstances applied which were not conducive to carrying out a formal discounted cash flow analysis of life cycle costs in this case. A cost benefit analysis was carried out in an informal manner, taking account of the broader considerations which uniquely applied in this case. I am satisfied that there was sufficient relevant information available to ensure the most prudent decision was made.

In any event, in light of the escalation in costs to over €1.3 million, it was clear that any future benefits that might accrue, over a maximum five year remaining life span, would not have outweighed this level of increased costs and the risk of further unforeseen costly maintenance and repair issues arising at any time.

- 8.41** A competitive sales process or auction should normally be used for the disposal of State assets with a significant market value. Such a process helps to ensure transparency and is more likely to achieve the fair market price. In the circumstances, the Department found itself with few alternatives and decided that a competitive tendering process would have been impossible. However, the rationale for this decision should have been documented at the time.
- 8.42** An informal valuation of the aircraft estimated that its value without repair could be below €750,000. The Air Corps estimated the value of the spare parts at just over €400,000. The aircraft was sold for €418,000 and the spare parts for €53,000. In the absence of a competitive sales process, it is difficult to conclude on whether best value was obtained. The Department has stated that it is fully satisfied with the value achieved in the sale of the aircraft and spare parts, given the extenuating circumstances involved.