

From: Page, Kevin
Sent: April 20, 2012 2:17 PM
To: 'DAN.ROSS@forces.gc.ca'
Cc: ROBERT.FONBERG@forces.gc.ca; KEVIN.LINDSEY@forces.gc.ca
Subject: RE: Response to your inquiry

Dear Dan, Rob and Kevin

Dan, with great respect, I appreciate the difficulties and importance of the issue, but I am not sure you understand how we estimated Operating and Support (O&S) costs in our March 2011 report. If you do, let me apologize in advance.

Using a cost estimating relationship (CER) type model and historical data we derive an O&S estimate per aircraft per year. The estimate is derived from an estimate of program average unit acquisition costs, the F35 basic mass empty weight, plus assumptions and adjustments for flying hours and complexity. We come up with a number of 6.4 % of the program average unit acquisition costs or US\$8.24 million per aircraft per year. In our 2011 Report we acknowledge that this estimate may be somewhat higher than other fighter/strike jets (in the 3 to 5% range).

On O&S we use standard definitions as defined in policy and practice as noted in the letter we sent yesterday (with the letter we were trying to accomplish two things – respond to your request plus send the signal that we have been asked to do more work on F35). We recognize that O&S is a major cost component of ongoing sustainment so, right from the get go, we wanted a standard and comprehensive definition. As noted in our report “all costs associated with keeping the aircraft in an operational state of readiness”. Dan, as you know, this includes all the material costs in your list (personnel salaries, fuel, engineering services etc) as they are included in standard accounting definitions of O&S, as annexed in our letter.

CER models (and top down types, more generally), as Rob knows from experience that we shared at Finance, can play an important role in decision support environments. Next week we will be at the House Finance Committee talking about economic and fiscal projections, economic impacts of the budget, estimates of cyclically adjusted budget balances etc. Our analysis and estimates will flow from top down type econometric models. We will have an estimate for CPI inflation (I replaced Rob as the CPI inflation analyst in 1981 at Finance) which will play an important role in generating other estimates (payments on OAS etc). I say this because we will have an estimate for total CPI inflation, but not for food, clothing, accommodation etc. Top down models are not built from the bottom up. We accept the definition of the CPI (from coverage to weights etc)

In public sector financial environments, like the costing of new procurement, top down CER models can provide very useful tests of reasonableness. In this regard, I can understand why DND would use a bottom up model (i.e., estimates of all individual components of O&S to create an estimate for O&S) and then perhaps use a top down CER model as a test of reasonableness. As a legislative budget office (with between 12 to 15 people), we will rely heavily on top down models to provide analytical support to MPs to hold the government to account.

Dan, if you want to do a test of reasonableness (coverage, potential accuracy etc) on our PBO estimate for F35 O&S costs, you may wish to use historical data on the CF18s – create a benchmark and provide judgement and scaling adjustments for an F35.

My apologies for this long email and its digressions. I have had the honour to work with all three of you over my public service career

Kevin