

Audit of effective profit margins at RUAG Aviation 2013–2017

Summary of the results

What is the effective profit margin of RUAG in the maintenance and repair of fighter jets and armed forces helicopters? Does it correspond to the agreed profit margin of 8%? Due to the repeated allegations in December 2018 in newspaper articles of inflated prices, RUAG asked the Swiss Federal Audit Office (SFAO) to investigate these questions. The audit was conducted in spring 2019 with the full support of RUAG and with complete transparency.

The audit of fiscal years 2013 to 2017 shows that RUAG's estimated effective profit margin in the case of federal contracts that were not advertised publicly is on average between 11.6% and 14.6%. This is higher than the fixed 8%, but significantly lower than the 30% to 35% that was reported in the media. In these five years, RUAG Aviation realised a net turnover of CHF 1 billion with the Federal Department of Defence, Civil Protection and Sport (DDPS).

Calculation method and results

In its audit, the SFAO found no manipulations in the entries. Invoicing is considered to be in conformity with the contract. RUAG reported the profit margins as agreed to the Chief of Defence Procurement. The SFAO's estimates regarding the effective profit margin is based on an originator-oriented allocation of the costs and thus deviates from the agreed flat-rate distribution. Both the minimum and maximum adjustment requirements were determined for each item. This defines a bandwidth. The main objective of the procedure was to allocate only those costs to the DDPS contracts which are effectively necessary to provide the service ordered. This corrects the impact of cross-financing. According to the dispatch on the Federal Act of 16 April 1997 on Federal Armaments Companies (FArmCA), cross-subsidisation of civilian activities from the military equipment sector must be avoided. Accordingly, the development of third-party business must be financed only through the profits generated, but not through cost allocation that does not reflect the cause. The SFAO has made the following adjustments to its calculations:

- Two-fold levying of a profit margin on spare parts: the RUAG group procures some spare parts via the group company Mecanex domiciled in the USA. The spare parts invoiced to the DDPS carry profit surcharges for the foreign and Swiss companies. Only the Swiss profit surcharge was taken into account.
- Research and development costs: the project costs invoiced by RUAG for the civil aircraft Dornier 228 represent cross-financing and have been deducted.

- Sales and marketing:
 - A significant portion of marketing costs relates to international airshows in Singapore, Australia or Paris and trade fairs such as the *European Business Aviation Convention & Exhibition (EBACE)* in Geneva. According to RUAG, these are partially outsourced marketing and communication services for the armed forces – without an explicit mandate from the DDPS. Marketing costs for the Dornier 228 are also included in this item.
 - RUAG also sponsors various DDPS and militia events, such as *AIR 14, Thun meets Army, 50th anniversary of the Bure military training area, Fondation du Musée de l'aviation militaire de Payerne, Anniversaire Grenadier et Eclaireurs parachutistes, Swiss Officers Association*. According to RUAG, such sponsorship contributions indirectly support the DDPS in achieving its political objectives.

In estimating the effective profit margin, only a small portion of this item was considered. In addition, the SFAO will discuss sponsorship and the outsourced marketing and communication services with the DDPS management.

- Administration costs: deduction of consultancy costs for the Dornier 228 and reduction of management and brand fees, which do not create any added value for the DDPS in the Service Level Agreement services.

Abolition of the premium for imputed depreciation and interest: although this imputed premium was agreed with the DDPS in 2001, it clearly represents a profit component. Remarkably, this surcharge has not been taken into account by RUAG's other customers.

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