

Report of the Ministry of Defence

for the year ended 30 June 2001

*Presented to the House of Representatives
pursuant to Section 39 of the Public Finance Act 1989*



MINISTRY OF
DEFENCE

MANATU KAUPAPA WAONGA

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Defence Update (eleven editions)
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Departmental Forecast Report
Annual Report

Acts Administered

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Secretary of Defence's Overview

Introduction

The key objective for the Ministry over the last twelve months has been the implementation of the Government's defence policy. This was announced in the June 2000 *Defence Policy Framework* and given effect in May 2001 by the *Government Defence Statement – A Modern, Sustainable Defence Force Matched to New Zealand's Needs*. The Defence Policy Framework was substantially based on the recommendations of the Foreign Affairs, Defence and Trade Select Committee Report *Defence Beyond 2000*.

These announcements of the Government's defence policy have been central in guiding the Ministry in its three roles. These are: to provide timely high quality advice to help the Government make well-informed judgements on the defence of New Zealand and its interests; to arrange for the acquisition of significant items of military equipment needed to meet capability requirements; and to conduct evaluations of the New Zealand Defence Force (NZDF).

The crisis in East Timor and the overthrow of democratically elected governments in Solomon Islands and Fiji continued to impact on the shaping of defence policy. Events in Asia are also being closely monitored with ongoing religious, ethnic and political violence in Indonesia of particular concern. Closer to home, the NZDF worked with Fisheries and Customs to counter the smuggling of illegal goods and threats to New Zealand's fishery resources.

Over the past year, the Ministry bedded down changes in its operation as an organisation and in its relationship with the NZDF. Combining the Ministry's public relations and policy units with those of the NZDF has proved to be a success, with outputs being improved in both cases.

The Ministry was also able to contribute to the Government's plans for rebuilding the NZDF. Major milestones in the light armoured vehicles and tactical communications acquisitions projects were reached when the Government signed contracts for the purchase of the Canadian General Motors LAV III vehicles and tactical radios. As there was, however, some concern about the process followed for acquisition of the LAVs, I requested that the Auditor General undertake an audit of the process itself.

Policy and Planning

Development of defence and security policy is a key activity for the Ministry. The Secretary of Defence is the principal civilian advisor on defence matters to the Minister of Defence and other Ministers. The Chief of Defence Force is the principal military advisor. The Secretary and Chief of the Defence Force must work closely together in the formation of defence and military policy.

Last year was the first full year of operation of the Defence Policy and Planning Unit (DPPU). The DPPU combined the Ministry of Defence and NZDF policy groups into an integrated unit providing separate advice to the Chief of Defence Force (on military operational matters) and to me. The integration of policy functions has been a success. It has created a better informed stream of policy advice from the joint expertise and critical mass of the combined policy units. It has also led to improved external relationships, as other agencies now have to go to only one group for defence policy information and liaison.

THE MAY 2001 GOVERNMENT DEFENCE STATEMENT

The DPPU's work has been dominated by the reviews that lead to the release, on 8 May 2001, of the *Government Defence Statement – A Modern, Sustainable Defence Force Matched to New Zealand's Needs*. This was the key defence document released over the past year. It was accompanied by the release of other documents: the Maritime Patrol Review; the Air Combat Review; the Land Forces and Sealift Review; and associated cabinet papers.

The Government's core requirement in rebuilding the NZDF is for well-equipped, combat trained land forces, which are also able to act as effective peacekeepers, supported by the Navy and Air Force. This approach is reflected in the decisions made by the Government, which were as follows:

A Joint Approach

- The acquisition of a modern joint command and control system to support the Joint Force Operational Headquarters that began operation at Trentham in July 2001.
- Reorganisation and rationalisation of the NZDF and single services to reflect a better, joint approach to planning and to managing the NZDF.
- A new Maritime Co-ordination Centre to be established and co-located with the Joint Force Operational Headquarters. It will be responsible for integrating the work of all agencies to ensure there is a comprehensive national approach to managing maritime risks.

A Modernised Army

- The current structure of the Army, based on two light infantry battalions within a brigade framework, is to be maintained. The two battalions provide a capacity to sustain a 600-900 person commitment for a year or a 900-1,200 person commitment for six months. These levels can be enhanced by the deployment of Territorials when and where necessary.
- The Government will address the issues surrounding service in the Territorial Army to make it more attractive to both Territorials and employers.
- The acquisition of new armoured vehicles, tactical communications, and light operational vehicles is underway. These acquisitions will address major equipment deficiencies in the Army.
- Other investment requirements to be considered include: close in fire support; vehicles and sensors to equip the reconnaissance companies; command and control equipment; and combat service support equipment.
- Other capability issues to be addressed are engineer support, artillery, air defence and electronic warfare.

A Practical Navy Fleet

- The two ANZAC frigates will continue in service.
- HMNZS *Charles Upham* has been sold.
- The requirement for an appropriate sealift capability will be considered as part of a review of the composition of the maritime surface fleet which will also examine how to best meet civilian requirements for coastal and mid-range offshore capabilities.
- Work will proceed on identifying a suitable multi-role vessel, with long distance and Southern Ocean capabilities, to be phased in as the *Canterbury* is retired.
- Consideration will be given to acquiring additional combat and detection equipment for the new Seasprite naval helicopters, the first two of which arrived in New Zealand in June.

A Refocused and Updated Air Force

- The C-130 Hercules fleet will be upgraded or replaced.
- The Iroquois helicopter fleet will be upgraded or replaced.
- A study will be conducted as soon as possible to identify the options for replacing the B727 transport planes, including ownership, leasing or chartering.
- The Orion fleet will be retained, and provided with a limited upgrade, using good quality commercial systems wherever possible.
- There will be an investigation into the feasibility of equipping the Orions with a missile capability.

- A study will be undertaken to determine the best options for short and medium range air patrol.
- The air combat force will be disbanded.

A funding commitment to provide financial certainty

- There will be modest increases in the net operating funding for defence over the next ten years. Total capital investment over the same period will exceed two billion dollars.

CAPABILITY STUDIES

As well as the work undertaken on the four capability studies for the May defence statement, work continued on the Special Operations Forces Study. This study will define the capability requirements for Special Operations Forces and will provide a basis for future investment decisions in the area. Special Operations Forces have an inherent high utility in operations that are diverse and involve flexible capabilities.

As a result of the Government's May defence statement, the *Maritime Forces Review* was initiated to determine the optimum composition of the RNZN surface fleet. In addition to military and foreign policy related uses of naval vessels, the review will: identify a suitable type of multi-role vessel, with long distance and Southern Ocean capabilities and appropriate sealift capability, to replace HMNZS *Canterbury*; and examine how best to meet civilian and military requirements for coastal and mid-range patrol.

OTHER POLICY AND CAPABILITY PROJECTS

In addition to work on the Government's defence statement, the DPPU also undertook project work in other areas. A review on information operations was substantially completed. As part of the Government's review of its relations with the South Pacific, a review of New Zealand's Pacific defence policy was commenced. The Ministry has also sought to increase its involvement in arms control and disarmament and has provided input to the Ministry of Foreign Affairs and Trade on issues such as small arms proliferation and conventional arms control.

International Defence Relations

Developments in the Asia-Pacific region influence New Zealand's security and well-being. New Zealand continues to play an active role in support of regional security and stability. The amalgamated International Defence Relations Branch provides advice to both the Secretary of Defence and the Chief of Defence Force and supports the management of New Zealand's defence relations.

Defence diplomacy is giving greater substance to the partnership between defence policy and foreign policy. There is an increasingly wide range of linkages. These include visits by senior officials; the work of our defence attaches and their foreign counterparts accredited to New Zealand; bilateral and multilateral defence and security dialogues; exercise activity; participation in more than a dozen peace support operations; and defence aid, particularly to the South Pacific.

CLOSER DEFENCE RELATIONS WITH AUSTRALIA

Australia remains our most important defence partner. The relationship is embodied in the concept of Closer Defence Relations (CDR). We share many common interests notably the security and stability of the Asia-Pacific region. We share a commitment to work together to contribute to peace and stability in the South Pacific. The closest possible cooperation is a sensible means of ensuring our mutual security. That cooperation is reflected, for instance, in our continued combined efforts in three regional trouble spots: East Timor, Bougainville, and Solomon Islands. The East Timor mission underlines our ability to work together effectively in an operational environment.

Regular meetings take place at several levels, beginning with the annual meeting of Defence Ministers and the concurrent meeting of the Secretaries of Defence and the Chiefs of Defence. This year's meeting took place in Melbourne in early July. Ministers directed that their officials give further emphasis to achieving the highest possible levels of interoperability between the two defence forces within national defence priorities, so that the full potential of CDR can be realised.

SOUTH PACIFIC

Problems in the South Pacific are serious and wide-ranging. Many are systemic. There has been a growing resort to violence to settle disputes or to advance personal interests. The tentacles of trans-national crime are also touching the region. These problems, together with often bitter land grievances, have fuelled internal political, ethnic and tribal conflicts, particularly in Melanesia.

Defence has a part to play in assisting South Pacific countries deal with these issues. We are seeking better targeted and more effective delivery of defence assistance to the South Pacific, and to develop with the New Zealand Police a coordinated programme of assistance for law enforcement. Military planning must also take into account the increasing likelihood of operational deployments in the region.

Papua New Guinea

Our defence assistance to the PNG Defence Force has slowed as the Force grapples with the need to downsize and restructure to remain within budget.

Bougainville

A comprehensive peace settlement is within the grasp of the parties to the long-running conflict in that province. Recent progress has enabled a decision on a significant downsizing of the regional Peace Monitoring Group, which includes NZDF personnel, to take place shortly. But it is too soon to disband this mission. It continues to have an important role in building confidence in the political settlement that has now been negotiated. Patience remains the key to the resolution of this conflict.

Solomon Islands

The International Peace Monitoring Team, which includes seven members of the NZDF, is working to consolidate the success of the Townsville Peace Agreement in bringing to an end fighting between parties. The conflict has largely destroyed the country's economy and much of its infrastructure.

Building momentum in the peace process, however, has proved difficult. It will need ongoing international support. There has been a mixed response to the surrender of weapons, which is a key feature of the Townsville Peace Agreement. RNZN ships have deployed to Honiara at regular intervals in support of the peace process, sharing this task with the Royal Australian Navy.

Fiji

Defence cooperation with Fiji was suspended following the removal by force of its democratically elected government in May 2000. The exemption was for the provision of assistance directly related to Fiji's peacekeeping roles in East Timor (where a Fijian company is attached to the New Zealand battalion), and in Bougainville.

SOUTHEAST ASIA

Five Power Defence Arrangements

New Zealand maintains bilateral and multilateral defence and security relationships in Southeast Asia. Our enduring security interests in this region are reflected in our active engagement in, and commitment to, the Five Power Defence Arrangements (FPDA). The other members of

this group, that will later this year mark its 50th anniversary, are Australia, Malaysia, Singapore and the United Kingdom. The FPDA continues to play an important confidence building role, and also provides us with opportunities for engagement in the region. New Zealand's participation in the triennial FPDA ministerial meeting in July 2000 underscored New Zealand's commitment to this set of consultative arrangements. That meeting approved organisational changes that will add value to the range of activities it conducts.

Singapore

The attachment of a 70-strong Singapore unit to our battalion in East Timor in May added a new and significant dimension to an already close relationship. The relationship has been reinforced by regular exercise activity, exchanges and a steady flow of defence visitors between Singapore and New Zealand including the Minister of State for Defence, David Lim.

Malaysia

Bilateral defence relations with Malaysia date back to the early 1950s. The relationship today is built on annual meetings of the Defence Coordinating Group (DCG), renewed bilateral exercise activity and assistance provided under the Mutual Assistance Programme. Two meetings of the DCG were held this year - the first in Kuala Lumpur in September, the second in Wellington, in which the Malaysian Secretary of Defence, Dato Hashim Meon, also participated.

Thailand

New Zealand has a small but important defence relationship with Thailand. We enjoy a close and productive relationship with the Thailand battalion serving in East Timor. A Thai general, Lieutenant General Winnai Phattiyakul, commands UNTAET. In addition to peacekeeping, current cooperation centres on an active programme of training and advisory assistance provided under the Mutual Assistance Programme, occasional bilateral exercises and periodic visits by senior officials.

East Timor

New Zealand continues to make a major contribution to East Timor's transition to nationhood. We have now sustained a battalion level commitment in the country for 21 months. It is our largest commitment to an operational mission for several decades.

That is a major commitment (and no mean achievement) for a Defence Force that has only two regular force battalions. The RNZAF's Iroquois helicopters also play a major role in UNTAET. New Zealand's role in facilitating the participation of Fiji, Ireland, Nepal and Singapore

in UNTAET through attachments to our battalion is greatly appreciated by the United Nations. The NZDF is also assisting with the development and training of the East Timor Defence Force.

ASEAN Regional Forum (ARF)

The multilateral process is essential for collective security in the region. The ARF provides a forum that has no precedent in the Asia-Pacific, for bringing foreign affairs and defence officials together to discuss regional security issues and to consider ways of building confidence among its growing membership. The ARF has made encouraging progress this year in acquiring the first management tools to assist conflict prevention. It has already become indispensable. North Korea, the most recent addition to the ARF, joined in July 2000.

The ARF also provides an important means by which New Zealand is able to engage multilaterally with its partners on security matters. We participated in several ARF activities during the year. This included attendance at the ARF Ministerial meeting in Bangkok in July 2000, the May 2001 senior officials' meeting in Hanoi and inter-sessional working groups held in Seoul in November and Kuala Lumpur in April. Participation in the ARF has also had the effect of strengthening some of our bilateral defence linkages.

Peacekeeping

In addition to our major ongoing peacekeeping effort in East Timor, the NZDF is committed to 12 other UN or UN-sanctioned peace support or humanitarian demining missions around the world, including the Middle East, Bosnia, Sierra Leone and Mozambique. At present 839 personnel are serving on peace support operations, almost 700 of whom are involved with East Timor.

NORTH ASIA

The security and prosperity of the wider Asia-Pacific region depends to a very large degree on relations between China, Japan and the United States. China-US relations were tested during the EP3 aircraft surveillance incident. Progress in inter Korean relations appears to have slowed after a promising start in 2000. Other tensions remain, including Taiwan's relations with China.

New Zealand's defence engagement with North Asia has grown considerably in line with the expansion of other areas of our relationships. Depth and breadth are being added to defence contacts and cooperation, a process that is consistent with our emphasis on regional confidence building.

China

New Zealand has an active defence relationship with China. There has been a steady flow of senior PLA visitors to New Zealand, the most significant being Gen Zhang Wannian, Vice Chairman of the Central Military Commission of the PLA in April. Last October, the PLA hosted a visit by the Chief of Defence Force. A second PLA officer is attending the RNZAF Command and Staff College senior officers' course, and we again had the opportunity to take part in a professional development programme at the National Defence University in Beijing. A second bilateral security dialogue meeting was held in Beijing in November.

Republic of Korea

The contribution of a 11 strong contingent to the United Nations Command Honour Guard in Seoul for a period of six months from January to July 2001 added a significant new dimension to bilateral relations with the Republic of Korea. It underlined our support for the role of the UN as expressed in the armistice agreement, while also demonstrating New Zealand's ongoing commitment to peace and stability on the Korean Peninsula and in the wider East Asian region. This deployment was timed to enable the contingent to provide support to some of the commemorative activities associated with the 50th anniversary of the Battle of Kap'yong in which New Zealand played a significant role. There is also increasing contact in peacekeeping through Korea's participation in UNTAET.

Other developments included the second round of political/military dialogue in Seoul in November; the visit of the CDF to the Republic of Korea in April 2001; the participation of Korean naval officers in a RNZN exercise in October 2000; the first bilateral special forces exercise with the Republic of Korea in August 2000; and the RNZN Band and Maori Cultural Group's performance in the Kangwon International Tattoo in October 2000.

Japan

Defence links with Japan are expanding. CDF visited Japan in October 2000, the first such visit for 18 years. General Takegouchi, his Japanese counterpart, will reciprocate when he makes the first-ever visit to New Zealand by a Japanese officer at this level in September 2001.

Another milestone in the relationship was the first political/military dialogue that was held with Japan in November 2000. A professional development course run by the Japanese National Institute of Defence Studies was attended by a NZDF officer and the President of the Institute visited New Zealand in March 2001.

NORTH AMERICA

United States

While United States restrictions on defence cooperation with New Zealand remain in place, the two countries share common interests in relation to regional security. The most senior United States military visitor this year was Admiral Blair, Commander-in-Chief of Pacific Command. The opportunity such visits provide for high-level dialogue on defence and security issues is valued. Access to United States information, training and technology enhances New Zealand's ability to operate alongside other forces and to play a meaningful role in pursuit of our shared security objectives.

Canada

New Zealand's defence relationship with Canada centres on cooperation in regional security and peacekeeping; participation in exercises; an annual three month reciprocal exchange of around 20 personnel from each country; and attendance at Canadian courses. Early in the year the Canadians completed their attachment to our battalion in UNTAET.

Acquisition

The Ministry of Defence, through the Acquisition Division, is responsible for procuring all major items of capital equipment for the NZDF. The procurement process is often lengthy. It commences with the Government, on the basis of a user specification developed by the NZDF, giving approval in principle to begin a tender process. From that point on, the Ministry undertakes risk assessments, identifies preferred bidders, and invites tenders. Once the Government has given approval to proceed and commits the necessary funding, the Ministry negotiates and manages the contract arrangements, through to delivery of the equipment to the Defence Force.

Following the change of government in November 1999, many of the acquisition projects being run by the Ministry were put in abeyance pending new direction from the Government. Decisions were made on three major acquisition projects, initiated before the 1999 election, in August 2000. The Government decided to proceed with the light armoured vehicle project and the tactical communications systems. It decided not to proceed with the Project Sirius mission systems upgrade for the P-3 Orion. With these decisions made and those announced as part of the May 2001 defence statement, the Ministry is now proceeding with the projects that will contribute to the Government's objectives for rebuilding the Defence Force.

UPGRADE THE ARMY

Vehicles

- *Light Armoured Vehicle* – The Prime Minister signed a contract for the supply of 105 light armoured vehicles on 29 January 2001. The first batch of vehicles is due for acceptance in March 2003 with the last due in May 2004.
- *Light Operational Vehicles* – In December 2000 a revised Invitation-to-Register was issued for the supply of 308 Light Operational vehicles. Ten responses were received. In lieu of field tests, these vehicles have been subjected to an evaluation utilising the NATO Reference Mobility Model (“NRM”). The Australian Department of Defence Land Engineering Authority has carried this out. Government approval will be sought to issue a Request-for-Tender to those candidate vehicles that have shown appropriate mobility.

Tactical Communications

This project covers tactical communications for the Army and supporting RNZAF units. The Government approved the purchase of the equipment on 20 September 2000. The radios are being obtained through the United States Government Foreign Military Sales organisation. Deliveries have already commenced.

Weapons

The direct fire support weapon (area) and the medium range anti-armour projects have been on hold pending the development by the NZDF of revised force development proposals, following the May 2001 defence statement.

PROVIDE EFFECTIVE AIR AND NAVAL TRANSPORT CAPABILITIES

Sealift

Decisions concerning future sealift capabilities will be made after consideration by Government of the Maritime Forces Review.

C-130 Hercules aircraft

A Request-for-Tender to conduct a life of type study on the current fleet of C-130H transport aircraft has been issued. This study will enable the Government, in due course, to consider the options of replacement or extension to the life of the current aircraft.

Strategic Transport

A force development proposal is currently being prepared by the NZDF to detail the requirements for future strategic jet aircraft (Boeing 727 replacement). Subject to government approval to proceed, proposals will be sought from industry worldwide to fulfil this requirement. Proposals are expected to include, as options, outright ownership, operating lease and shared ownership.

MAINTAIN EFFECTIVE MARITIME SURVEILLANCE CAPABILITIES

Maritime Surveillance Aircraft

The six P-3 Orion aircraft are continuing to be upgraded to extend their life for another fifteen years. Projects involving the Orions include:

- *Aircraft re-winging* – Project Kestrel. The sixth and final aircraft is almost complete, and will be returned by September.
- *Autopilot systems replacement* – The autopilot has been installed and tested in two aircraft. The contractor is currently resolving a system functional problem before further aircraft modifications are commenced. This problem is also being experienced by other nations undertaking similar projects.

Maritime Helicopters

Four Kaman Seasprite naval helicopters are scheduled to be delivered this year and the fifth in the first quarter of 2003. Delays occurred in the delivery of the first four helicopters as a result of a greater level of new design and manufacture and more complex testing and certification processes than originally envisaged.

NEW ZEALAND INDUSTRIAL INVOLVEMENT

Defence Technologies New Zealand Joint Action Group

The Ministry has continued to support local companies seeking to obtain defence work from major acquisition projects and through exports. The main conduit for this assistance has been through the Defence Technologies New Zealand Joint Action Group (the JAG), which has a focus on defence work. The Ministry provided regular briefings at JAG meetings and assisted that organisation make contact with appropriate defence people in New Zealand, Australia and overseas. Assistance is also provided to the JAG to sponsor the annual Defence Industry Seminar. The 2000 event was held in Wellington and was attended by 200 defence and industry people.

Defence Industry Committee of NZ

The Ministry provided support for the Defence Industry Committee of New Zealand (“DICNZ”). This Ministerial appointed committee provides industry feedback into Defence and briefs the Minister on issues relating to industry. The DICNZ established the “Defence Industry Committee Award of Excellence,” which is awarded annually to companies that have provided Defence with excellence in service or products. The Minister presents the Award at the Defence Industry Seminar dinner. The winner in 2000 was Swing Thru New Zealand Ltd which, at short notice, provided the New Zealand Army with revolutionary truck mounted container cranes that were essential for the handling of containers by the troops deployed to East Timor. Several military organisations overseas are now reviewing the use of these cranes for their own supply chain.

INDUSTRY PROGRAMMES

ANZAC Ship Project

The industry programme on the ANZAC ship project is now almost complete. The ANZAC Ship Treaty, signed in 1989, guaranteed New Zealand companies A\$585 million (1988 dollars) of work from the project and from access to other Australian defence work. Currently the achievement totals A\$565.1 million (1988), 96.6% of the guaranteed figure, with some final ANZAC ship deliveries and further Australian defence work to be counted. It is likely that the achievement figure will exceed A\$600 million (1988) when the accounting is complete at the end of the project. This represents over NZ\$1,000 million in current day dollars.

Maritime Helicopter Project

The other major industry programme currently associated with a major acquisition project is that of the maritime helicopter project. This industry programme has grown significantly

since the contract with Kaman Aerospace was signed. It appears likely that this programme will exceed the contracted amount, possibly by up to 40%. Much of the increase has been associated with the local partner of Kaman, Safe Air Ltd of Blenheim, providing additional technical support in the design, manufacture and testing of the new aircraft. In addition to the positive employment issues, the greater involvement by Safe Air personnel will provide greater in-depth knowledge of the helicopters once in service, thereby assisting the NZDF by improving through-life service and support.

LAVIII Armoured Vehicles

The contract with General Motors of Canada for the supply of 105 LAVIII armoured vehicles has offered only limited opportunity for local industry involvement in their manufacture. This acquisition involves buying a product produced from an existing production line, similar to buying a motor vehicle. Serco New Zealand, however, has a close association with General Motors and has been focusing on obtaining the knowledge and experience necessary to support these vehicles through-life.

Evaluation

The Ministry, through the Evaluation Division, undertakes independent evaluations of NZDF functions and activities. The main focus is on output evaluation and management and system review. The Division also assists with the management of risk associated with Ministry of Defence acquisition projects, and undertakes Ministry of Defence internal audits.

Output evaluations examine NZDF outputs for consistency with defence policy, and determine whether they are being delivered in a quantity and to a quality that meets policy objectives. Issues highlighted in output evaluations are considered as part of defence planning. During the first half of the year the Division completed an evaluation of the Navy's Mine Countermeasures, Diving and Diving Support Forces. No other output evaluations were undertaken as government decisions during the second half of the year altered the basis for many of the Defence Force's 2000/2001 outputs. Output evaluations will resume in the coming year. Assessment of the progress being made towards reshaping the Defence Force to meet the Government's policy framework will be included.

Management and system reviews analyse the efficiency and effectiveness of NZDF management practices and systems. Reviews completed included management of minor capital equipment programmes; management of the introduction into service of new equipment; commercialisation of the provision of Defence Force clothing; management of bulk fuels; progress towards introduction of management systems required to meet the Hazardous Substances and New Organisms Act 1996; and commercialisation of the Air Force's depot level maintenance.

Evaluations were completed at the direction of the Minister of Defence, on the overseas travel of senior NZDF officers.

The Division monitored progress towards introduction of the new hazardous substances regime. This requires that the Ministry audit the controls issued by the CDF for hazardous substances under defence control.

The ANZAC Ship Project Joint Audit Board, which maintained audit oversight of the ANZAC Ship Project in conjunction with the Australian Department of Defence, met for the last time during the year. Following completion of the warranty period on HMNZS *Te Mana*, there is no further need for New Zealand audit involvement in the project.

Corporate

Corporate Division provides support services and policy advice in the areas of human resources, information, administration, communications and legal. It is responsible for all aspects of Ministerial services and support. Considerable disruption to the work of the Ministry and of the Division was experienced as a result of the flooding of Defence House towards the end of the financial year.

Strategic Business Plan

The Ministry completed implementation of internal planning processes with the publication of its first Strategic Business Plan. This is designed to provide staff with guidance on the Ministry's strategic direction and the culture within which they work. A representative number of staff was engaged in developing the plan, which was published prior to the Defence announcements on 8 May 2001. The Plan will cover a two-year period with the intention to review it in 2002.

ISO 9001 Certification

In January 2001, the Ministry underwent successful recertification of its management system to the ISO 9001 standard. This complete reaudit is required every three years. The Ministry's program of developing and enhancing its management systems, which commenced last year, was of considerable assistance in achieving this favourable outcome.

Other Issues

Improvements and enhancements to the Ministry's management systems have continued, particularly with regard to the electronic document management system. The Ministry has placed considerable emphasis on training for its staff and participation in the e-government initiatives. The final stages of recovery from the flood were undertaken. Staff had been relocated around the floor for six weeks while half of the Ministry's premises were dried out, furniture and equipment repaired or replaced and many paper records recovered and dried. Documentation of the events and processes followed to restore functions has been invaluable for future disaster recovery planning.

Conclusion

The last year has seen the Ministry play a role in aiding the Government, through advice and acquisitions work, to provide shape to and implement its policy framework. This formed the focus of the Ministry's work during the year, especially through the completion of capability reviews that fed into the May 2001 defence statement.

The significant domestic policy changes underway were not, however, at the expense of engagement on international defence and security issues. This was a key message we sent to our security partners and was underlined by our continued commitment to Closer Defence Relations with Australia, and the deployments to East Timor, Solomon Islands, and Bougainville.

A significant amount of work has been done over the past year to enhance and improve the Ministry as an organisation and the way in which it interacts with its staff. Some of the benefits of this are now apparent and further work will be done in this area in the coming year.



Graham Fortune

Secretary of Defence

27 September 2001

Statement of Responsibility

In terms of sections 35 and 37 of the Public Finance Act 1989, I am responsible, as Chief Executive of the Ministry of Defence, for the preparation of the Ministry's financial statements and the judgements made in the process of producing those statements.

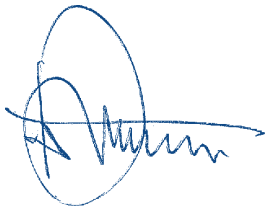
I have the responsibility of establishing and maintaining, and I have established and maintained, a system of internal control procedures that provide reasonable assurance as to the integrity and reliability of financial reporting.

In my opinion, these financial statements fairly reflect the financial position and operations of the Ministry for the year ended 30 June 2001.



Graham Fortune
Secretary of Defence
27 September 2001

Countersigned by:



S J Patterson
Assistant Secretary of Defence (Finance)
27 September 2001



Audit New Zealand

REPORT OF THE AUDIT OFFICE

TO THE READERS OF THE FINANCIAL STATEMENTS OF THE MINISTRY OF DEFENCE FOR THE YEAR ENDED 30 June 2001

We have audited the financial statements on pages 21 to 63. The financial statements provide information about the past financial and service performance of the Ministry of Defence and its financial position as at 30 June 2001. This information is stated in accordance with the accounting policies set out on pages 35 to 39.

Responsibilities of the Secretary of Defence

The Public Finance Act 1989 requires the Secretary of Defence to prepare financial statements in accordance with generally accepted accounting practice which fairly reflect the financial position of the Ministry of Defence as at 30 June 2001, the results of its operations and cash flows and the service performance achievements for the year ended 30 June 2001

Auditor's responsibilities

Section 38(1) of the Public Finance Act 1989 requires the Audit Office to audit the financial statements presented by the Secretary of Defence. It is the responsibility of the Audit Office to express an independent opinion on the financial statements and report its opinion to you.

The Controller and Auditor-General has appointed Chris Fabling, of Audit New Zealand, to undertake the audit.

Basis of opinion

An audit includes examining, on a test basis, evidence relevant to the amounts and disclosures in the financial statements. It also includes assessing:

- the significant estimates and judgements made by the Secretary of Defence in the preparation of the financial statements *and*
- whether the accounting policies are appropriate to the Ministry of Defence's circumstances, consistently applied and adequately disclosed.

We conducted our audit in accordance with generally accepted auditing standards, including the Auditing Standards issued by the Institute of Chartered Accountants of New Zealand. We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatements, whether caused by fraud or error. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements.

We have performed assurance related work for the Controller and Auditor General in relation to the preparation of the report: "Ministry of Defence: Acquisition of Light Armoured Vehicles and Light Operational Vehicles". Other than this assignment, and in our capacity as auditor acting on behalf of the Controller and Auditor-General, we have no relationship with or interests in the Ministry of Defence.

Unqualified opinion

We have obtained all the information and explanations we have required.

In our opinion the financial statements of the Ministry of Defence on pages 21 to 63:

- comply with generally accepted accounting practice and
- fairly reflect:
 - the financial position as at 30 June 2001
 - the results of its operations and cash flows for the year ended on that date and
 - the service performance achievements in relation to the performance targets and other measures set out in the forecast financial statements for the year ended on that date.

Our audit was completed on 27 September 2001 and our unqualified opinion is expressed as at that date.



C R Fabling

Audit New Zealand

On behalf of the Controller and Auditor-General

Wellington, New Zealand



Statement of Objectives and Service Performance

For the year ended 30 June 2001

OBJECTIVES

The Estimates of Appropriations and Purchase Agreement formed the framework for the definition of objectives and performance indicators by divisions within the Ministry. These were reviewed and adapted where necessary in response to external change during the year. In addition, at the end of each quarter, divisions formally evaluated their performance against their objectives in order to compare actual results with priorities, resource allocations and targets set at the beginning of the year. A quarterly report was made to the Minister of Defence on the delivery of outputs to the Crown.

QUALITY ASSURANCE

The Ministry applied to all outputs quality assurance processes designed to maintain professional standards and quality of work. These processes included: the provision of appropriate training and skilling programmes and career development opportunities; annual evaluations and reviews of staff performance; and managerial oversight. The Ministry maintains the financial management systems necessary to ensure that classes of outputs are delivered within approved appropriation and in compliance with the provisions of the Public Finance Act. Regular monitoring of expenditure against output forecasts was undertaken. Systems are in place to ensure working capital is managed at an optimum level and foreign currency exposure is minimal.

OUTPUT CLASS PERFORMANCE

Performance for each output class is reviewed in the following statements of service performance. Each section of the statements sets out the outputs under review, and reviews performance in terms of the appropriate measures.

CLASS OF OUTPUT D1 – POLICY ADVICE

DESCRIPTION

Under this output class the Minister of Defence will purchase advice on defence policy matters. This includes advice on changes in the strategic environment, defence and security policies, goals and outcomes and strategies for their achievement and the military capabilities required to meet defence policy goals, along with the broad resource implications and the relative merits and risks associated with proposed capability options. Included in this output class is management of international defence relations, including closer defence relations with Australia and the enhancement of regional security through participation in multilateral defence and security forums, and the development of bilateral defence relationships. It also includes: responses to ministerial and parliamentary questions, Official Information Act enquiries and Ombudsman correspondence; and public affairs advice.

OUTCOME

The outcome of this output class is to contribute by the formulation of effective policies to the protection of New Zealand and its external interests.

SERVICE PERFORMANCE

| TARGET | DELIVERED |
|--------|-----------|
|--------|-----------|

- | | |
|---|---|
| <p>1. <i>Undertake reviews of different options for achieving the Government's defence policy goals</i></p> | <ul style="list-style-type: none"> ▪ Reviews were completed by 1 December 2000 on Land Forces and Sealift as part of the first phase of the capability reviews outlined in the Government's Defence Policy Framework. ▪ As part of the Ministry's participation in the Department of the Prime Minister and Cabinet led review of maritime patrol requirements, a joint Ministry of Defence and New Zealand Defence Force paper was submitted to the review group in December 2000. ▪ A review of the Air Combat Force was completed by February 2001 for the Government's May 2001 defence statement. ▪ Arrangements commenced for the follow up reviews announced in the May 2001 defence statement, in particular those concerning the Maritime Forces Review, Hydrographic Survey, and Naval Medical Service. |
|---|---|

- Phase 1 and a substantial part of phase 2 of the review of the Special Operations Capability were completed.
- The review of New Zealand's Pacific defence policy was commenced.
- A review of Information Operations was substantially completed.

2. *Manage defence relationships with Australia and other regional countries*

- *Australia:*
Final arrangements were completed for the July 2001 annual meeting of the NZ and Australian Ministers of Defence and the annual meeting of the Australia-New Zealand Consultative Committee (ANZCC) comprising defence principals. Special briefings were provided in Canberra by the Deputy Secretary (Policy & Planning) prior to the release of the May 2001 defence statement. An Australia-New Zealand Defence Co-ordinating Group (comprising senior defence officials) met in Wellington in May 2001.
- *Pacific:*
Mutual Assistance Programme (MAP) talks were held with Tonga, Samoa, and Vanuatu.
- *South East Asia:*
Bilateral security and defence talks, including Mutual Assistance talks, were held with Malaysia, Singapore, Thailand, Philippines and Brunei.
- *North Asia:*
Bilateral security and defence talks were held with Japan, Korea and China.
- *High Level Visits:*
New Zealand hosted a number of high level visits to New Zealand including:
 - Mr David Lim, the Singapore Minister of State for Defence;
 - UNTAET Head, Mr. De Mello;
 - General Zhang, the Vice-Chair of China's Central Military Commission;
 - Dato' Hashim Meon, the Malaysian Secretary General of Defence;
 - Admiral Blair, the United States Commander in Chief Pacific;
 - Admiral Fargo, the United States Commander in Chief Pacific Fleet.

- *Visits by New Zealand:*

There were high level visits by New Zealand Defence Force to North Asia, Hawaii, Thailand, Philippines, US, Singapore and Malaysia.

- *Briefing notes:*

A large number of briefing notes were prepared on defence and security matters including for the Prime Minister's visits to East Timor and Australia, visits by the Minister of Defence to Timor, Korea, and Singapore; and New Zealand's engagement in Timor, Solomon Islands, Bougainville, and Fiji.

3. *Participate in the regional multilateral security dialogue*

- *ASEAN Regional Forum (ARF):*

Participated and contributed to one Senior Officials' meeting (SOM) and two Intersessional Group (ISG) meetings.

- *Five Power Defence Arrangements (FPDA):*

The Minister of Defence attended the Ministerial meeting in July 2000.

- *Japanese Asia-Pacific Defence Officials' Meeting:*

New Zealand attended the annual meeting in Tokyo in October 2000.

4. *Host the biennial symposium of military operational research specialists in the Asia-Pacific region*

- The Fifth Asia-Pacific Military Operations Research Symposium was organised and hosted successfully in Wellington in November 2000.
-

5. *Respond to the following Ministerial servicing products:*

- *Ministerial Correspondence.*

Draft replies to ministerial correspondence will be provided within fourteen working days of receipt by the Ministry

- 237 Ministerial letters of reply were completed over the reporting year. The flood in Defence House on 11 May meant that 29 ministerial replies were unable to be completed within the required timeframe.

- *Parliamentary questions.*
 - 144 Parliamentary Questions have been answered within the required timeframe.
- *Parliamentary questions will be actioned within time frames set by Standing Orders of the House of Representatives.*
- *Official Information Act requests.*
 - 58 Official Information Act requests were responded to within the required timeframe.
- *Official Information Act requests will be actioned within statutory requirements.*

-
- 6. *Produce publications in accordance with an agreed programme.*
 - 11 issues of Defence Update were published.

-
- The Ministry has maintained quality control procedures to support the expectations for policy advice delivered under this output class. The 2000 Departmental Forecast Report detailed the quality standards intended.
 - ISO 9001 certification has been maintained.

FINANCIAL PERFORMANCE (GST EXCLUSIVE) For the year ended 30 June 2001

| 30/6/2000 Actual \$000 | | 30/6/2001 Actual \$000 | 30/6/2001 Main. Estimates \$000 | 30/6/2001 Supp. Estimates \$000 |
|------------------------------|----------------------|------------------------------|---------------------------------------|---------------------------------------|
| | Revenue | | | |
| 3,106 | Crown | 3,120 | 3,120 | 3,120 |
| 28 | Other | 2 | 30 | – |
| 3,134 | Total Revenue | 3,122 | 3,150 | 3,120 |
| 2,984 | Expenditure | 2,946 | 3,150 | 3,120 |
| 150 | Surplus | 176 | – | – |

The appropriation (GST inclusive) for this output class was decreased by \$33,000 to reflect the loss of revenue from sales of the *Defence Quarterly Magazine*, which is no longer published.

CLASS OF OUTPUT D2 – AUDIT AND ASSESSMENT OF PERFORMANCE

DESCRIPTION

Under this output class the Minister of Defence will purchase independent evaluations of the New Zealand Defence Force's delivery of its outputs, reviews of the efficiency and effectiveness of the New Zealand Defence Force's management systems and resources utilisation and reviews of the Ministry's acquisition activities. In addition, the Minister of Defence will purchase audits of the controls on hazardous substances under his control as required by the Hazardous Substances and New Organisms Act 1996.

OUTCOME

An effective and efficient New Zealand Defence Force capable of meeting New Zealand's defence objectives to protect New Zealand and its external interests.

SERVICE PERFORMANCE

TARGET

DELIVERED

1. *Complete at least 15 evaluations against an agreed programme set by the Defence Evaluation Board*

- Eight reports were completed during the year:
 - Report No 259 - NZDF Minor Capital Equipment Programme
 - Report No 260 - Managing the Introduction into Service of New Capital Equipment
 - Report No 261 - Evaluation of the Delivery of NZDF Output Class 4 - MCM, Diving & Diving Support Forces
 - Report No 262 - Defence Clothing Agency Commercialisation
 - Report No 263 - NZDF Fuel Management
 - Report No 264 - Implementation of financial policy in the NZDF
 - Report No 265 - HSNO Preparations
 - Report No 266 - Commercialisation of RNZAF Depot Level Maintenance

Three approved projects were commenced during the year but were found, after preliminary research, not to warrant further action. One project was commenced but suspended awaiting a more suitable timing and is to be reactivated late 2001 or early

2002. Two further projects had been completed as at 30 June 2001 but the associated reports were awaiting revision of drafts before being issued.

Eleven internal audits of the Ministry's activities were completed during the year.

2. *Conduct other assessments and audits of the Defence Force as and when required by the Minister of Defence*
- A review of travel by the Chief of Defence Force and Chiefs of Staff was completed and at 30 June 2001 was awaiting feedback from the Minister before being issued.
 - A review of travel by senior NZDF officers was in progress at 30 June 2001.
-
- Evaluations were conducted in accordance with practice detailed in the Ministry's Evaluation Manual.
 - Findings and recommendations were a logical derivation from the circumstances found.
 - Evidence was kept of adequate consultation with interested parties.
 - Managerial review was maintained throughout the evaluation process.

FINANCIAL PERFORMANCE (GST EXCLUSIVE) For the year ended 30 June 2001

| 30/6/2000 Actual \$000 | | 30/6/2001 Actual \$000 | 30/6/2001 Main. Estimates \$000 | 30/6/2001 Supp. Estimates \$000 |
|------------------------------|----------------------|------------------------------|---------------------------------------|---------------------------------------|
| | Revenue | | | |
| 2,011 | Crown | 1,853 | 2,000 | 1,852 |
| – | Other | 2 | – | – |
| 2,011 | Total Revenue | 1,855 | 2,000 | 1,852 |
| 1,798 | Expenditure | 1,669 | 2,000 | 1,852 |
| 213 | Surplus | 186 | – | – |

The appropriation (GST inclusive) for this output class was decreased by a fiscally neutral adjustment of \$166,000 to provide for preliminary project costs which must now be expensed in Output Class D3 – Management of Equipment Procurement, and not capitalised.

CLASS OF OUTPUT D3 – MANAGEMENT OF EQUIPMENT PROCUREMENT

DESCRIPTION

Under this output class the Minister of Defence will purchase management of procurement or refurbishment, on behalf of the Crown, of significant equipment contributing to a capability of the New Zealand Defence Force. This output covers the management of procurement functions from the initial identification of a requirement through ministerial “approval in principle” to the acquisition process involving project investigation, risk assessment, quality assurance, equipment selection, negotiation and execution of contract arrangements, up to the point when the equipment is delivered to the New Zealand Defence Force, and the management of any warranty provisions beyond that date. It also covers the investigation of any associated financing arrangements and the arrangement of on-sale to the New Zealand Defence Force.

Also included in this output class are the maintenance of information on industrial capability and the provision of advice to industry on Defence requirements.

OUTCOME

New Zealand armed forces equipped to the level appropriate for the protection of New Zealand and its external interests according to the Government’s defence policy.

SERVICE PERFORMANCE

| TARGET | DELIVERED |
|--------|-----------|
|--------|-----------|

- | | |
|---|--|
| <p>1. <i>Subject to Government approval, progress the light operational vehicles project for the Army</i></p> | <ul style="list-style-type: none"> ▪ On 11 December 2000 the Government approved expenditure of \$0.566 million (GST inclusive) in 2000/01 and 2001/02 to meet the costs of completing the tender phase for light operational vehicles. ▪ A revised Invitation-to-Register (ITR) was issued in December 2000 for the supply of 508 light operational vehicles. Ten responses were received. Due to the importance Army placed on the mobility of the vehicles the responses will be evaluated by the Australian Army Land Authority using the NATO Reference Mobility Model. The results will be considered and a recommendation made to the Ministry of Defence Tenders |
|---|--|

Review Board in August 2001 on which vehicles should remain in the formal tender process.

- The original budget of \$0.529 million (GST exclusive) in 2000/01 was reduced in Supplementary Estimates to \$0.235 million (GST exclusive). Actual expenditure to 30 June 2001 was \$0.116 million (GST exclusive).

-
2. *Subject to Government approval, progress the direct fire support (area) weapons project for the Army*
- Following on from the Government's May 2001 defence statement, a revised Force Development Proposal is awaited from the New Zealand Defence Force prior to seeking Government approval to proceed with the project.
-
3. *Subject to Government approval, progress the medium range anti-armour weapons project for the Army*
- Following on from the Government's May 2001 defence statement, a revised Force Development Proposal is awaited from the New Zealand Defence Force prior to seeking Government approval to proceed with the project.
-
4. *Progress the special operations communications systems project*
- The Chief of Defence Force approved expenditure of \$4.948 million (GST exclusive) in 2000/2001 to purchase special operations communications. The Letters of Offer and Acceptance from the United States Department of Defence were signed on 16 May 2001 Delivery of the equipment commenced in January 2001 and is expected to be complete by May 2004.
-
5. *Progress the tactical mobile communications project for the Army and the Air Force*
- On 20 September 2000 the Government approved expenditure of \$154.126 million (GST inclusive) over financial years 2000/2001 to 2002/2005 to purchase tactical mobile communications equipment. The Letters of Offer and Acceptance from the United States Department of Defence were signed on 11 October 2000 Delivery of the equipment commenced in February 2001 and is expected to be complete by October 2002.
-
6. *Subject to Government approval, progress P-3 Orion mission equipment (Project Sirius) for the Air Force*
- Government announced that it did not wish to proceed with this project in its current form. The project has been cancelled. Any alternative capability will be considered in the context of the current capability reviews.
-

-
7. *Progress the armoured vehicles project for the Army*
- On 27 June 2001 the Government approved expenditure of \$652.835 million (GST inclusive) over financial years 2000/2001 to 2004/2005 to purchase 105 light armoured vehicles.
 - The Prime Minister signed a contract with General Motors Defence on 29 January 2001. The first batch of vehicles is due for acceptance in March 2003 with the last due May 2004.
-
8. *Subject to Government approval, progress a possible conversion or replacement of HMNZS Charles Upham for the Navy*
- In light of the Government's decision to sell HMNZS *Charles Upham*, the project has been cancelled. Any requirement for another vessel will be considered in the context of the current capability reviews.
-
9. *Subject to Government approval, progress acquisition of very low level air defence alerting and cueing systems for the Army*
- This project remains in abeyance pending the outcome of the capability reviews.
-
10. *Subject to Government approval, progress the joint command and control system*
- A top level User Requirement, and scope for a Project Definition Study, have been approved by the Secretary of Defence and Chief of Defence Force. It is currently planned that the study will be undertaken about June 2002.
-
11. *Progress acquisition of maritime helicopters*
- It was expected that the first four helicopters would be delivered by 30 June 2001 but contractor delays have caused this to slip to 30 September 2001. The fifth helicopter remains on schedule for delivery in the first quarter of 2003.
-
12. *Complete the direct fire support weapons (heavy machine guns) for the Army*
- The 24 heavy machine guns were introduced into service during the period June 2000 to March 2001.
 - A targeting and fire control unit was to be purchased in 2000/01 to complete the project, but this equipment will now be included in the direct fire support weapon (area) project which has not been approved by Government.
-

-
13. *Complete the bridge simulator for the Navy*
- The simulator was commissioned in September 2000. The project was delivered on time and within budget.
-
14. *Complete the P-3 Orion autopilot project for the Air Force.*
- The autopilot has been installed and tested in two aircraft. The contractor is currently resolving a system functional problem before further aircraft are modified. The project is slightly behind schedule but remains within budget.
-
15. *Complete the P-3 Orion surveillance aircraft project to replace the wings and horizontal stabilisers*
- The sixth (and final) aircraft is almost complete. The project is expected to be completed ahead of schedule and with a substantial budget saving.
-
16. *Complete acquisition of surveillance, target acquisition and night observation equipment for the Army*
- The final equipment deliveries were made in 2000 and introduced into service. The project has been completed within budget.
-
17. *Continue management of the ANZAC ship project*
- The warranty period for HMNZS *Te Mana* was completed on 19 October 2000. There are fourteen class issues being closely monitored. The way ahead is clear for all but two of these class issues. None of these issues are assessed as having significant financial implications at this time.
-
18. *Subject to Government approval progress the life of type study of Air Force C-130H transport aircraft*
- No approval has been given to commit to this study.
-
19. *Maintain close links with New Zealand's industry and provide support for the Defence Industry Committee of New Zealand*
- Supported meetings of the Defence Industry Committee of NZ (DICNZ) on 11 July 2000, 17 October 2000 and 28 February 2001;
 - Held interviews with companies nominated for DICNZ Awards of Excellence;
 - Arranged for the presentation of the Defence Industry Committee Awards of Excellence at a dinner on 2 November 2000.
-

20. Ensure New Zealand companies are given maximum opportunity to compete for work from projects managed by the Ministry.

- Supported activities of the New Zealand companies forming the Defence Technologies NZ Joint Action Group (JAG) by assisting in the planning of the November Defence Industry Seminar.
- Provided assistance to the JAG planning the 2001 Defence Industry Seminar.
- Attended JAG meetings on 12 July 2000 and 4 October 2000 where updates on Defence projects were presented.
- The JAG has confirmed that the Ministry has provided adequate industry advice in support of Tradenz export activity.

21. Complete material for the Australia and New Zealand Industry Defence Equipment and Capability Catalogue database and update databases on industrial capability.

- Database material was obtained from New Zealand companies in January 2001 and forwarded to Australia in March for publication in May 2001.

22. Conduct industry briefing sessions on current defence projects and activities.

- In addition to briefing JAG meetings on future work (see above), a briefing on 'Doing Business with Defence' was given to a Dunedin City Council business cluster on 7 September 2000 and the Wellington Chamber of Commerce on 28 March 2001.
-

Project Financial Performance For the year ended 30 June 2001

Project payments capitalised against Crown appropriations in 2000/01 were:

| | 2000/01 Budget \$000 | 30/6/2001 Actual \$000 |
|---------------------------------------|----------------------------|------------------------------|
| ANZAC Ships | 88,211 | 72,648 |
| Maritime Helicopter | 97,214 | 90,300 |
| Kestrel – P3 Orion rewing | 5,254 | 3,704 |
| P3 Orion autopilot | 3,943 | 533 |
| RNZN Bridge Simulator | 614 | 589 |
| STANO | 582 | 163 |
| Light Armoured Vehicles | 88,122 | 86,127 |
| Tactical Communications | 55,959 | 62,148 |
| Direct Fire Support Weapon | 190 | 17 |
| Other projects | 2,399 | 206 |
| GST on imported goods and NZ payments | 41,202 | 25,234 |
| Total | 383,690 | 341,669 |

- Prices agreed for new projects approved by the Government during the financial year have been based on a competitive tender process, and contract awards have been subjected to consideration of through-life costs, quality, delivery schedule and local industrial participation.
- Potential risks for all projects have been identified together with corrective actions required or taken.
- All payments made have been at the contracted prices to the correct suppliers upon the achievement of agreed milestones.
- ISO 9001 certification has been maintained.

**FINANCIAL PERFORMANCE (GST exclusive)
For the year ended 30 June 2001**

| 30/6/2000 Actual \$000 | | 30/6/2001 Actual \$000 | 30/6/2001 Main. Estimates \$000 | 30/6/2001 Supp. Estimates \$000 |
|------------------------------|--------------------------|------------------------------|---------------------------------------|---------------------------------------|
| | Revenue | | | |
| 2,952 | Crown | 3,332 | 2,949 | 3,332 |
| – | Other | 7 | – | – |
| 2,952 | Total Revenue | 3,339 | 2,949 | 3,332 |
| 5,232 | Expenditure | 3,217 | 2,949 | 3,332 |
| (2,280) | Surplus/(deficit) | 122 | – | – |

The appropriation (GST inclusive) for this output class was increased by \$431,000 for:

| | \$(000) |
|--|---------|
| <ul style="list-style-type: none"> ■ a fiscally neutral transfer from Output Class D2 – Audit and Assessment of Performance to meet preliminary project costs which must now be expensed and not capitalised. | 166 |
| <ul style="list-style-type: none"> ■ tender phase costs for Light Operational Vehicles | 265 |
| | 431 |

Statements of Accounting Policies

For the year ended 30 June 2001

1. REPORTING ENTITY

The Ministry of Defence is a Government Department as defined by section 2 of the Public Finance Act 1989.

These are the financial statements of the Ministry of Defence prepared pursuant to section 35 of the Public Finance Act 1989.

2. MEASUREMENT SYSTEM

These financial statements have been prepared on the basis of modified historical cost except for certain items with specific accounting policies outlined below.

3. ACCOUNTING POLICIES

The following accounting policies have been applied:

DEPARTMENTAL

Budget Figures

The Budget figures are those presented in the Budget Night Estimates (Main estimates) and those amended by the Supplementary Estimates and any transfer made by Order in Council under section 5 of the Public Finance Act 1989 (Supplementary estimates).

Revenue

The Ministry derives revenue through the provision of outputs to the Crown, for services to third parties and interest on its deposits with the New Zealand Debt Management Office (NZDMO). Such revenue is recognised when earned and is reported in the financial period to which it relates.

Depreciation

Depreciation of fixed assets is provided on a straight line basis so as to allocate the cost of assets, less any estimated residual value, over their useful lives. Revalued fixed assets are depreciated on their revalued amount on a straight line basis over their remaining useful lives.

The estimated economic useful lives are:

| | |
|--|--------------|
| Office Equipment | 3 - 10 years |
| Office Furniture | 5 - 10 years |
| Computer Equipment | 3 years |
| Motor Vehicles | 3 years |
| Financial Management and Information Systems | 5 years |
| Leasehold Improvements | 3 years |

Cost Accounting

The Ministry has derived the costs of outputs using a cost allocation system which is outlined below:

■ ***Criteria For Direct and Indirect Costs***

“Direct costs” are those costs directly attributed to an output.

“Indirect Costs” are those costs that cannot be identified in an economically feasible manner, with a specific output.

■ ***Direct Costs Assigned to Outputs***

Direct costs are charged directly to outputs. Personnel costs are charged by a predetermined percentage of time to be incurred.

For the year ended 30 June 2001, direct costs accounted for 69% of the Ministry’s costs (30 June 2000 = 67%).

■ ***Basis for Assigning Indirect and Corporate Costs to Outputs***

Indirect costs are assigned to outputs based on a predetermined percentage fixed for the year for each output.

For the year ended 30 June 2001, indirect costs accounted for 31% of the Ministry’s costs (30 June 2000 = 33%).

Receivables

Receivables are recorded at estimated realisable value, after providing for doubtful debts.

Fixed Assets

The initial cost of a fixed asset is the value of the consideration given to acquire or create the asset and any directly attributable costs of bringing the asset to working condition for its intended use.

All fixed assets costing more than \$5,000 are capitalised and recorded at historical cost.

Taxation

Government Departments are exempt from the payment of income tax in terms of the Income Tax Act 1976. Accordingly, no charge of income tax has been provided for.

Goods and Services Tax (GST)

The Statement of Financial Performance, Statement of Movements in Equity, Statement of Cash Flows, Statement of Commitments and Statement of Contingent Liabilities are exclusive of GST. The Statement of Financial Position is also exclusive of GST except for the amount of GST owing to or from the Inland Revenue Department at balance date, being the difference between Output GST and Input GST which is included in Creditors and Payables or Debtors and Receivables (as appropriate).

Provision for Employee Entitlements

Annual, long service, resigning, and retirement leave are recognised as they accrue to employees.

Commitments

Future payments are disclosed as commitments at the point a contractual obligation arises, to the extent that there are equally unperformed obligations. Commitments relating to employment contracts are not disclosed.

Contingent Liabilities

Contingent liabilities are disclosed at the point at which the contingency is evident.

Financial Instruments

Revenues and expenses in relation to all financial instruments are recognised in the Statement of Financial Performance. The Ministry enters into foreign currency forward contracts to hedge foreign currency transactions. Any exposure to gains or losses on these exchange contracts is generally offset by a related loss or gain on the item being hedged.

Apart from foreign currency forward contracts, all financial instruments are recognised in the Statement of Financial Position.

CROWN

Crown Activities

The management of procurement or refurbishment of military equipment are reflected through the Crown Statement of Cash Flows.

These activities are not reflected in the Crown Statement of Financial Performance because the military equipment procured or refurbished are not traded but passed at cost to the New Zealand Defence Force.

Budget Figures

The Budget figures are those presented in the Budget Night Estimates (Main estimates) and those amended by the Supplementary Estimates and any transfer made by Order in Council under section 5 of the Public Finance Act 1989 (Supplementary estimates).

Goods and Services Tax (GST)

The Input GST arising on the procurement or refurbishment of military equipment is not recoverable. Accordingly this cost is expensed in the Crown Statement of Financial Performance.

Crown Work in Progress

Invoices for progress payments, and other add-on costs incurred in the procurement or refurbishment of various items of equipment on behalf of the Crown, are recognised at the time the liability arises.

Foreign Currency

Foreign currency transactions are converted at the New Zealand dollar exchange rate at the date of the transaction. Where a forward exchange contract has been used to establish the price of a transaction, the forward rate specified in that forward exchange contract is used to convert that transaction to New Zealand dollars. Consequently no exchange gain or loss resulting from the difference between the forward exchange contract rate and the spot exchange rate on date of settlement is recognised.

Monetary assets and liabilities are translated to New Zealand dollars at the closing mid-point exchange rate. The resulting unrealised exchange gain or loss is recognised in the Crown Statement of Financial Performance. Other exchange gains or losses, whether realised or unrealised, are recognised in the Crown Statement of Financial Performance in the period to which they relate.

4. CHANGES IN ACCOUNTING POLICIES

There have been no changes in accounting policies since the date of the last audited financial statements.

Statement of **Financial Performance**

For the year ended 30 June 2001

| 30/6/2000 Actual \$000 | Note | 30/6/2001 Actual \$000 | 30/6/2001 Main Estimates \$000 | 30/6/2001 Supp. Estimates \$000 | |
|------------------------------|--|------------------------------|--------------------------------------|---------------------------------------|--------------|
| Revenue | | | | | |
| 8,069 | Crown | 2 | 8,305 | 8,069 | 8,304 |
| 28 | Other | 3 | 11 | 30 | — |
| 51 | Interest | 5 | 61 | 30 | 58 |
| 8,148 | Total Revenue | | 8,377 | 8,129 | 8,362 |
| Expenditure | | | | | |
| 4,152 | Personnel Costs | 6 | 3,843 | 4,371 | 4,221 |
| 5,239 | Operating Costs | 7 | 3,474 | 3,091 | 3,546 |
| 467 | Depreciation | | 359 | 481 | 381 |
| 156 | Capital Charge | 8 | 156 | 156 | 156 |
| 10,014 | Total Expenses | | 7,832 | 8,099 | 8,304 |
| (1,866) | Net operating surplus/(deficit) | | 545 | 30 | 58 |

The accompanying accounting policies and notes form part of these financial statements.

Statement of **Movements In Taxpayers' Funds**

For the year ended 30 June 2001

| 30/6/2000 Actual \$000 | | 30/6/2001 Actual \$000 | 30/6/2001 Main. Estimates \$000 | 30/6/2001 Supp. Estimates \$000 |
|------------------------------|--|------------------------------|---------------------------------------|---------------------------------------|
| 1,555 | Taxpayers' funds brought forward as at 1 July | 1,555 | 1,555 | 1,555 |
| (1,866) | Net operating surplus/(deficit) | 545 | 30 | 58 |
| (1,866) | Total recognised revenues and expenses for the year | 545 | 30 | 58 |
| 2,371 | Department/Crown asset/ liability transfer | – | – | – |
| (505) | Provision for repayment of surplus to the Crown | (545) | (30) | (58) |
| 1,555 | Taxpayers' funds as at 30 June | 1,555 | 1,555 | 1,555 |

The accompanying accounting policies and notes form part of these financial statements.

Statement of Financial Position

As at 30 June 2001

| 30/6/2000 Actual \$000 | Note | 30/6/2001 Actual \$000 | 30/6/2001 Main Estimates \$000 | 30/6/2001 Supp. Estimates \$000 |
|-------------------------------------|------|------------------------------|--------------------------------------|---------------------------------------|
| Taxpayers' Funds | | | | |
| 1,555 | | 1,555 | 1,555 | 1,555 |
| 1,555 Total taxpayers' Funds | | 1,555 | 1,555 | 1,555 |
| Represented by: | | | | |
| Current Assets | | | | |
| 532 | | 275 | 184 | 104 |
| 1,300 | 9 | 2,000 | 1,200 | 1,200 |
| 1,832 | | 2,275 | 1,384 | 1,304 |
| 108 | | 38 | 84 | 14 |
| 25 | 10 | 54 | 2 | 2 |
| 1,965 | | 2,367 | 1,470 | 1,320 |
| Non-Current Assets | | | | |
| 869 | 11 | 660 | 925 | 951 |
| 869 | | 660 | 925 | 951 |
| 2,834 Total Assets | | 3,027 | 2,395 | 2,271 |
| Current Liabilities | | | | |
| 413 | 12 | 582 | 335 | 335 |
| 505 | | 545 | 30 | 58 |
| 207 | 13 | 209 | 220 | 200 |
| 1,125 | | 1,336 | 585 | 593 |
| Non-Current Liabilities | | | | |
| 154 | 13 | 136 | 255 | 123 |
| 1,279 Total Liabilities | | 1,472 | 840 | 716 |
| 1,555 Net Assets | | 1,555 | 1,555 | 1,555 |

The accompanying accounting policies and notes form part of these financial statements.

Statement of Cash Flows

For the year ended 30 June 2001

| 30/6/2000 Actual \$000 | | 30/6/2001 Actual \$000 | 30/6/2001 Main. Estimates \$000 | 30/6/2001 Supp. Estimates \$000 |
|------------------------------|--|------------------------------|---------------------------------------|---------------------------------------|
| | Cash Flows – Operating Activities | | | |
| | Cash provided from: | | | |
| | Supply of outputs to | | | |
| 8,069 | - Crown | 8,305 | 8,069 | 8,304 |
| 19 | - Customers | 1 | 30 | – |
| 51 | Interest | 61 | 30 | 58 |
| 8,139 | | 8,367 | 8,129 | 8,362 |
| | Cash disbursed to: | | | |
| | Produce outputs | | | |
| (4,230) | – Personnel | (3,814) | (4,371) | (4,221) |
| (2,834) | – Operating | (3,102) | (3,091) | (3,536) |
| (24) | – Net GST paid | (75) | – | – |
| (156) | – Capital charge | (156) | (156) | (156) |
| (7,244) | | (7,147) | (7,618) | (7,913) |
| 895 | Operating activities net cash flows | 1,220 | 511 | 449 |
| | Cash Flows – Investing Activities | | | |
| | Cash provided from: | | | |
| 88 | Sale of fixed assets | 55 | 28 | 28 |
| | Cash disbursed for: | | | |
| (265) | Purchase of fixed assets | (327) | (500) | (500) |
| (177) | Investing activities net cash flows | (272) | (472) | (472) |
| | Cash Flows - Financing Activities | | | |
| | Cash disbursed for: | | | |
| (205) | Repayment of surplus | (505) | (180) | (505) |
| (205) | Financing activities net cash flows | (505) | (180) | (505) |
| 513 | Net increase in cash held | 443 | (141) | (528) |
| 1,319 | Add opening cash and deposits | 1,832 | 1,525 | 1,832 |
| 1,832 | Closing cash and deposits | 2,275 | 1,384 | 1,304 |

The accompanying accounting policies and notes form part of these financial statements.

Reconciliation of **Net Operating Surplus to Net Cash Flow from Operating Activities**

For the year ended 30 June 2001

| 30/6/2000 Actual \$000 | | 30/6/2001 Actual \$000 | 30/6/2001 Main. Estimates \$000 | 30/6/2001 Supp. Estimates \$000 |
|------------------------------|--|------------------------------|---------------------------------------|---------------------------------------|
| (1866) | Net operating surplus/(deficit) | 545 | 30 | 58 |
| 2371 | Department/Crown asset/liability transfer | – | – | – |
| | Add/(Less) non-cash items | | | |
| 467 | Depreciation | 359 | 481 | 381 |
| (101) | Inc/(Dec) in non-current employee entitlements | – | – | – |
| – | Reclassification of fixed assets | 121 | – | – |
| 2,737 | Total non-cash items | 480 | 481 | 381 |
| | Working capital movements | | | |
| 26 | (Inc)/Dec in debtors and receivables | (20) | – | 32 |
| 13 | (Inc)/Dec in prepayments | 70 | – | 94 |
| 10 | Inc/(Dec) in creditors and payables | 169 | – | (78) |
| (16) | Inc/(Dec) in current employee entitlements | (16) | – | (38) |
| 33 | Working capital movements – net | 203 | – | 10 |
| | Add/(Less) investing activity items | | | |
| (9) | (Gain)/Loss on sale of fixed assets | (8) | – | – |
| (9) | Total investing activity items | (8) | – | – |
| 895 | Net cash flow from operating activities | 1,220 | 511 | 449 |

The accompanying accounting policies and notes form part of these financial statements.

Statement of **Commitments**

As at 30 June 2001

There are no commitments for future payments and expenditure to be incurred on contracts that have been entered into at balance date. (There were no commitments at 30 June 2000.)

Statement of **Contingent Liabilities**

As at 30 June 2001

No guarantees and indemnities have been given outside the normal course of business.

There are no claims against the Ministry at balance date.

| 30/6/2000 Actual \$000 | | 30/6/2001 Actual \$000 |
|------------------------------|-------------------------------------|------------------------------|
| 15 | Personal grievances | — |
| 15 | Total contingent liabilities | — |

Statement of **Unappropriated Expenditure**

For the year ended 30 June 2001

No expenditure has been made or costs incurred in excess of or without appropriation by Parliament.

There was unappropriated expenditure at 30 June 2000 of \$2.280 million due to a change in accounting treatment for the capitalisation of military equipment expenditure.

The accompanying accounting policies and notes form part of these financial statements.

Statement of **Departmental Expenditure and Appropriations**

For the year ended 30 June 2001

(Figures are GST inclusive where applicable)

| | 30/6/2001 Expenditure Actual \$000 | 30/6/2001 Appropriation Voted \$000 |
|--|---|--|
| VOTE: DEFENCE | | |
| Appropriations for classes of outputs | | |
| D1 – Policy advice | 3,336 | 3,510 |
| D2 – Audit and assessment of performance | 1,901 | 2,084 |
| D3 – Management of equipment procurement | 3,634 | 3,749 |
| Total | 8,871 | 9,343 |

The accompanying accounting policies and notes form part of these financial statements.

Notes to the Financial Statements

For the year ended 30 June 2001

NOTE 1: BUDGET COMPOSITION

| | Note | 30/6/2001 Budget Forecasts \$000 | 30/6/2001 Supp. Estimates Changes \$000 | 30/6/2001 Budget Total \$000 |
|------------------------------|------|---|--|---------------------------------------|
| Revenue | | | | |
| Crown | 2 | 8,069 | 235 | 8,304 |
| Other | 3 | 30 | (30) | – |
| Interest | 5 | 30 | 28 | 58 |
| Total revenue | | 8,129 | 233 | 8,362 |
| Expenditure | | | | |
| Personnel costs | 6 | 4,371 | (150) | 4,221 |
| Operating costs | 7 | 3,091 | 455 | 3,546 |
| Depreciation | | 481 | (100) | 381 |
| Capital charge | 8 | 156 | – | 156 |
| Total Expenses | | 8,099 | 205 | 8,304 |
| Net Operating Surplus | | 30 | 28 | 58 |

NOTE 2: REVENUE – CROWN

This is revenue earned for the supply of outputs to the Crown.

NOTE 3: OTHER REVENUE

| | 30/6/2000 Actual \$000 | 30/6/2001 Actual \$000 | 30/6/2001 Main Estimates \$000 | 30/6/2001 Supp. Estimates \$000 |
|---------------------------------------|------------------------------|------------------------------|--------------------------------------|---------------------------------------|
| 19 Defence Quarterly magazine | | 1 | 30 | – |
| 9 Net gain on sale of assets (Note 4) | | 8 | – | – |
| - Other | | 2 | – | – |
| 28 Total other revenue | | 11 | 30 | – |

Notes to the Financial Statements

For the year ended 30 June 2001

NOTE 4: GAIN ON SALE OF FIXED ASSETS

| 30/6/2000 Actual \$000 | | 30/6/2001 Actual \$000 |
|------------------------------|-----------------------------------|------------------------------|
| 4 | Motor Vehicles | (7) |
| 5 | Computer equipment | 15 |
| 9 | Net gain on sale of assets | 8 |

NOTE 5: INTEREST REVENUE

The Ministry invests surplus cash with the New Zealand Debt Management Office (NZDMO) and earns interest at variable rates.

NOTE 6: PERSONNEL COSTS

| 30/6/2000 Actual \$000 | | 30/6/2001 Actual \$000 | 30/6/2001 Main Estimates \$000 | 30/6/2001 Supp. Estimates \$000 |
|------------------------------|--------------------------------|------------------------------|--------------------------------------|---------------------------------------|
| 4,144 | Salaries and wages | 3,842 | 4,368 | 4,218 |
| 8 | Retirement and resigning leave | 1 | 3 | 3 |
| 4,152 | Total personnel costs | 3,843 | 4,371 | 4,221 |

Notes to the Financial Statements

For the year ended 30 June 2001

NOTE 7: OPERATING COSTS

| 30/6/2000 Actual \$000 | | 30/6/2001 Actual \$000 | 30/6/2001 Main Estimates \$000 | 30/6/2001 Supp. Estimates \$000 |
|------------------------------|---|------------------------------|--------------------------------------|---------------------------------------|
| 19 | Consultancy | 12 | 15 | 15 |
| 56 | Professional services | 190 | 200 | 200 |
| 70 | Audit fees to auditors for audit of the financial statements | 70 | 70 | 70 |
| 542 | Share of NZDF costs for maintaining services | 515 | 515 | 515 |
| 167 | Grants and contributions | 208 | 152 | 252 |
| 11 | Inventory items | 335 | 280 | 280 |
| 171 | General maintenance and servicing | 230 | 112 | 132 |
| 368 | Travel and related costs | 267 | 300 | 300 |
| 50 | Courses, conferences and exhibitions | 115 | 58 | 120 |
| 698 | Rental of premises | 675 | 760 | 765 |
| 2,371 | Preliminary project costs | 362 | 246 | 481 |
| 716 | Other operating costs | 495 | 383 | 416 |
| 5,239 | Total operating costs | 3,474 | 3,091 | 3,546 |

Notes To The Financial Statements

For the year ended 30 June 2001

NOTE 8: CAPITAL CHARGE

The Ministry pays a capital charge to the Crown on its average taxpayers' funds as at 30 June and 31 December each year. The capital charge rate for the year ended 30 June 2001 was 10 percent (2000 = 10 percent).

NOTE 9: SHORT-TERM DEPOSITS

As at balance date the following term deposits had been placed with the New Zealand Debt Management Office (NZDMO):

| 30/6/2000 Actual \$000 | Counterparty | Interest Rate | Term | 30/6/2001 Actual \$000 |
|------------------------------|----------------------------------|---------------|--------|------------------------------|
| – | NZDMO | 4.938% | 7 Days | 2,000 |
| 1,300 | NZDMO | 5.688% | 7 Days | – |
| 1,300 | Total short-term deposits | | | 2,000 |

NOTE 10: DEBTORS AND RECEIVABLES

| 30/6/2000 Actual \$000 | | 30/6/2001 Actual \$000 |
|------------------------------|--------------------------------------|------------------------------|
| 25 | Trade debtors | 54 |
| 25 | Total debtors and receivables | 54 |

Notes to the Financial Statements

For the year ended 30 June 2001

NOTE 11: FIXED ASSETS

| 30/6/2000 Actual \$000 | | 30/6/2001 Actual \$000 |
|------------------------------|---|------------------------------|
| | Leasehold Improvements | |
| 324 | At cost | 396 |
| (68) | Accumulated depreciation | (177) |
| 256 | Leasehold improvements – net book value | 219 |
| | Office and computer equipment | |
| 1,415 | At cost | 753 |
| (1,134) | Accumulated depreciation | (621) |
| 281 | Office and computer equipment – net book value | 132 |
| | Office Furniture | |
| 1,034 | At cost | 262 |
| (1,004) | Accumulated depreciation | (262) |
| 30 | Office furniture – net book value | 0 |
| | Motor Vehicles | |
| 83 | At cost | 28 |
| (18) | Accumulated depreciation | (12) |
| 65 | Motor vehicles – net book value | 16 |
| | Other Assets | |
| 539 | At cost | 732 |
| (302) | Accumulated Depreciation | (439) |
| 237 | Other Assets – Net Book Value | 293 |
| | Total Fixed Assets | |
| 3,395 | At cost | 2,171 |
| (2,526) | Accumulated depreciation | (1,511) |
| 869 | Total Carrying Amount of Fixed Assets | 660 |

Notes to the Financial Statements

For the year ended 30 June 2001

NOTE 12: CREDITORS AND PAYABLES

| 30/6/2000 Actual \$000 | | 30/6/2001 Actual \$000 |
|------------------------------|-------------------------------------|------------------------------|
| 154 | Trade creditors | 341 |
| 245 | Accrued expenses | 166 |
| 14 | GST payable | 75 |
| 413 | Total creditors and payables | 582 |

NOTE 13: PROVISION FOR EMPLOYEE ENTITLEMENTS

| 30/6/2000 Actual \$000 | | 30/6/2001 Actual \$000 |
|------------------------------|--|------------------------------|
| | Current Liabilities | |
| 207 | Annual leave | 209 |
| 207 | Total current portion | 209 |
| | Non Current Liabilities | |
| 154 | Long service, retirement and resigning leave | 136 |
| 154 | Total non-current portion | 136 |
| 361 | Total provision for employee entitlements | 345 |

NOTE 14: CONTINGENT ASSETS

The Ministry does not have any contingent assets as at 30 June 2001 (30 June 2000 = nil).

Contingent liabilities are separately disclosed in the Statement of Contingent Liabilities.

Notes to the Financial Statements

For the year ended 30 June 2001

NOTE 15: FINANCIAL INSTRUMENTS

The Ministry is party to financial instrument arrangements as part of its everyday operations. These include instruments such as bank balances, investments, accounts receivable, and accounts payable.

- *Credit Risk*

In the normal course of its business, the Ministry incurs credit risk from trade debtors, and transactions with financial institutions and the New Zealand Debt Management Office (NZDMO).

The Ministry does not require any collateral or security to support financial instruments with financial institutions that the Ministry deals with, or with the NZDMO, as these entities have high credit ratings. For its other financial instruments, the Ministry does not have significant concentrations of credit risk.

- *Fair Value*

The fair value of all financial instruments is equivalent to the carrying amount disclosed in the Statement of Financial Position.

- *Currency Risk and Interest Rate Risk*

Currency risk is the risk that debtors and creditors due in foreign currency will fluctuate because of foreign exchange rates. The Ministry uses forward contracts to manage foreign exchange exposures.

The Ministry has no significant exposure to interest rate risk on its financial instruments.

All interest earned on short-term deposits with the NZDMO are returned to the Crown as part of the surplus repayable to the Crown.

NOTE 16: RELATED PARTY INFORMATION

The Ministry is a wholly owned entity of the Crown. The Government significantly influences the roles of the Ministry as well as being its major source of revenue.

The Ministry enters into transactions with other Government Departments, Crown agencies and state-owned enterprises. These transactions are not considered to be related party transactions.

Notes to the Financial Statements

For the year ended 30 June 2001

NOTE 17: MAJOR BUDGET VARIATIONS

- *Statement of Financial Performance*
 - Revenue Crown was increased in Supplementary Estimates to fund preliminary project costs.
 - Personnel costs were reduced because of lower staff levels throughout the reporting period.
 - Preliminary project costs on the light operational vehicle project, which must now be expensed and not capitalised, were underspent by \$119,000 due to the timing of commitments.
- *Statement of Financial Position (and Cash Flows)*
 - Net cash held was increased by the higher net operating surplus, reduced spending on the purchase of fixed assets and a higher level of trade creditors unpaid at balance date.
 - Fixed assets were reclassified at 1 July 2000 pending the introduction of the new financial reporting standard FRS-3 on Property, Plant and Equipment. The minimum level for fixed assets was increased from \$2,000 to \$5,000. The estimated useful life of leasehold improvements was reduced to three years.

Crown Statement of **Financial Performance**

For the year ended 30 June 2001

| 30/6/2000 Actual \$000 | | Note | 30/6/2001 Actual \$000 | 30/6/2001 Budget Total \$000 | 30/6/2001 Supp. Estimates \$000 |
|--|------------------------------------|------|------------------------------|------------------------------------|---------------------------------------|
| Crown Revenue | | | | | |
| 1,051 | Interest | C1 | 1,220 | 400 | 750 |
| 22,333 | Other operational revenue | C2 | 4,089 | 1,738 | – |
| 23,384 | Total Crown revenue | | 5,309 | 2,138 | 750 |
| Crown Expenditure | | | | | |
| 83,487 | GST input tax expensed | | 25,234 | 40,449 | 41,202 |
| 19,347 | Other operating expenses | C3 | 14 | – | – |
| (418) | Unrealised exchange losses/(gains) | | 4,204 | 1,738 | – |
| 102,416 | Total Crown expenses | | 29,452 | 42,187 | 41,202 |
| Net operating surplus/(deficit) | | | | | |
| (79,032) | – Crown Operations | | (24,143) | (40,049) | (40,452) |

The accompanying accounting policies and notes form part of these financial statements. For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated audited Crown Financial Statements for the year ended 30 June 2001.

Crown Statement of **Financial Position**

As at 30 June 2001

| 30/6/2000 Actual \$000 | | 30/6/2001 Actual \$000 | 30/6/2001 Main Estimates \$000 | 30/6/2001 Supp- Estimates \$000 |
|------------------------------|---|------------------------------|--------------------------------------|---------------------------------------|
| | Crown Funds | | | |
| 261,583 | Opening balance at 1 July | 170,651 | 163,141 | 170,651 |
| (79,032) | Net operating surplus/(deficit) - Crown operations | (24,143) | (40,049) | (40,452) |
| 243,000 | Funds received from New Zealand Debt Management Office | 274,000 | 186,000 | 305,000 |
| (252,529) | Funds paid to New Zealand Debt Management Office | (152,225) | (158,010) | (153,800) |
| (2,371) | Crown/Department asset transfer | – | – | – |
| 170,651 | Total Crown funds | 268,283 | 151,082 | 281,399 |
| | Represented by: | | | |
| | Current Assets | | | |
| 80,712 | Cash | 62,257 | 89,038 | 57,393 |
| 28,103 | Short-term deposits | 25,910 | – | – |
| 22,728 | Debtors and receivables | 271 | – | – |
| 80,179 | Work in progress | 209,614 | 71,630 | 233,592 |
| 211,722 | Total current assets | 298,052 | 160,668 | 290,985 |
| 211,722 | Total assets | 298,052 | 160,668 | 290,985 |
| | Current Liabilities | | | |
| 41,071 | Creditors and payables | 29,769 | 9,586 | 9,586 |
| 41,071 | Total current liabilities | 29,769 | 9,586 | 9,586 |
| 170,651 | Net Assets - Crown | 268,283 | 151,082 | 281,399 |

The accompanying accounting policies and notes form part of these financial statements. For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated audited Crown Financial Statements for the year ended 30 June 2001.

Crown Statement of Cash Flows

For the year ended 30 June 2001

| 30/6/2000 Actual | | 30/6/2001 Actual | 30/6/2001 Budget | 30/6/2001 Supp- Estimates |
|--|------|---------------------|---------------------|---------------------------------|
| \$000 | Note | \$000 | \$000 | \$000 |
| Cash Flows – Operating Activities | | | | |
| Cash provided from: | | | | |
| 1,051 | | 1,220 | 400 | 750 |
| 20,595 | C2 | 4,089 | 1,738 | – |
| Cash disbursed to: | | | | |
| (3) | | (14) | – | – |
| (83,487) | | (8,482) | (40,449) | (41,202) |
| (61,844) | | (3,187) | (38,311) | (40,452) |
| Cash Flows – Investing Activities | | | | |
| Cash provided from: | | | | |
| 194,886 | | 153,047 | 155,872 | 153,050 |
| 36,025 | | – | – | – |
| 28,843 | | 23,635 | 19,484 | 19,484 |
| Cash Disbursed For: | | | | |
| (227,042) | | (288,079) | (146,356) | (315,220) |
| (28,843) | | (23,635) | (19,484) | (19,484) |
| 3,869 | | (135,032) | 9,516 | (162,170) |
| Cash Flows - Financing Activities | | | | |
| Cash provided from: | | | | |
| 243,000 | | 274,000 | 186,000 | 305,000 |
| Cash Disbursed For: | | | | |
| (252,529) | | (152,225) | (158,010) | (153,800) |
| (9,529) | | 121,775 | 27,990 | 151,200 |
| (67,504) | | (16,444) | (805) | (51,422) |
| 175,901 | | 108,815 | 89,843 | 108,815 |
| 418 | | (4,204) | – | – |
| 108,815 | | 88,167 | 89,038 | 57,393 |

The accompanying accounting policies and notes form part of these financial statements. For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated audited Crown Financial Statements for the year ended 30 June 2001.

Crown Reconciliation of **Net Operating Surplus to Net Cash Flow from Operating Activities**

For the year ended 30 June 2001

| 30/6/2000 Actual \$000 | | 30/6/2001 Actual \$000 |
|------------------------------|--|------------------------------|
| (79,032) | Net operating surplus/(deficit) | (24,143) |
| (418) | Plus unrealised exchange losses/(gains) | 4,204 |
| 19,347 | Plus work in progress expensed | – |
| – | Increase/(decrease) in GST payable | 16,752 |
| (1,741) | Other items | – |
| (61,844) | Net cash flow from operating activities | (3,187) |

The accompanying accounting policies and notes form part of these financial statements. For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated audited Crown Financial Statements for the year ended 30 June 2001.

Crown Statement of **Commitments**

As at 30 June 2001

| 30/6/2000 Actual \$000 | | 30/6/2001 Actual \$000 |
|------------------------------|----------------------------------|------------------------------|
| | Capital commitments | |
| 180,177 | Less than one year | 219,309 |
| 50,906 | One to two years | 368,221 |
| 47,152 | Two to five years | 204,149 |
| 31,001 | More than five years | — |
| 309,236 | Total capital commitments | 791,679 |

Crown Statement of **Expenditure And Appropriations**

For the year ended 30 June 2001

(Figures are GST inclusive where applicable)

| | 30/6/2001 Expenditure Actual \$000 | 30/6/2001 Appropriation Voted \$000 |
|--|---|--|
| VOTE: DEFENCE | | |
| Appropriations for purchase or development of capital assets by the Crown. | | |
| Defence equipment | 316,435 | 342,488 |
| GST on defence equipment | 25,234 | 41,202 |
| Total | 341,669 | 383,690 |

The accompanying accounting policies and notes form part of these financial statements. For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated audited Crown Financial Statements for the year ended 30 June 2001.

Notes to the Crown Financial Statements

For the year ended 30 June 2001

NOTE C1: INTEREST REVENUE

The Ministry invests surplus foreign currency cash with financial institutions that the Ministry deals with. All interest earned on short-term deposits are returned to the Crown.

NOTE C2: OTHER OPERATIONAL REVENUE

| 30/6/2000 Actual \$000 | | 30/6/2001 Actual \$000 |
|------------------------------|--|------------------------------|
| 22,333 | Realised foreign exchange gains following the decision to exit the arrangement to lease F-16 aircraft. | – |
| – | Refunds from foreign military sales cases following the decision to exit the arrangement to lease F-16 aircraft. | 4,089 |
| 22,333 | Total operational revenue | 4,089 |

NOTE C3: OTHER OPERATING EXPENSES

| 30/6/2000 Actual \$000 | | 30/6/2001 Actual \$000 |
|------------------------------|---------------------------------------|------------------------------|
| 19,347 | F-16 project costs expensed | 14 |
| 19,347 | Total other operating expenses | 14 |

Notes to the Crown Financial Statements

For the year ended 30 June 2001

NOTE C4: BUDGET COMPOSITION

| | 30/6/2001 Budget Forecasts \$000 | 30/6/2001 Supp Estimates Changes \$000 | 30/6/2001 Budget Total \$000 |
|--------------------------------|---|--|---------------------------------------|
| Current Non Tax Revenue | | | |
| Crown interest | 400 | 350 | 750 |
| Capital Receipts | | | |
| Defence equipment | 191,897 | (2,822) | 189,075 |
| Expenditure | | | |
| Defence equipment | 145,084 | 197,404 | 342,488 |
| GST on defence equipment | 40,449 | 753 | 41,202 |

NOTE C5: MAJOR BUDGET VARIATIONS

- *Purchase or Development of Capital Assets by the Crown Defence Equipment*

The appropriation was increased by \$197.404 million for the following items:

| | |
|--|-------------------|
| (a) New Work | |
| Tactical Mobile Communications Equipment | 62.250 |
| Light Armoured Vehicles for Army | 87.891 |
| Timing differences | (6.060) |
| (b) Timing changes in existing contract payments | 53.323 |
| | \$197.404 million |

- *GST on Defence Equipment*

The appropriation was increased by \$0.753 million for the following items:

| | |
|--|-----------------|
| Additional GST on the Tactical Mobile Communications Equipment | 0.753 |
| | \$0.753 million |

Notes to the Crown Financial Statements

For the year ended 30 June 2001

NOTE C6: FINANCIAL INSTRUMENTS

- *Credit Risk*

Financial instruments which potentially subject the Ministry of Defence to credit risk principally consist of bank balances, debtors and receivables and forward exchange contracts.

The Ministry also incurs credit risk from down payments made to overseas suppliers of military equipment.

- *Maximum Credit Risk Exposure*

Maximum exposures to credit risk at balance date are:

| | 30 June 2001 \$000 | 30 June 2000 \$000 |
|----------------------------|-----------------------|-----------------------|
| Cash | 62,257 | 80,712 |
| Short-term deposits | 25,910 | 28,103 |
| Debtors and receivables | 271 | 22,728 |
| Forward exchange contracts | 497,406 | 61,511 |
| | 585,844 | 193,054 |

The above maximum exposures are net of any recognised provision for losses on these financial instruments.

- *Collateral or security in respect of Credit Risk.*

The Ministry does not require any collateral or security to support financial instruments with financial institutions that the Ministry deals with, or with the NZDMO, as these entities have high credit ratings.

The Ministry requires security (such as Letters of Credit) in the form of collateral for down payments with certain suppliers. The Letters of Credit entitle the Ministry to the return of payments made.

- *Significant Concentrations of Credit Risk*

Forward exchange contracts with the New Zealand Debt Management Office are considered risk free to the Ministry. The Ministry further reduces counterparty risk by spreading the balance of its cash, investments and forward exchange contracts over registered New Zealand banks thereby limiting the credit exposure to any one financial institution.

The major concentration of credit risk with respect to accounts receivable is the New Zealand Defence Force for the on-sale of military equipment.

Notes to the Crown Financial Statements

For the year ended 30 June 2001

▪ Fair Values

The fair value of Crown financial instruments are:

| | 30 Jun 2001 Carrying Amount \$000 | 30 Jun 2001 Fair Value \$000 | 30 Jun 2000 Carrying Amount \$000 | 30 Jun 2000 Fair Value \$000 |
|----------------------------|--|---------------------------------------|--|---------------------------------------|
| Cash | 62,257 | 62,257 | 80,712 | 80,712 |
| Short-term deposits | 25,910 | 25,910 | 28,103 | 28,103 |
| Debtors and receivables | 271 | 271 | 22,728 | 22,728 |
| Forward exchange contracts | | | | |
| NZDMO | 496,972 | 496,972 | 57,314 | 57,314 |
| Other Banks | 434 | 434 | 4,197 | 4,197 |
| Payables and provisions | 29,769 | 29,769 | 41,071 | 41,071 |

▪ Currency Risk

The Ministry has a foreign exchange covering policy that minimises the currency risk. The policy has key parts:

- individual transactions above \$NZ100,000 equivalent are to be covered with foreign exchange contracts.
- a maximum of net aggregate \$NZ2 million equivalent exposure at one time is allowed.
- cover will occur within 5 working days of any exposure being identified. These exposures are identified contracts both formal and informal.
- the Anzac Ship project has a specific strategy of hedging 100 percent of forecasts in foreign currency exposure, as well as commitments.

▪ Interest Risk

The Ministry has no exposure to interest rate risk.

Other Information

EQUAL EMPLOYMENT OPPORTUNITIES

The Ministry has an equal employment opportunity policy and procedures in place to ensure fairness and equity of opportunity for Ministry employees. The Ministry monitors its recruitment and retention of staff and progress made towards achieving equity is reported to the State Services Commission each year.

MANAGEMENT PERFORMANCE

- ***Good Employer Requirements***

The Ministry has comprehensive human resources policies which include the recruitment of staff, the contractual arrangements under which they are employed, their training and development, performance management, and annual remuneration reviews. Health and safety is given particular attention, with strong emphasis on the prevention of occupational overuse syndrome. An Employee Assistance Programme is in place.

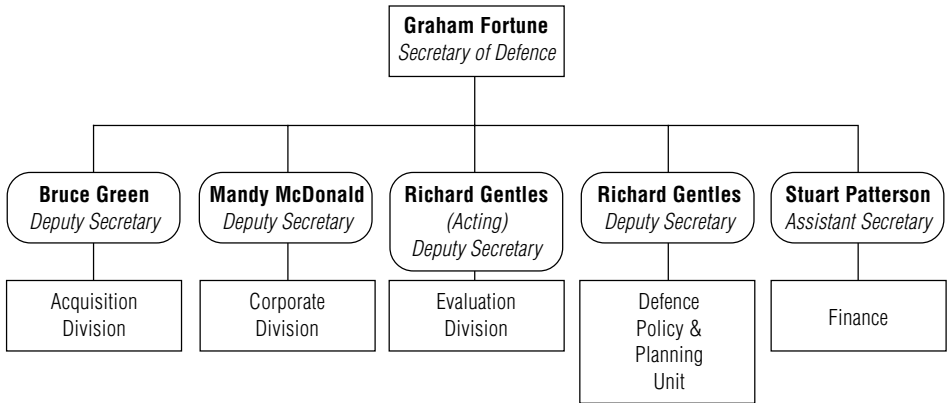
- ***Public Service Integrity***

The Ministry provides instruction and guidance to employees about the ethical standards required of public servants. In addition, all employees are required to have current security clearances as a condition of their employment.

- ***Quality***

The Ministry is ISO 9001 certified and in January was recertified for a further three years. This means that it implements continuous improvements to its management policies and procedures. During the year the Ministry completed its review of corporate policies.

ORGANISATION CHART



Staff numbers at 30 June 2001 were 51 (excluding the Chief Executive).

CAPABILITY DEVELOPMENT

The Ministry has undertaken a significant training and development programme over the last seven months. This has included skills training (e.g. presentation skills, writing skills and negotiation skills) training seminars (e.g. Official Information Act, Privacy Act and Protected Disclosures Act) and one-on-one training to address skill gaps (e.g. project management, strategic planning). There is still, obviously, room for development.

Effort has also gone into providing tools to enable the staff to undertake their work. A draft manual on providing high quality policy advice was completed and is currently undergoing peer review. The Acquisition Division Manual, which prescribes all acquisition procedures in detail, has been revised.

MANAGEMENT OF THE INTRODUCTION OF THE EMPLOYMENT RELATIONS ACT

All staff were given general information prior to and after the introduction of the Employment Relations Act and various booklets on the Act were made readily available to staff through Human Resources. All staff received a copy of the Dispute Resolution procedure to be used to settle any employment relationship problems should these arise. In addition the Ministry arranged for the Crown Law Office to give a seminar on the Act to all second and third tier Managers. The Ministry also redrafted the individual employment contracts into agreements, including the dispute resolution procedure, so that new employees now have compliant agreements. This includes advising new staff to seek independent advice prior to signing their employment agreement. All Ministry staff are on individual agreements and not collective agreements.

E-GOVERNMENT

The Ministry of Defence has incorporated the vision for Electronic Government into its Information Management and Knowledge Management Strategy and the e-government requirements have been at the fore of planning for information management projects. The Ministry has actively contributed to the GUIDE project, provided feedback on planned initiatives such as the Government Portal, participated in the Agency Leaders and CIO Fora, contributed to the Shared Policy Workspace project, and been involved in the e-procurement project.

FINANCIAL PERFORMANCE

| | 2000/2001 | | |
|--|-----------|-----------------|-----------------|
| | Budgeted | Estimated | Actual |
| | \$000 | Actual \$000 | Actual \$000 |
| Departmental Activities | | | |
| Revenue: Crown | 8,304 | 8,304 | 8,305 |
| Revenue: Other | — | — | 11 |
| Output expenses | 8,304 | 8,304 | 7,832 |
| Net operating surplus/(deficit) | 58 | 58 | 545 |
| Receipts from the sale of fixed assets | 28 | 28 | 55 |
| Expenditure on fixed assets | 500 | 500 | 327 |
| Taxpayers' funds | 1,555 | 1,555 | 1,555 |
| Net cash flows from operating, investing and financing activities | (528) | (528) | 443 |
| Crown Activities | | | |
| Purchase or development of capital assets on behalf of the Crown | 383,690 | 383,690 | 341,669 |
| Total Crown revenue and receipts | 189,825 | 189,955 | 190,296 |

SUMMARY OF APPROPRIATIONS

| | Policy Advice \$(000) | Audit and Assessment of Performance \$(000) | Management of Equipment Procurement \$(000) | Purchase or Development of Capital Assets by the Crown \$(000) | GST on Defence Equipment \$(000) |
|--|-----------------------------|--|--|---|---|
| Main Estimates appropriation | 3,543 | 2,250 | 3,318 | 145,084 | 40,449 |
| Supplementary Estimates change | (33) | (166) | 431 | 197,404 | 753 |
| Change by Order in Council under section 5 of the Public Finance Act 1989 | — | — | — | — | — |
| Total amount appropriated for 2000/2001 | 3,510 | 2,084 | 3,749 | 342,488 | 41,202 |
| Estimated actual outturn for 2000/2001 as reported in 2001/2002 estimates | 3,510 | 2,084 | 3,749 | 342,488 | 41,202 |
| Audited actual outturn for 2000/2001 | 3,336 | 1,901 | 3,634 | 316,435 | 25,234 |
| Unappropriated expenditure, expenses or liabilities approved under section 12 of the Public Finance Act 1989 | — | — | — | — | — |
| Unappropriated expenditure, expenses or liabilities requiring validating legislation | — | — | — | — | — |

HISTORICAL FINANCIAL PERFORMANCE OF SIGNIFICANT ITEMS: PAYMENTS ON BEHALF OF THE CROWN

(a) Defence Equipment

| | 2000-2001 \$(000) | 1999-2000 \$(000) | 1998-99 \$(000) | 1997-98 \$(000) | 1996-97 \$(000) | 1995-96 \$(000) |
|--------------------|----------------------|----------------------|--------------------|--------------------|--------------------|--------------------|
| Voted in Estimates | 342,488 | 248,534 | 222,128 | 261,236 | 293,001 | 307,752 |
| Actual Expenditure | 316,435 | 214,820 | 197,388 | 165,366 | 180,840 | 162,579 |
| Variance | 26,053 | 33,714 | 24,740 | 95,870 | 112,161 | 145,173 |

(b) Gst on Defence Equipment

| | 2000-2001 \$(000) | 1999-2000 \$(000) | 1998-99 \$(000) | 1997-98 \$(000) | 1996-97 \$(000) | 1995-96 \$(000) |
|--------------------|----------------------|----------------------|--------------------|--------------------|--------------------|--------------------|
| Voted in Estimates | 41,202 | 85,673 | 8,850 | 80,280 | 8,100 | 13,000 |
| Actual Expenditure | 25,234 | 83,487 | 7,794 | 76,365 | 8,089 | 3,075 |
| Variance | 15,968 | 2,186 | 1,056 | 3,915 | 11 | 9,925 |

HISTORICAL FINANCIAL PERFORMANCE OF SIGNIFICANT ITEMS: RECEIPTS ON BEHALF OF THE CROWN

Sales of Equipment to New Zealand Defence Force (excluding GST)

| | 2000-2001 \$(000) | 1999-2000 \$(000) | 1998-99 \$(000) | 1997-98 \$(000) | 1996-97 \$(000) | 1995-96 \$(000) |
|----------|----------------------|----------------------|--------------------|--------------------|--------------------|--------------------|
| Planned | 189,075 | 230,741 | 196,028 | 226,359 | 181,664 | 233,135 |
| Actual | 189,076 | 194,886 | 196,007 | 157,130 | 181,669 | 233,306 |
| Variance | (1) | 35,855 | 21 | 69,229 | (5) | (171) |