



MINISTRY OF DEFENCE ANNUAL REPORT

for the year ended 30 June 2016

Presented to the House of Representatives pursuant to section 44(1) of the Public Finance Act 1989

ISSN: 1176-8355 (Print)
ISSN: 1178-5071 (Online)

Published in September 2016

The Ministry of Defence administers the Defence Act 1990.

www.defence.govt.nz

© Crown Copyright This copyright work is licensed under the Creative Commons Attribution 3.0 New Zealand licence. In essence, you are free to copy, distribute and adapt the work, as long as you attribute the work to the Ministry of Defence and abide by the other licence terms.

To view a copy of this licence, visit <http://creativecommons.org/licenses/by/3.0/nz/>. Please note that no Ministry of Defence or New Zealand Government emblem, logo or Coat of Arms may be used in any way which infringes any provision of the Flags, Emblems, and Names Protection Act 1981 or would infringe such provision if the relevant use occurred within New Zealand. Attribution to the Ministry of Defence should be in written form and not by reproduction of any such emblem, logo or Coat of Arms.

CONTENTS

05

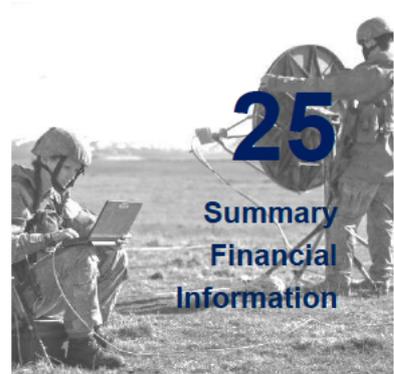
Overview by the
Secretary of Defence

10

Delivering on the
Ministry's Strategic
Intentions

25

Summary
Financial
Information



PART 1: OVERVIEW	5
By the Secretary of Defence _____	5
PART 2: THE MINISTRY'S PERFORMANCE AND OPERATIONS	7
The Ministry's priorities and outcomes framework _____	7
Measuring defence outcomes: assessing current security and likely changes _____	8
Delivering on the Ministry's Strategic Intentions _____	10
Summary financial information _____	25
Organisational health and capability _____	26
The Ministry's operations _____	28
Non-departmental capital expenditure: purchase of defence equipment _____	35
PART 3: STATEMENT OF RESPONSIBILITY AND AUDIT REPORT	53
Statement of responsibility _____	53
Independent auditor's report _____	54
PART 4: APPROPRIATION STATEMENTS	57
Statement of expenses and capital expenditure against appropriations _____	57
Statement of expenses and capital expenditure incurred without, or in excess of, appropriation or other authority _____	58
Statement of departmental capital injections without, or in excess of, authority _____	58
Transfers under section 26A of the Public Finance Act 1989 _____	58
Performance information _____	58
PART 5: DEPARTMENTAL FINANCIAL STATEMENTS	59
Statement of comprehensive revenue and expense _____	59
Statement of financial position _____	60
Statement of changes in equity _____	61

Statement of cash flows _____	62
Statement of commitments _____	63
Statement of contingent liabilities and contingent assets _____	63
Notes to the financial statements _____	64
PART 6: NON-DEPARTMENTAL STATEMENTS AND SCHEDULES	77
Schedule of non-departmental revenue _____	77
Schedule of non-departmental expenses _____	77
Schedule of non-departmental assets _____	78
Schedule of non-departmental liabilities _____	78
Schedule of non-departmental capital receipts _____	79
Schedule of non-departmental capital expenditure _____	80
Schedule of non-departmental capital commitments _____	81
Schedule of non-departmental contingent liabilities and contingent assets _____	81
Notes to the non-departmental schedules _____	82

PART 1: OVERVIEW

BY THE SECRETARY OF DEFENCE

The 2015/16 year included the publication of a new Defence White Paper and the first year of a new change programme for the Ministry. In June 2016, the Prime Minister and the Minister of Defence launched the Defence White Paper which sets out New Zealand's defence policy, our capability intentions and funding parameters out to 2030.

The *Defence White Paper 2016* envisages significant new investment, of about \$20 billion over 15 years, to fund the development of new and enhanced capabilities at sea, in the air, on land and in cyberspace. Over this period, New Zealand will replace major capabilities including the C-130 Hercules, the ANZAC frigates, and P3 Orion aircraft.

This investment will ensure that New Zealand continues to have the defence capability it needs to protect New Zealand, support our partners in the South Pacific, and make a meaningful contribution to global security.

Managing these projects will require more people and a strong capability management system to deliver them. This reflects both the size of the projects and the technical and systems complexity we expect to manage.

To meet these requirements, the Ministry received \$27.1 million in additional funding over four years in Budget 2015. This funding allows us to employ more people at the acquisition and capability development stages, and integrate systems between the Ministry and the Defence Force.

We are implementing this programme jointly with the Defence Force and I expect the changes to be substantively in place by June 2017. The Ministry made good progress on this work in 2015/16. Many new roles are in place and work is well underway implementing the practices and systems that are needed.

During the year, the Ministry continued to deliver across its responsibilities. We supported a demanding programme of defence engagements, building New Zealand's international defence relationships. Regionally, our contribution included co-chairing (with Brunei Darussalam) the ASEAN Defence Ministers Meeting Plus (ADMM-Plus) Experts' Working Group on Maritime Security, as well as accepting a co-chair role with the Philippines for the new Experts' Working Group on Cyber Security.

We also provided advice on deployments of New Zealand Defence Force personnel. This included a review of the building partner capacity mission in Iraq, which the Government subsequently extended through to 30 November 2018.



The Evaluation Division published a report on recruit training: *Assessing the Quality of Recruit Training in the New Zealand Defence Force*. The report addressed recruit training in all three armed services, which found the system generally does a good job but there are areas for improvement. The Defence Force has already made progress on most of the report's recommendations.

We delivered a significant capability programme. Capabilities delivered included:

- 11 new T6 Texan pilot training aircraft. On 2 February 2016 the first intake of trainee pilots commenced their training using these aircraft
- 194 Medium and Heavy Operational Vehicles delivered to units and tested as part of Exercise Southern Katipo last year
- the delivery of all 10 SH-2G(I) Super Seasprites, including two spare airframes, and
- completing a major upgrade of the systems aboard the frigate HMNZS *Te Mana*.

The fifth and final C-130 Hercules is currently being upgraded at the Ministry's Woodbourne facility. We expect to finish it before the end of the 2016 calendar year, reflecting that this aircraft has needed more work than the others.

Towards the end of last year the Government also approved the purchase of new Individual Weapons from Lewis Machine and Tools in the United States. These weapons will provide the Defence Force with a combat proven rifle that has been tested in the most challenging of environments. The Special Forces have also chosen this rifle as a suitable replacement. The first rifles will be introduced into service in 2016 with deliveries completed in 2017.

The Ministry is continuing its significant change programme while continuing to manage a high tempo across the work it does for New Zealand and to support our defence force personnel. As we move into 2016/17, this is with increasing confidence that we are effectively supporting the people and have the expertise to deliver continued improvement in future.



Helene Quilter
Secretary of Defence

PART 2: THE MINISTRY'S PERFORMANCE AND OPERATIONS

THE MINISTRY'S PRIORITIES AND OUTCOMES FRAMEWORK

The *Estimates of Appropriations for 2015/16* and *Strategic Intentions 1 July 2014 – 30 June 2018* both formed the framework for defining the Ministry's objectives and performance indicators for the year ended 30 June 2016. Divisions regularly evaluated their performance against objectives, comparing results with priorities, resource allocations and targets that were set at the beginning of the year.

The Ministry's outcomes framework for this period is set out below, with three outputs supporting nine core business activities, and five strategic priorities. These contribute to the Ministry's two high-level outcomes.

HIGH-LEVEL OUTCOMES

New Zealand is secure	New Zealand's efforts enhance the security of other nations
-----------------------	---

STRATEGIC PRIORITIES

Defence decisions keep pace with the dynamic security environment; and NZ contributes to and benefits from successful defence relationships	Capability advice balances policy, capability and cost, and establishes the true risk and cost of projects early	Major military equipment is acquired on time, on budget and delivers against the government's intentions	The defence agencies successfully manage a period of change and reform	The Ministry becomes sustainable and resilient
---	--	--	--	--

CORE BUSINESS ACTIVITIES

Assessing and giving advice on the strategic defence environment	Contributing to regional and international defence engagements	Supporting New Zealand Defence Force deployments
Undertaking evaluations and assessments directed by the Minister of Defence	Defining and selecting military capability	Acquiring and upgrading military capability
Assessing the benefits of capability and readiness of the Defence system	Administering the joint Ministry/Defence Force Capability Management System	Contributing to a sustainable, resilient defence and security sector workforce

OUTPUTS

Evaluation, audit and assessment of performance	Management of equipment procurement	Policy advice
---	-------------------------------------	---------------

The government's direction for defence during the period of this report was the *Defence White Paper 2010*, and the improved investment certainty arising from the Defence Midpoint Rebalancing Review work. This was significantly updated as a result of the release in June 2016 of the *Defence White Paper 2016*. In addition, the Ministry's operating environment has changed as a result of the Government Budget 2015 decision to invest \$27.1 million of new operating funding into the Ministry.

MEASURING DEFENCE OUTCOMES: ASSESSING CURRENT SECURITY AND LIKELY CHANGES

The Ministry contributes to two high-level outcomes:

- New Zealand is secure
- New Zealand's efforts enhance the security of other nations.

The Ministry constantly monitors the security environment. A summary of developments is provided below.

HOW DOES THE MINISTRY CONTRIBUTE TO THE ACHIEVEMENT OF THESE OUTCOMES?

The Ministry contributes to the primary outcomes in three ways:

1. it provides the government with policy advice concerning defence and security issues, including the security environment, the military capabilities of the Defence Force, the deployment of military forces and the conduct of international defence relations
2. it undertakes the acquisition of major platforms and items of military equipment for use by the New Zealand Defence Force in undertaking defence and security tasks
3. it undertakes evaluations, audits and assessments of the Defence Force and the acquisition function of the Ministry to examine and help improve their efficiency and effectiveness.

ASSESSING THE STATE OF THE SECURITY ENVIRONMENT

In an increasingly interconnected, uncertain and unstable world, assessing the state of a security environment requires complex judgements. The Ministry has assessed the security environment during the period covered by this annual report as part of developing the *Defence White Paper 2016*. The assessment of the security environment in the *Defence White Paper 2016* updates and builds upon the judgements in the *Defence Assessment 2014*.

Below are the Ministry's high-level assessments of the security environment for five geographical areas of interest. The assessment considers two aspects of security:

- *the current security outlook* – the likelihood that security will be compromised by use of destruction or deadly force, or hostile incursion. This is assessed according to the set of classifications: Very Low, Low, Moderate, Mixed, High and Conflict.
- *the apparent direction of change* – whether the analysis suggests that the security environment is getting better or worse. This is assessed according to the classifications: Improving, Stable, Deteriorating and Unclear.

CURRENT SECURITY STATE

Region	Current security outlook	Direction of change	Commentary
New Zealand and its Exclusive Economic Zone	Very low	Stable	There have been no material changes to New Zealand's outlook during the period of this report. A direct security threat to New Zealand and its Exclusive Economic Zone remains unlikely.
Australia	Low	Stable	An armed attack on Australia is unlikely. Australia remains vigilant in the face of continued non-traditional threats such as terrorism and cyber security.
South Pacific	Moderate	Stable	There have been no material changes to New Zealand's outlook of the South Pacific during the period of this report. A direct military threat from outside the region remains unlikely. Threats to security arise from many Pacific states' vulnerability to internal instability caused by chronic social, economic, demographic, environmental and governance stresses. Such stresses have the potential to develop into situations where nations' security could be compromised.
Asia-Pacific ¹	Moderate	Deteriorating	Threat factors relate primarily to heightened tensions over maritime territorial disputes in the East and South China Seas, the risk of conflict on the Korean Peninsula, as well as ongoing concerns around Weapons of Mass Destruction proliferation and terrorism.
Global	Mixed	Unclear	<p>The world continues to experience high levels of volatility and change. This includes a number of ongoing security challenges:</p> <ul style="list-style-type: none"> • turmoil across the Middle East and North Africa • continued weakness in the global economy since the Global Financial Crisis • increasing challenges to the rules-based international order • constraints on the ability of international institutions to forge consensus on trans-boundary problems • the emergence of new centres of economic strength that are shifting the global balance of power • swiftly evolving technologies including cyber and anti-space capabilities resulting in the emergence of new threats • the risk of weapons proliferation, both conventional and chemical, biological and nuclear • terrorism continuing to challenge public safety and state authority. <p>The security implications of the United Kingdom's exit from the European Union are unclear at this time, but will be closely monitored.</p>

¹ 'Asia-Pacific' is defined as North, East, South and Southeast Asia and the Western Pacific Ocean.

DELIVERING ON THE MINISTRY'S STRATEGIC INTENTIONS

The Ministry set five strategic priorities for the reporting period:

1. Defence decisions keep pace with the dynamic security environment; and NZ contributes to and benefits from successful defence relationships.
2. Capability advice balances policy, capability and cost, and establishes the true risk and cost of projects early.
3. Major military equipment is acquired on time, on budget and delivers against the government's intentions.
4. The defence agencies successfully manage a period of change and reform.
5. The Ministry becomes sustainable and resilient.

To deliver on this medium-term strategy, the Ministry undertakes nine core business activities. Each of these contributes to one or more of the strategic priorities, and manages fiscal and strategic risks for the government.

Below is each core business activity, the associated four-year milestones from the Ministry's *Strategic Intentions*, and details of the progress made during the reporting period.

ASSESSING AND GIVING ADVICE ON THE STRATEGIC DEFENCE ENVIRONMENT

The Ministry is responsible for undertaking Defence Assessments and providing advice on defence policy, engagements, and strategic policy advice on defence capability. This activity includes contributing defence advice to whole-of-government policy initiatives.

Over

2014–2018

this work will involve the Ministry:

- undertaking a Defence Assessment in 2014, and completing a new White Paper as directed by the Government
- providing advice between formal assessments, focused on capability/material, infrastructure and people needed to respond to changes in the security environment.



In 2016 the Ministry produced the *Defence White Paper 2016* in collaboration with the Defence Force and other key government agencies. The White Paper describes the international strategic environment, the Government's defence policy objectives, and how the Defence Force will be structured and equipped to deliver on these objectives out to 2030 and beyond.²

The *Defence White Paper 2016* built upon the Defence Midpoint Rebalancing Review in 2013 and the formal assessment of the international strategic environment completed in 2014 (the Defence Assessment). The Defence Assessment identified major changes in the strategic environment out to 2040 since the publication of the *Defence White Paper 2010*.

The *Defence White Paper 2016* finds that, although New Zealand does not face a direct military threat in the foreseeable future, its ability to protect and advance its security interests is becoming increasingly challenging as the strategic environment evolves, sometimes rapidly.

These challenges include maintaining an awareness of and an ability to respond to activities in New Zealand's Exclusive Economic Zone; supporting New Zealand's presence in Antarctica and the Southern Ocean; protecting against increasing cyber threats to Defence Force networks and the space-based infrastructure required to undertake defence activities safely and effectively; and rising pressure on the rules-based international order.

The *Defence White Paper 2016* indicates that the Government will maintain the Defence Force's existing mix of capabilities and invest in a range of new or enhanced capabilities to respond to these challenges. Further details on the Government's updated mix of capabilities will be included in the next Defence Capability Plan, to be released in 2016.

During 2015/16 the Ministry also worked closely with the wider security sector and, on occasion, regulatory agencies to develop defence policy and contribute to policy development across government. In areas such as cyber, space and maritime security, the Ministry has worked to ensure that defence policy supports wider government objectives and that the efforts of other agencies benefit from the expertise and information held in Defence.

² The *Defence White Paper 2016*, and an accompanying report summarising views received on Defence issues from the public consultation process, is available on the Ministry's website: <http://defence.govt.nz/defence-white-paper-2016.html>.

CONTRIBUTING TO REGIONAL AND INTERNATIONAL DEFENCE ARRANGEMENTS

The Ministry manages New Zealand's international defence engagement in conjunction with the New Zealand Defence Force in support of New Zealand's enduring interest in fostering strong international relationships. It provides the direction on international defence partnerships to maximise the benefit to New Zealand security and foreign policy interests. This includes leading bilateral defence talks, supporting high level defence diplomacy activities and representing New Zealand in regional and international defence arrangements.

Over

2014–2018

this work will involve the Ministry:

- implementing a strategic approach with the New Zealand Defence Force to international defence engagements in pursuit of medium and long term security and foreign policy objectives
- managing greater intensity of the highest priority defence relationships and commitments to the Asia-Pacific regional defence architecture
- responding, as required, to any new security developments in the Asia-Pacific region and beyond.



Defence engagement with traditional and emerging partners supported defence and wider foreign policy objectives. With the New Zealand Defence Force, the Ministry continues to implement a strategic approach to international defence engagements.

During 2015/16 the Ministry supported travel by the Minister of Defence on bilateral visits to Australia, Fiji and China as well as participation in the Association of Southeast Asian Nations (ASEAN) Defence Ministers' Meeting-Plus, Counter-ISIL Ministerial meetings and the Shangri-La Dialogue. The Ministry also supported the Minister's operational visit to Iraq, the Golan Heights and the Sinai as well as the Minister's travel to Turkey, including to Gallipoli for commemorations on Anzac Day. Through such visits New Zealand develops familiarity with less established partners and deepens the trust of those partners to which it is already close. The Ministry also supports the Minister's engagement with international counterparts visiting New Zealand.

New Zealand continues to be an active participant in the region's security architecture and is a member of the East Asia Summit, the ASEAN Regional Forum, the ASEAN Defence Ministers' Meeting-Plus (ADMM-Plus) and the South Pacific Defence Ministers' Meeting. New Zealand's contribution to enhancing trust and confidence through regional security arrangements was demonstrated through our co-chairing (with Brunei Darussalam) of the ADMM-Plus Experts' Working Group on Maritime Security. New Zealand continued to

show its commitment to the ADMM-Plus when it agreed to take up a co-chair role with the Philippines for the new Experts' Working Group on Cyber Security.

The Ministry continued to lead the programme of bilateral defence consultations with a wide range of partner countries. Through such engagement, New Zealand is able to increase its understanding of the international strategic environment and allows it to convey its views on international security matters. Of note is the enhanced relationship with Fiji as a result of defence re-engagement.

UNDERTAKING EVALUATIONS AND ASSESSMENTS DIRECTED BY THE MINISTER OF DEFENCE

The Ministry's Evaluation Division delivers a work programme approved by the Minister of Defence. The evaluation work programme addresses strategic risks to the defence system.

Over

2014–2018

this work will involve the Ministry:

- implementing a strategic risk framework that systematically profiles defence system risk
- redesigning and implementing a new set of evaluation and assessment products
- introducing empirical, data-driven reporting on the defence system
- sustaining, over the four years, a programme of in-depth assessment of areas of particular government priority and risk, including implementation of the Defence Midpoint Rebalancing Review.



In 2014/15, the Evaluation Division implemented its new business model, which moved away from a focus on audits to a more data-driven and evidence-based assessment approach. In 2015/16 the Division's work has embedded these new practices, with a positive uptake of the recommendations from the reports. The work programme addresses government priorities and takes strategic risk into account.

In October 2015 the Division released a report on recruit training: *Assessing the Quality of Recruit Training in the New Zealand Defence Force*.³ The report surveyed all three armed services to determine what was working well and where improvements were required in the current recruit training system.

The review showed that the system is delivering good outcomes but there are areas requiring improvement, particularly around the selection, training and supervision of instructors. It assisted the Defence Force to target deficiencies in recruit training that are being addressed by the three Services as a priority. Progress has already been made on most of the recommendations made within the review, including improving selection screening processes, increasing supervision, an improved ratio of students to instructors (8 to 1) and developing a more proactive approach to safety.

³ This report is available from the Ministry's website: <http://defence.govt.nz/reports-publications/evaluation-report-recruit-training/contents.html>.

In addition the Division has delivered a Hazardous Substances Audit for the Defence Force and continues to develop relationships with partner governments to identify ways to prevent, or detect and respond to defence sector fraud and corruption.

To support understanding of the New Zealand defence and security systems, the Ministry coordinated work to support Transparency International's 2015 Government Defence Anti-Corruption Index, which was published at the end of 2015. This index measures the degree of corruption risk in government defence and security establishments. It draws material from a wide variety of sources and interviewees across 76 indicators to provide a detailed assessment of the integrity of national defence institutions, and awarded a score for each country from A to F.

The 2015 Index incorporated New Zealand for the first time. New Zealand's defence and security institutions received the highest overall score across 130 countries and were awarded a score of A, which indicates a Very Low risk of corruption. The only other country to be awarded an A is the United Kingdom.

SUPPORTING NEW ZEALAND DEFENCE FORCE DEPLOYMENTS

The Ministry provides advice to the Government on the deployment of New Zealand's defence forces in collaboration with the New Zealand Defence Force and the Ministry of Foreign Affairs and Trade.

This advice outlines the strategic rationale for New Zealand's participation in a deployment including how it would contribute to New Zealand's security, national or international strategic interests and foreign policy goals. The advice also sets out risks to New Zealand Defence Force personnel and how these would be managed.

Over

2014–2018

this work will involve the Ministry providing advice:

- as determined by developments in the strategic environment, and in individual theatres where defence personnel are deployed
- on potential new New Zealand Defence Force deployments.



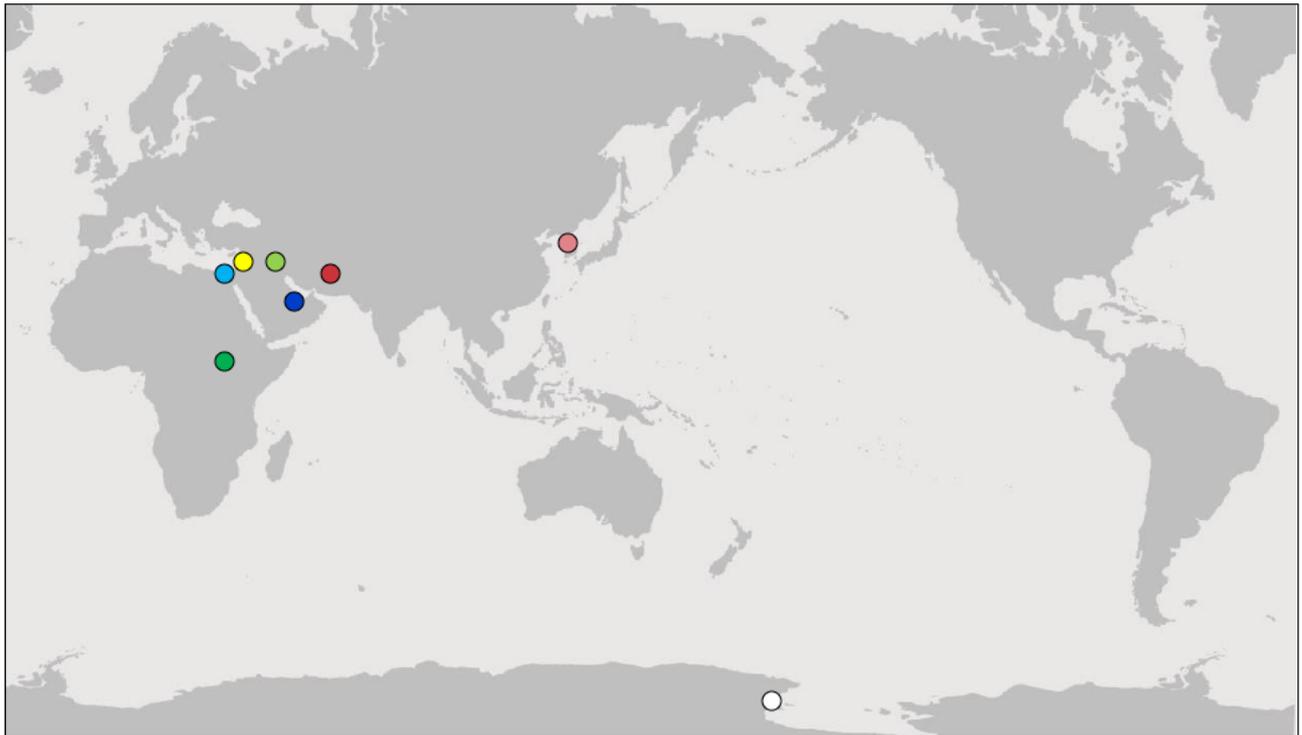
In 2015/16 deployment-related advice to the Government included Cabinet papers extending New Zealand's deployment to the:

- building partner capacity mission in Iraq
- Afghan National Army Officer Academy
- Multinational Force and Observers in the Sinai
- Maritime Security Operations in the Middle East and Africa region, and
- the United Nations Command Military Armistice Commission in South Korea.

Advice was also provided on deployment of a C-130 Hercules transport aircraft, and an agreed process was established to provide a mandate for the approval of the deployment of New Zealand Defence Force personnel while serving on exchange with partner country defence forces – something which was previously done on a case-by-case basis.

In addition to new deployments and mandate extensions, advice was regularly provided on ongoing deployments such as the nine-month review of the building partner capacity mission and through the provision of regular updates on a particular security situation or where the mission was evolving to ensure ministers remained well informed.

Figure 1: Current New Zealand Defence Force deployments



- | | | |
|-----------------|--|------------------------|
| ● Afghanistan | ● Iraq | ● South Sudan |
| ○ Antarctica | ● Israel, Lebanon, Syria (Golan Heights) | ● United Arab Emirates |
| ● Egypt (Sinai) | ● Republic of Korea | |

DEFINING AND SELECTING MILITARY CAPABILITY

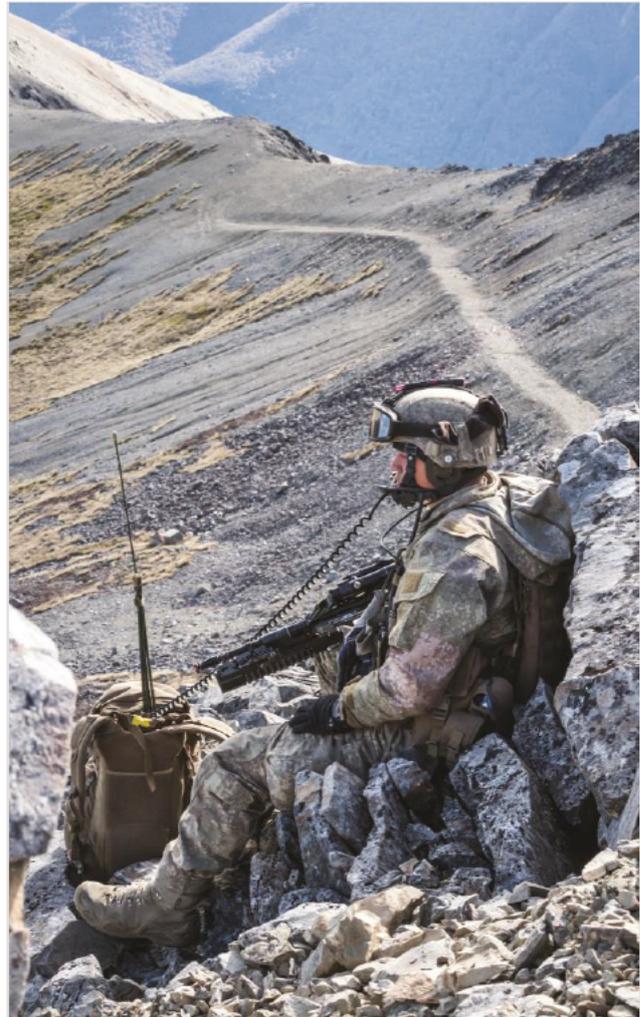
The Ministry leads the process, which it undertakes with the New Zealand Defence Force, of defining what military capability is needed to meet the Government's priorities and selecting what should be acquired.

Over

2014–2018

this work will involve the Ministry:

- delivering business cases for projects totalling \$3.7 billion (identified in the *Defence Midpoint Rebalancing Review* and *Defence Capability Plan*), and capital and capability plans that reflect the 2014 Defence Assessment and, potentially, a new Defence White Paper
- exercising leadership and influence early in the capability process to ensure issues are identified early and all options (including 'do nothing') are considered
- engaging Acquisition Division project directors early in each capability project to provide practical expertise and continuity of personnel.



Over the reporting period, business cases have been developed and submitted to Cabinet for the following defence capabilities:

- Maritime Sustainment Capability
- Littoral Operations Support Capability
- Underwater Intelligence Surveillance and Reconnaissance Capability, and
- Counter-Explosive Hazards Capability.

These support the Ministry to deliver on the capabilities set out in the *Defence White Paper 2016*.

In addition, advice was provided to Ministers on options to bring forward consideration for replacing elements of the air transport fleet. Ultimately, Ministers decided not to pursue this option at this time.

Through the joint Defence Capability Change Action Programme of work, system improvements have been made to:

- integrate the Ministry into the Defence Force portfolio management information system (Planview)

- grow the Ministry's capacity to undertake a more detailed exploration of capability options at an earlier stage in the process, as a result of appointments to new positions within the areas of capability development and acquisition
- develop and begin to implement systems and organisational structures that will support a more integrated approach with the Defence Force in the operation of project teams, project oversight and assurance, and portfolio management
- initiate a framework that will enhance the ability to articulate the policy implications of different investment options
- develop a robust and consistent approach to capturing whole-of-life costs for projects at each stage in the capability life cycle.

ASSESSING THE BENEFITS OF CAPABILITY AND READINESS OF THE DEFENCE SYSTEM

The Ministry provides contestable advice on whether the defence system is efficient and capable, and can deliver on the Government's priorities.

Over

2014–2018

this work will involve the Ministry providing:

- assurance on individual capability projects and issues, and periodic assessments of the New Zealand Defence Force's whole-of-organisation performance
- contemporaneous, whole-of-system advice on performance.



The Ministry works closely and collaboratively with the Defence Force on a variety of policy matters. In addition to delivery of the *Defence White Paper 2016*, this work has included engagement with the central and other government agencies on the regeneration of the Defence Estate, housing and accommodation, implementation of the new health and safety legislation, youth development and all-of-government maritime security policy.

ACQUIRING AND UPGRADING MILITARY CAPABILITY

The Ministry has primary responsibility – working closely with the New Zealand Defence Force – to procure major military capability. It is also responsible for major upgrades, and is itself undertaking an upgrade of C-130 Hercules aircraft.

Over

2014–2018

this work will involve the Ministry:

- completing major upgrades to New Zealand's C-130 Hercules and P-3K Orion fleets at Woodbourne Air Base in Blenheim. The work on the Hercules is led by Ministry staff and is the largest work ever undertaken on any aircraft in New Zealand
- acquiring major military equipment as approved by the Government, and in conjunction with the New Zealand Defence Force
- ensuring all acquisitions projects have the right expertise and support, including in project management, risk and scheduling.



Highlights of the acquisition work during the year included:

- the tender was let for the replacement of individual weapons for the Defence Force
- the Platform Systems Upgrade Phase 2 work was completed on HMNZS *Te Mana*
- the last two SH2G(I) Super Seasprite helicopters were delivered to New Zealand from the United States
- remediation work on the Project Protector ships was completed
- tenders were received for the four vehicle types under the Special Operations Vehicle project.

The Ministry provided ongoing support to facilitate effective communications between Defence and New Zealand industries. This included regular updates to industry groups on project opportunities and progress – particularly at the New Zealand Defence Industry Association Annual Forum, held in Wellington in November 2015.

During 2015/16, the Ministry has been involved in the acquisition of 17 major defence capability projects (where 'major' refers to projects with a whole-of-life cost over \$15 million):

New projects	In flight projects	Projects where capability is being introduced into service or is due for completion
<ul style="list-style-type: none"> • Maritime Sustainability Capability • Underwater Intelligence, Surveillance and Reconnaissance • Special Operations Vehicles 	<ul style="list-style-type: none"> • ANZAC Frigates' Systems Upgrade • Individual Weapon Replacement • Network Enabled Army – Tranche 1 • C-130 Hercules Life Extension (final aircraft) • Defence Command and Control System • Strategic Bearer Network – Phase 1 	<ul style="list-style-type: none"> • ANZAC Frigates' Platform System Upgrade • P-3K Orion Mission Systems Upgrade • NH90 Medium Utility Helicopter • Pilot Training Capability • Protector Remediation • Maritime Helicopter Replacement • Medium-Heavy Operational Vehicles • Training/Light Utility Helicopter

Full details of the progress of all acquisition projects in the reporting period are provided in the Current Projects section starting on page 35. Information about requests for information and tenders undertaken is provided from page 32.

ADMINISTERING THE JOINT MINISTRY/NEW ZEALAND DEFENCE FORCE CAPABILITY MANAGEMENT SYSTEM

The Ministry administers, with the New Zealand Defence Force, the capability management governance arrangements that are the shared responsibility of the Chief of Defence Force and the Secretary of Defence.

Over

2014–2018

this work will involve the Ministry and New Zealand Defence Force developing improved shared datasets and approaches. The Ministry will apply these to taking an ongoing portfolio view of defence capability, to build on the Defence Midpoint Rebalancing Review and Defence Assessment processes.



Following the Government's Budget 2015 investment in the Ministry's baselines, the Ministry and Defence Force established the Defence Capability Change Action Programme. This programme is enhancing the spectrum of defence activities that develop, deliver and sustain the military capabilities required to implement government policy. It will ensure the right equipment is bought at the right time, for the right price, and that the right people and structures are in place to deliver the benefits of using it.

In August 2015, the Ministry undertook a restructuring of its Acquisition Division. This is enabling the Ministry to bring in a greater range of skills and backgrounds, implement portfolio and programme management disciplines, and provides a structure that is scalable and flexible for the challenge ahead delivering on the government's intent to invest approximately \$20 billion in major defence capital purchases out to 2030. The new team brings significant defence and private sector experience. The programme is focused on achieving value from integrated systems and processes across both defence agencies:

- excellent governance and portfolio, programme and project management
- updating the Capability Management Framework
- whole-of-life costing
- a focus on health and safety built into the system
- partnership with defence industry.

During 2015/16, the Ministry and Defence Force were assessed under the first Investor Confidence Rating review, to produce a combined rating for Defence. This rating by the Treasury is an evidence-based assessment of how the government's most investment-intensive agencies are performing and where they could improve. The Treasury has rated Defence a B. This strong rating is a positive assessment of defence performance, and means greater autonomy and higher financial delegations for capital projects. It contributes to a confidence in Defence's current and impending capability development and capability acquisition activities.

CONTRIBUTING TO A SUSTAINABLE, RESILIENT DEFENCE AND SECURITY SECTOR WORKFORCE

The Ministry works as part of a wider defence and security sector to ensure it has the workforce needed to make the sector function optimally.

Over

2014–2018

this work will involve the Ministry working as part of a wider defence and security sector to develop people and talent.

The Ministry is committed to offering its people the best opportunities and, increasingly, to being able to offer people a career in the external security sector. Since 2014, the Ministry's human resource and people services have been provided by the intelligence community. This has helped the Ministry to participate in work across the sector to move toward common approaches to recruitment, talent management and leadership development.

The Ministry offers development opportunities through the public service's Leadership Development Centre and the State Services Commission's talent management programme. It is working with partner agencies to offer broader career experiences.

Staff rated development as a significant strength in the Ministry of Defence's 2015 staff engagement

survey, and investing in this remains a priority for the Leadership Team. To increase diversity and address disparities in gender pay, the Ministry has also added policies in 2015/16 that provide workplace flexibility for staff and support them to stay engaged through a longer career.

The Ministry's work to establish a larger, professionalised acquisition workforce during 2015/16 has broadened the range of career opportunities it can offer. Staff can work across roles that deliver policy advice and long-range strategic advice, carry out formal assessments and evaluations, conduct international defence relationships, take military procurement intentions from strategy through to approved business cases, and undertake complex military procurements.

SUMMARY FINANCIAL INFORMATION

SUMMARY OF 2015/16 APPROPRIATIONS

	Policy advice and related outputs MCA	Evaluation, audit and assessment of performance	Management of equipment procurement	Capital expenditure: defence equipment
	\$000	\$000	\$000	\$000
Main estimates appropriation	6,620	1,927	7,857	222,795
Supplementary estimates change	(135)	466	(1,254)	(2,958)
Change under s26A of the Public Finance Act	-	(260)	260	-
Total amount appropriated for 2015/2016	6,485	2,133	6,863	219,837
Estimated actual outturn for 2015/16 as reported in 2016 Estimates	6,410	2,343	4,920	219,837
Audited actual outturn for 2015/16	6,480	2,128	6,165	212,412

DEPARTMENTAL EXPENDITURE BY APPROPRIATION

	2015/16 \$000	2014/15 \$000	2013/14 \$000	2012/13 \$000	2011/12 \$000	2010/11 \$000
Revenue						
Revenue Crown	14,223	11,165	12,116	11,366	10,729	10,545
Revenue other	588	703	1,484	2,154	442	328
Total Revenue	14,811	11,868	13,600	13,520	11,171	10,873
Expenditure						
Policy advice and related outputs	6,480	5,941	6,174	5,434	5,205	4,704
Evaluation, audit and assessment of performance	2,128	1,913	2,149	2,066	1,665	1,479
Management of equipment procurement	6,165	3,968	5,255	5,787	4,249	3,880
Total expenditure under appropriations	14,773	11,822	13,578	13,287	11,119	10,063
Surplus/(deficit)	38	46	22	233	52	810

Where restructuring of the appropriation has occurred then, to the extent practicable, prior year's information is presented in a manner consistent with current year appropriations.

PAYMENTS AND RECEIPTS ON BEHALF OF THE CROWN

	2015/16 \$000	2014/15 \$000	2013/14 \$000	2012/13 \$000	2011/12 \$000	2010/11 \$000
Capital expenditure: defence equipment						
Voted in Supplementary Estimates	219,837	400,737	286,600	149,914	154,897	228,753
Actual capital expenditure	212,412	386,929	273,572	132,789	102,359	144,506
Variance	7,425	13,808	13,028	17,125	52,538	84,247
Capital receipts	212,412	386,929	273,572	176,315	154,331	135,797

ORGANISATIONAL HEALTH AND CAPABILITY

The Ministry has started implementation of a significant change programme to be ready for an ambitious period of capability purchases. This will grow the organisation by about 80 per cent over its previous size, with this growth occurring over a three to four year period. This growth has centred on the Ministry's capability-related functions but has implications for everyone. The Ministry undertook work in 2015/16 to make sure it is fit for purpose as an enterprise, staff engagement is maintained, and its culture stays strong.

GOOD EMPLOYER PRACTICES AND STAFF DEVELOPMENT

During 2015/16 the Ministry of Defence introduced new policies for people and development. These exemplify the Ministry's values, are modern and fit for purpose, and support the Ministry's objectives of increasing its levels of diversity and attracting and retaining the best people.

Improving the representation of women has been a priority for the Ministry since 2013. Women now make up more than half of all Ministry staff, up from 38.3 per cent in mid-2013.

The Ministry is making sure women are able to progress in their careers, including through modern flexible working and talent management practices. This will help them to progress into more senior roles, which will in turn reduce the Ministry's gender pay gap over time.

The Ministry participates in public sector-wide talent initiatives such as those offered by the Leadership Development Centre and the State Services Commission Leadership Insight process. It is working with its sector partners on shared initiatives that will offer staff careers in our sector, rather than work in a single organisation only.

STAFF ENGAGEMENT

The Ministry carried out its last staff engagement survey in June 2015, which reported a significant increase in the organisation's overall Engagement Index from 64 (in its previous 2013 survey) to 80, which places it in the top 25 per cent of public sector results.

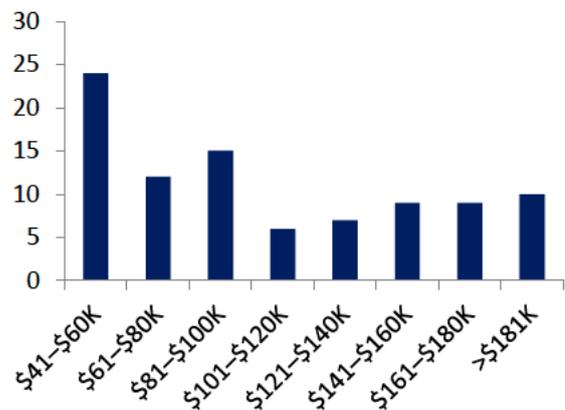
To maintain engagement through its period of change, the Ministry has continued its work to shape a positive culture, as well as making sure new staff are thoroughly inducted in the Ministry's

values, with a strong understanding of the importance of partnered working.

STAFF SALARY BANDS

The Ministry's remuneration policy ensures that all roles in the Ministry are evaluated using a recognised methodology and that salary bands are set accordingly, ensuring all employees, regardless of their age, gender or ethnicity, are rewarded on an appropriate salary scale.

Figure 2: Staff numbers by salary band as at 30 June 2016⁴



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.

EQUAL EMPLOYMENT OPPORTUNITIES

The Ministry has equal employment opportunity policy and procedures in place to ensure fairness and equity of opportunity for Ministry employees.

⁴ Further information about State sector pay, including to Ministry staff, is available from the State Services Commission website: <http://www.ssc.govt.nz/ssw-pay>.

The Ministry monitors its equal employment indicators to ensure employees are treated equitably. Relevant metrics are reported to the State Services Commission each year.

QUALITY ASSURANCE

The Ministry applied quality assurance processes to all outputs to maintain professional standards and quality of work. These processes included: the provision of appropriate training and skills programmes and career development opportunities; annual evaluations and reviews of staff performance; and managerial oversight.

International Standards Organisation (ISO) 9001 accreditation has been maintained in the Acquisition Division. The Ministry maintains the financial management systems necessary to ensure that classes of outputs are delivered within the approved appropriation and in compliance with the provisions of the Public Finance Act 1989. Regular monitoring and reporting 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 minimised.

THE MINISTRY'S OPERATIONS

MULTI-CATEGORY APPROPRIATION: POLICY ADVICE AND RELATED OUTPUTS

This appropriation is intended to achieve the provision of civilian advice on defence policy matters and development of international defence relations.

Under this Multi-Category Appropriation (MCA), the Minister of Defence purchases:

- advice on defence policy matters. This includes advice on:
 - strategies for achieving goals and outcomes
 - changes in the strategic environment with implications for defence policy
 - the defence and security policies of other countries
 - deployment of New Zealand Defence Force assets and personnel
 - the military capabilities required to meet defence policy goals, broad resource implications and the relative merits and risks associated with proposed capability options
- management and enhancement of bilateral and multilateral defence relations
- responses to Ministerial requests and Parliamentary Questions, Official Information Act enquiries and Ombudsmen correspondence.

	2014/15	2015/16	
Performance Measures	Actual	Budget	Actual
The performance of the MCA as a whole is assessed by the average of the difference between actual results and the budget standard of all percentage based measures within the MCA categories	New measure for 2015/16	>0%	+6.6%
Policy Advice			
Total cost per output hour	\$98.12	\$100	\$86.69
Technical quality of policy advice, as assessed by an independent review of a sample of policy papers	76%	≥70%	75%
Minister's satisfaction with the quality of policy advice, as assessed by survey	50% ¹	≥70%	70% ¹
Timeliness, as assessed by the percentage of papers that were submitted by the directed deadline	100%	≥95%	90%
Technical quality robustness, as assessed by the Common Indicator Set tool	100%	≥70%	100%
Policy Support			
Minister's satisfaction with the quality of policy support, as assessed by survey	50% ¹	≥70%	70% ¹
Timeliness, as assessed by the percentage of papers that were submitted by the directed deadline	100%	≥95%	95%

	2014/15	2015/16	
	Actual	Budget	Actual
Ministerial Services			
Quality, as assessed by the percentage of first draft of all correspondence accepted by the Minister	66%	≥70%	94%
Timeliness, as assessed by the percentage of papers that were submitted by the timeframe set in legislation, or otherwise agreed with the Minister	96%	≥95%	94%

Note

1. These scores reflect a shared rating across both the Ministry of Defence and New Zealand Defence Force.

Further information

Further detail about the 2015/16 operations of this output are provided in the previous section entitled Delivering on the Ministry's Strategic Intentions, specifically work in relation to:

- assessing and providing advice on the strategic defence environment
- contributing to regional and international defence engagement
- supporting New Zealand Defence Force deployments
- defining and selecting military capability
- assessing the benefits of capability and readiness of the defence system
- administering the joint Ministry of Defence/New Zealand Defence Force Capability Management System.

Cost for the year ended 30 June 2016

	2014/15	2015/16		
	Actual	Main estimates	Supp estimates	Actual
	\$000	\$000	\$000	\$000
Policy advice and related outputs multi-category appropriation	5,941	6,620	6,485	6,480

DEPARTMENTAL OUTPUT EXPENSE: EVALUATION, AUDIT AND ASSESSMENT OF PERFORMANCE

This appropriation is intended to achieve the completion of an approved schedule of evaluations, audits and assessments as required by the Minister of Defence.

This output class is for the provision of evaluations, audits and assessments of the New Zealand Defence Force and the Ministry.

	2014/15	2015/16	
Performance Measures	Actual	Budget	Actual
Evaluations, audits and assessments are in accordance with work priorities identified and advised by the Minister of Defence.	Standard met	Standard met	Standard met
A review of the evaluations, audits and assessments confirm that they meet acceptable standards based on pre-determined criteria.	Standard met	Standard met	Standard met

Note:

The standard for these measures is based on a continuum of standard not met, standard met and standard exceeded.

Further information

Further details about the 2015/16 operations for this output are provided in the earlier section entitled Delivering on the Ministry's Strategic Intentions, specifically work in relation to undertaking evaluations and assessments directed by the Minister of Defence.

Cost for the year ended 30 June 2016

	2014/15	2015/16		
	Actual	Main estimates	Supp estimates	Actual
	\$000	\$000	\$000	\$000
Evaluation, audit and assessment of performance	1,913	1,927	2,133	2,128

The Supplementary Estimates amounts presented in this table include transfers made under sections 26A of the Public Finance Act 1989.

DEPARTMENTAL OUTPUT EXPENSE: MANAGEMENT OF EQUIPMENT PROCUREMENT

This appropriation is intended to achieve the management of procurement of major military equipment in a transparent and fair way, and in accordance with government procurement policies.

'Major' means equipment that will have more than a \$15 million whole-of-life cost. The Ministry is committed to providing competitive industries with the opportunity to support defence, and to ensuring that the Government and the taxpayer receive value for money.

This output class involves:

- management of military equipment procurement functions on behalf of the Crown once equipment needs are determined and accepted by the Government. The acquisition process involves acquisition investigation, risk assessment, quality assurance, equipment selection, negotiation and execution of the contract arrangements, to the point when the equipment, initial training and spares are delivered to the New Zealand Defence Force
- management of any warranty provisions beyond delivery date
- management of financing commitments
- arrangement of on-sale to the New Zealand Defence Force and
- the provision of advice to industry on defence requirements.

Performance Measures	2014/15	2015/16	
	Actual	Budget	Actual
<p>Cost: Each procurement or refurbishment project will be managed within its approved budget, inclusive of approved variations to the contract price and project budget.</p> <p>The measure is the % of all project-related expenditure incurred in the year that is in excess of the approved project expenditure.</p>	0%	0%	0%
<p>Quality of deliverable: Each procurement or refurbishment project will achieve, on delivery, the agreed/contracted specifications that are critical to acceptance.</p> <p>The measure is the number of accepted projects that do not meet all specifications that are critical to acceptance.</p>	0	0	0 ¹
<p>Schedule: Each equipment procurement or refurbishment project will be managed to schedule, without avoidable schedule over-run.</p> <p>The measure is the % of all projects where, during the year, the project delivery schedule is extended by more than 10%.</p>	6% (1 of 17 projects)	0%	17% (3 of 17 projects)

Note:

1. All projects currently underway are anticipated to meet the agreed/contracted specifications and other contractual arrangements on the delivery of the capability.

Acquisition projects

Active acquisition projects are summarised in the previous section Acquiring and Upgrading Military Capability. A summary of each major acquisition project managed by this output is contained in the following Non-Departmental Capital Expenditure: Purchase of Defence Equipment section.

Defence industry

As part of work under this appropriation, the Ministry:

- continues to facilitate effective communication between Defence and New Zealand industries to provide appropriate goods and services as required
- provides support for the New Zealand Defence Industry Advisory Council
- ensures that local suppliers are afforded opportunities to compete for work consistent with the Government Rules of Sourcing issued by the Ministry of Business Innovation and Employment, and the Office of the Controller and Auditor-General's Procurement guidance for public entities, and
- conducts industry briefing sessions on current defence projects and activities.

The Ministry supported the Defence Industry Advisory Council by facilitating the Minister of Defence Awards of Excellence to Industry and a meeting held on 8 June 2016.

Industry groups have been regularly updated on project opportunities and progress through industry open days. Prime contractors are encouraged to submit engagement plans for industry as part of tender processes. To facilitate closer defence industry engagement, three new positions have been established across the Ministry and New Zealand Defence Force.

The Ministry presented at the quarterly New Zealand Defence Industry Association Members meetings, including on:

- the status of major acquisition projects
- the implementation of the Optimising New Zealand Industry Involvement in the New Zealand Defence Sector report's recommendations, and
- the Ministry's programme of work to improve defence capability management, which includes a work stream to improve engagement with Defence Industry.

The Ministry issued the following Requests for Tenders, Registrations of Interest and Request for Information to industry:

	Published	Closed
Network Enabled Army Programme – Provision of Tactical Network Equipment for Pilot Activity Request for Tender	11 Feb 2016	1 Mar 2016
The NH90 Synthetic Training Device Request for Information	14 Jun 2016	11 Jul 2016

The Ministry published lists of respondents to the following Requests for Information to enable New Zealand industry to engage with potential prime contractors at an early stage in a project's life:

Request for Information	Published
2nd Littoral Operation Support Capability	7 Sep 2015

Quality measures and standards

The Ministry's objective is to ensure that new capabilities and major refurbishment will be acquired within approved budgets, to the quality standards negotiated for each project, and within the agreed delivery schedule, and that all contracts will be negotiated in a timely manner and payments will be made on time if the provider is meeting the terms of the contract.

The Ministry's Acquisition Division holds accreditation to the ISO 9001 standard. Meeting the requirements of this standard ensures that there are defined policies and processes relative to the Division's roles and responsibilities and that these undergo a regular formal review process consistent with continuous improvement.

The most recent audit recommended that the Division be recertified for a further three year cycle, subject to ongoing annual surveillance audits.

Cost for the year ended 30 June 2016

	2014/15	2015/16		
	Actual	Main estimates	Supp estimates	Actual
	\$000	\$000	\$000	\$000
Management of equipment procurement	3,969	7,857	6,863	6,165

The Supplementary Estimates amounts presented in this table include transfers made under sections 26A of the Public Finance Act 1989.

PERMANENT LEGISLATIVE AUTHORITY: MINISTRY OF DEFENCE – CAPITAL EXPENDITURE

This appropriation is intended to achieve the purchase and development of assets by and for the use of the Ministry in its day-to-day operations.

	2014/15	2015/16	
Performance Measures	Actual	Budget	Actual
Capital expenditure is within budget	Within budget	Within budget	Within budget

Cost for the year ended 30 June 2016

	2014/15	2015/16		
	Actual	Main estimates	Supp estimates	Actual
	\$000	\$000	\$000	\$000
Capital expenditure permanent legislative authority	484	330	480	301

NON-DEPARTMENTAL CAPITAL EXPENDITURE: PURCHASE OF DEFENCE EQUIPMENT

This appropriation is managed by the Ministry on behalf of the Minister of Defence.

This appropriation is intended to achieve the procurement of major military equipment in a transparent and fair way, and in accordance with government procurement policies.

	2014/15	2015/16	
Performance Measures	Actual	Budget	Actual
Performance measures are the same as used for the departmental appropriation Management of Equipment Procurement and are reported under the appropriation on page 31.			

Cost for the year ended 30 June 2016

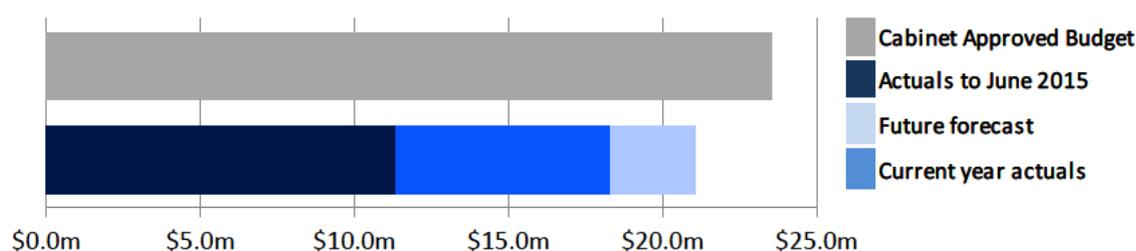
	2014/15	2015/16		
	Actual	Main estimates	Supp estimates	Actual
	\$000	\$000	\$000	\$000
Purchase of defence equipment	386,929	222,795	219,837	212,412

CURRENT PROJECTS

This section summarises the background and 2015/16 performance of all major projects undertaken under this output.

Project expenditure charts

The project expenditure charts in this section show the actual to date and forecast costs from the year of Cabinet approval to the expected project closure as described below:



Foreign exchange movements

The Ministry's foreign exchange policy requires the Ministry to manage currency risk arising from future transactions and recognised liabilities, by entering into foreign exchange forward contracts to hedge 100% of the foreign exchange exposure.

The approval by Cabinet to commit to total project costs uses foreign exchange rates prevailing at the time that Cabinet approval is sought. The subsequent recording of project expenditure uses exchange rates prevailing at the date of the transaction and creates a difference between the estimated costs included in the Cabinet approval and the amounts recorded in ledgers as project expenditure.

The project cost summaries show the financial effect of foreign exchange movements between Cabinet approval and recorded expenditure as at 30 June 2016: (favourable) / unfavourable.

MARITIME DOMAIN

ANZAC FRIGATES' PLATFORM SYSTEMS UPGRADE

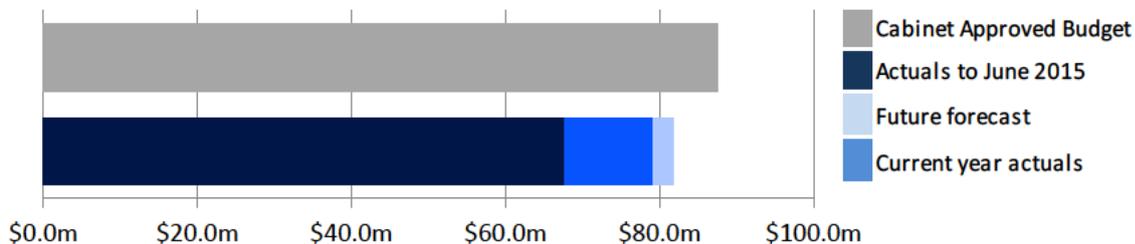
The Platform Systems Upgrade consists of four separate elements divided into two phases, each aimed at ensuring ongoing viability of the key platform systems in the ANZAC Frigates.

- Phase 1: The propulsion upgrade, stability enhancements and compartment enhancement elements were successfully integrated on HMNZS *Te Kaha* and *Te Mana*. Phase 1 was completed in 2010. The ships returned to operational service on time and within the approved Phase 1 budget of \$24.3 million.
- Phase 2: The upgrade work on the integrated platform management systems and the heating, ventilation and air conditioning systems aboard HMNZS *Te Kaha* and *Te Mana* has been completed.

Having completed Phases 1 and 2, the Platform Systems Upgrade project will shortly close.

Objectives	Performance
<ul style="list-style-type: none"> • Complete the Platform System Upgrade on HMNZS <i>Te Mana</i> • Operational Release by June 2016 • Close the project 	<ul style="list-style-type: none"> • Platform System Upgrade on HMNZS <i>Te Mana</i> was completed in April 2016 • Operational Release by October 2016 • Project closure expected in December 2016

Total project cost summary as at 30 June 2016	Actual cost 2015/16	Actual costs to 30 June 2016	Future commitments and forecasts	Estimated outturn 30 June 2016
	\$000	\$000	\$000	\$000
Project net expenditure	11,585	77,905	2,580	80,485
Cabinet approved cost				87,600
Effect of foreign exchange movements				(1,759)
				85,841



ANZAC FRIGATE SYSTEMS UPGRADE

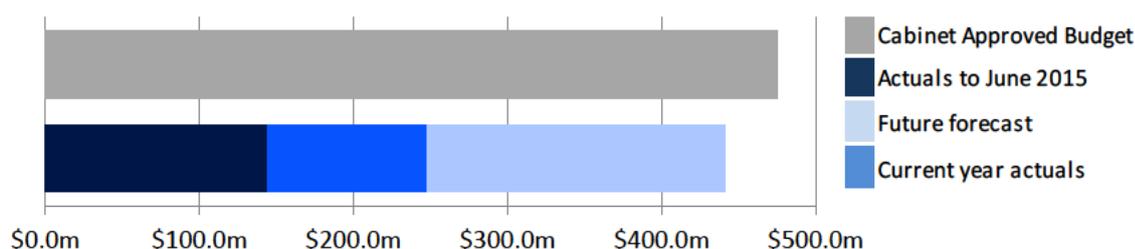
The primary objective of the Frigate Systems Upgrade project is to upgrade the ANZAC Frigates' combat capabilities to return their policy utility to the level provided on delivery. This is required to counter contemporary threats and to replace obsolescent systems.

In April 2014, Cabinet approved the Project Implementation Business Case, including capital expenditure of up to \$446.2 million between the Ministry and New Zealand Defence Force. Contracts have been awarded to Lockheed Martin Canada as the Prime System Integrator and eleven others for the provision of equipment and services.⁵

Due to the longer than planned preliminary design phase, the planned refit start date is now July 2017.

Objectives	Performance
<ul style="list-style-type: none"> Conduct Combat Systems Critical Design Review Conduct Platform Preliminary Design Review Negotiate Contract Change Proposal for Detailed Design Conduct scheduled Platform Detailed Design Reviews 	<ul style="list-style-type: none"> Successfully completed in September 2015 Successfully completed in December 2015 This was completed in January 2016 and work commenced immediately First of three reviews was successfully completed in June 2016. Two others are planned for October 2016 and February 2017
<ul style="list-style-type: none"> Complete installation and sea trials on the upgraded sonar and underwater telephone and conduct training Award contract for the design of the Combat System Trainer layout at Devonport 	<ul style="list-style-type: none"> Trials for the first systems were successfully completed in June 2016 with the trials for the second ship scheduled for November 2016 Contract awarded and design is on track for completion in August 2016

Total project cost summary as at 30 June 2016	Actual Cost 2015/16 \$000	Actual costs to 30 June 2016 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2016 \$000
Project net expenditure	103,402	247,592	193,204	440,796
Cabinet approved cost				475,537
Effect of foreign exchange movements				(34,741)
				440,796



⁵ The appropriation was subsequently increased through a non-cash technical adjustment to the approved budget, reflecting the effect of hedged foreign exchange movements.

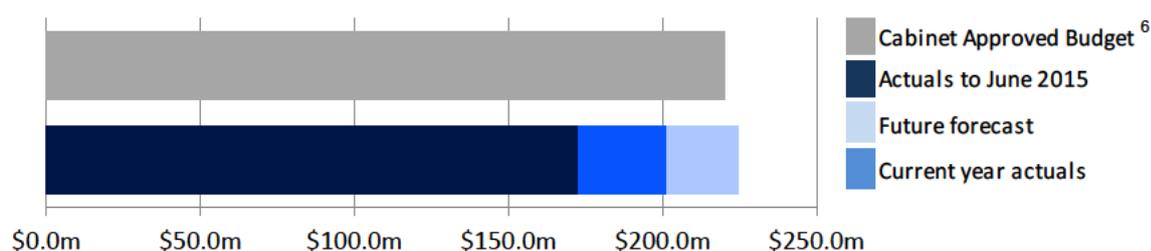
MARITIME HELICOPTER

This project is providing an upgraded fleet of naval helicopters for the Royal New Zealand Navy. Eight SH-2G(I) Super Seasprite helicopters are being acquired from Kaman Aerospace with associated spares, training aids and a full-motion flight training simulator. The package includes two additional helicopters which will be stored for use as attrition airframes and for spare parts.

All acquisition contract deliverables have now been delivered. The remaining project activity relates to Introduction into Service tasks associated with qualifying the aircraft for the full range of operational capabilities and replacing aging computers in the ground systems. The helicopters have been deployed on a Rim of the Pacific Exercise.

Objectives	Performance
<ul style="list-style-type: none"> Deliver all 10 helicopters and the flight training simulator 	<ul style="list-style-type: none"> Three helicopters were delivered in January 2015, a further three in May 2015, two in June 2015 and the last two in September 2015 The Flight Training Simulator was accepted in October 2015

Total project cost summary as at 30 June 2016	Actual Cost 2015/16 \$000	Actual costs to 30 June 2016 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2016 \$000
Project net expenditure	28,675	201,368	23,409	224,777
Cabinet approved cost				220,342
Effect of foreign exchange movements ⁶				5,049
				225,391



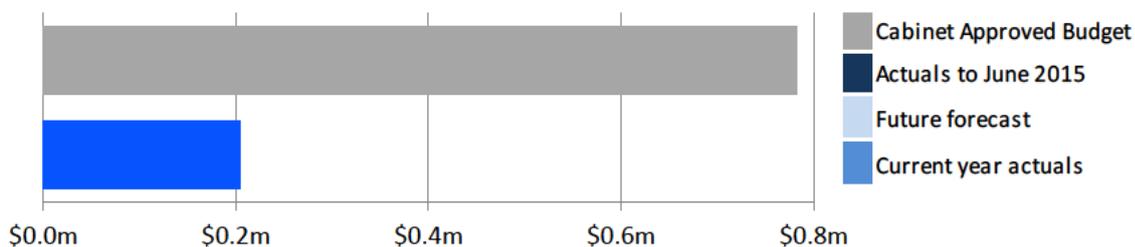
⁶ In 2016/17, the Ministry will seek a non-cash technical adjustment to the approved budget, reflecting the effect of foreign currency exchanges movements on the reported value of project expenditure.

MARITIME SUSTAINMENT CAPABILITY (SOURCE SELECTION PHASE)

The Maritime Sustainment Capability project seeks to replace the naval tanker, HMNZS *Endeavour*, with a vessel that will maintain an afloat sustainment capability for the Defence Force and its partners, as well as support New Zealand's civilian presence at Scott Base in Antarctica and its interests in the Southern Ocean more generally.

Objectives	Performance
<ul style="list-style-type: none"> Evaluate Tender responses and determine preferred tenderer 	<ul style="list-style-type: none"> Tender evaluation completed. On 28 August 2015, the Acquisition Review Board sought the down-selection of Best and Final Offers from two potential suppliers, the outcome of which was the selection of Hyundai Heavy Industries as the Preferred Tenderer (December 2015)
<ul style="list-style-type: none"> Negotiate Contract with preferred tenderer 	<ul style="list-style-type: none"> Contract negotiated with Hyundai Heavy Industries for both baseline enhanced naval tanker and Antarctic support option (24 March 2016)
<ul style="list-style-type: none"> Draft and submit Project Implementation Business Case to government for approval 	<ul style="list-style-type: none"> Project Implementation Business Case approved by Cabinet on 4 July 2016

Total project cost summary as at 30 June 2016	Actual Cost 2015/16 \$000	Actual costs to 30 June 2016 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2016 \$000
Project net expenditure	204	204	-	204
Cabinet approved cost				783
Effect of foreign exchange movements				-
				783



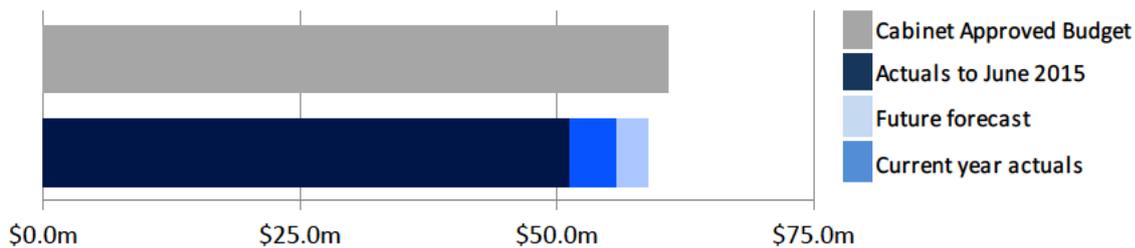
PROTECTOR REMEDIATION

Project Protector delivered a Logistics Support Ship, two Offshore Patrol Vessels and four Inshore Patrol Vessels. These vessels were acquired to perform a range of sealift and naval patrol tasks for the Defence Force and civilian agencies. The ships were delivered with capability shortfalls and deficiencies that were subject to a mediation claim and settlement.

These capability shortfalls and deficiencies are being addressed through the Protector Remediation Project. Solutions are being implemented in a staged fashion around the ships' operational commitments and maintenance periods. Ship work is practically complete and project closure has been initiated.

Objectives	Performance
<ul style="list-style-type: none"> Progress installation work consistent with the vessels' operational tasking Operational Release by June 2016 	<ul style="list-style-type: none"> Installation work is practically complete. Outstanding is the ballast work on HMNZS <i>Canterbury</i>, which was deferred to September 2016 so that the ship could deploy to Fiji as part of Operation Pacific Relief (response to Cyclone Winston) The Naval Capability Board endorsed the Operational Release of all seven Project Protector vessels, and this is expected early in 2016/17

Total project cost summary as at 30 June 2016	Actual Cost 2015/16	Actual costs to 30 June 2016	Future commitments and forecasts	Estimated outturn 30 June 2016
	\$000	\$000	\$000	\$000
Project net expenditure	4,677	55,919	2,901	58,819
Cabinet approved cost				60,759
Effect of foreign exchange movements				-
				60,759

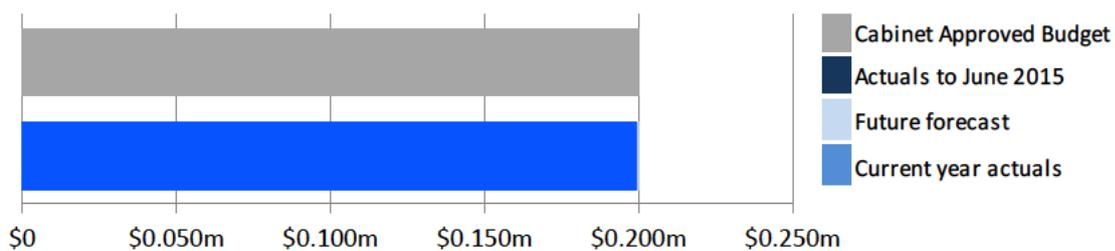


UNDERWATER INTELLIGENCE, SURVEILLANCE AND RECONNAISSANCE (SOURCE SELECTION PHASE)

The Underwater Intelligence, Surveillance and Reconnaissance project seeks to replace the underwater intelligence, surveillance and reconnaissance capability of the existing P-3K Orion fleet. In June 2014, Cabinet directed the Secretary of Defence to issue a Request for Tenders for the project.

Objectives	Performance
<ul style="list-style-type: none"> Select preferred bidder 	<ul style="list-style-type: none"> Acquisition Review Board approved Boeing as the preferred bidder on 23 September 2015
<ul style="list-style-type: none"> Conduct Best and Final Offer 	<ul style="list-style-type: none"> The Best and Final Offer was issued on 5 February and closed 19 February 2016
<ul style="list-style-type: none"> Agree acquisition contract 	<ul style="list-style-type: none"> Contract negotiations were held 21-24 March 2016
<ul style="list-style-type: none"> Seek Cabinet approval of the Project Implementation Business Case 	<ul style="list-style-type: none"> The Project Implementation Business Case was approved by Cabinet on 11 June 2016

Total project cost summary as at 30 June 2016	Actual Cost 2015/16	Actual costs to 30 June 2016	Future commitments and forecasts	Estimated outturn 30 June 2016
	\$000	\$000	\$000	\$000
Project net expenditure	200	200	-	200
Cabinet approved cost				200
Effect of foreign exchange movements				-
				200



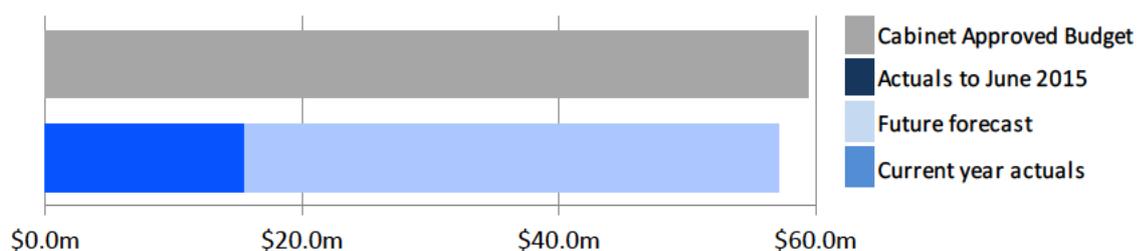
LAND DOMAIN

INDIVIDUAL WEAPONS REPLACEMENT

The project will replace the existing Defence Force Individual Weapon (Steyr rifle) with a new Modular Assault Rifle System – Light manufactured by Lewis Machine and Tools, along with necessary spares and ancillaries. Cabinet approved the Project Implementation Business Case authorising the acquisition in December 2015 at a cost of up to \$59.2 million. Deliveries started in April 2016.

Objectives	Performance
<ul style="list-style-type: none"> Award contracts for the supply of the Individual Weapons, Advanced Combat Optical Gunsight and Combat Torches Monitor contract deliveries in accordance with the contracted milestone delivery schedules 	<ul style="list-style-type: none"> Contracts awarded in December 2015 All contracted milestone deliveries up to 30 June 2016 have been met and all remaining deliveries will be completed by November 2017

Total project cost summary as at 30 June 2016	Actual Cost 2015/16 \$000	Actual costs to 30 June 2016 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2016 \$000
Project net expenditure	15,539	15,539	41,475	57,014
Cabinet approved cost				59,234
Effect of foreign exchange movements				(2,219)
				57,015



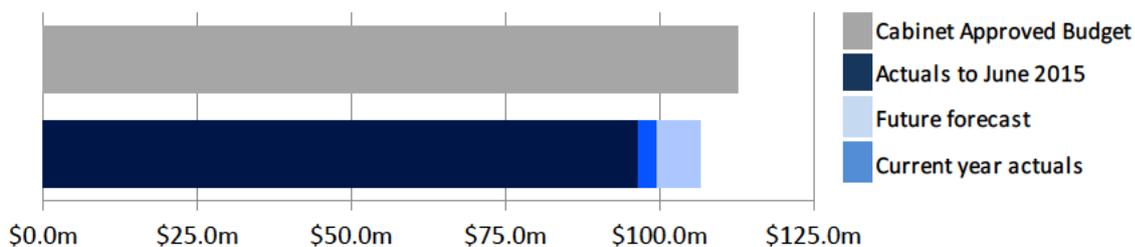
MEDIUM-HEAVY OPERATIONAL VEHICLES

The Medium-Heavy Operational Vehicles project is part of the Land Transport Capability Programme. It has provided the Defence Force with a fully supported and modern land mobility capability consisting of a range of medium and heavy trucks matched to the contemporary operating environment. Following authorisation from Cabinet in December 2012, Joint Ministers approved the procurement of up to 200 vehicles from Rheinmetall MAN Military Vehicles for \$112.6 million. Apart from some minor modifications, the purchase was largely off-the-shelf and the vehicles were based on vehicles supplied to the British Army. 194 of these vehicles have been delivered and are assigned to individual units. They have been deployed in New Zealand and overseas, including as part of the response to Cyclone Winston in Fiji.

The process for looking at options for the Recovery Vehicles, the remaining six vehicles, is ongoing.

Objectives	Performance
<ul style="list-style-type: none"> Establish requirements for the Recovery Vehicles 	<ul style="list-style-type: none"> Specification requirements developed and pricing data obtained from the contractor

Total project cost summary as at 30 June 2016	Actual Cost 2015/16 \$000	Actual costs to 30 June 2016 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2016 \$000
Project net expenditure	2,950	99,561	7,003	106,564
Cabinet approved cost				112,637
Effect of foreign exchange movements				(4,416)
				108,214

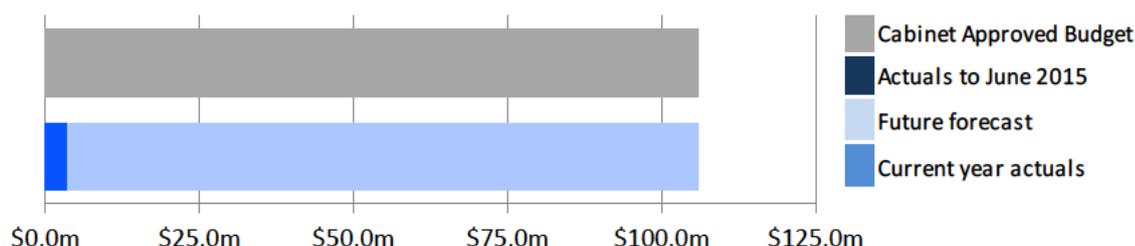


NETWORK ENABLED ARMY – TRANCHE 1

In April 2015, Cabinet approved Network Enabled Army – Tranche 1, including capital expenditure of up to \$106 million. Tranche 1 will deliver modern communications to Special Operations Forces, and an Infantry Task Group and its Headquarters comprised of around 200 personnel.

Objectives	Performance
<ul style="list-style-type: none"> Consult with known vendors and the United States Government Foreign Military Sales system to develop an appropriate acquisition strategy Scope the services required of a System Designer Issue a Request for Tender for the required Access Node designs Acquire a limited range of Command Post tentage and ancillary equipment for risk reduction 	<ul style="list-style-type: none"> Foreign Military Sales Letter of Request submitted to the United States Department of Defence for tactical broadband satellite terminals and infrastructure, provision of current communications waveforms, and network capable radios required for risk reduction Request for Proposal issued to Systematic for provision of Sitaware software and for potential services as Tranche 1 System Designer Contracts issued for military servers for evaluation and subsequent selection for full Tranche 1 server requirement Request for Proposal developed and issued to Systematic Detailed designs of each Access Node type that can be used for subsequent manufacture by industry Delivery of the limited range of Command Post tentage required for evaluation during Army exercises

Total project cost summary as at 30 June 2016	Actual cost 2015/16 \$000	Actual costs to 30 June 2016 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2016 \$000
Project net expenditure	3,507	3,539	102,434	105,973
Cabinet approved cost				106,000
Effect of foreign exchange movements				-
				106,000

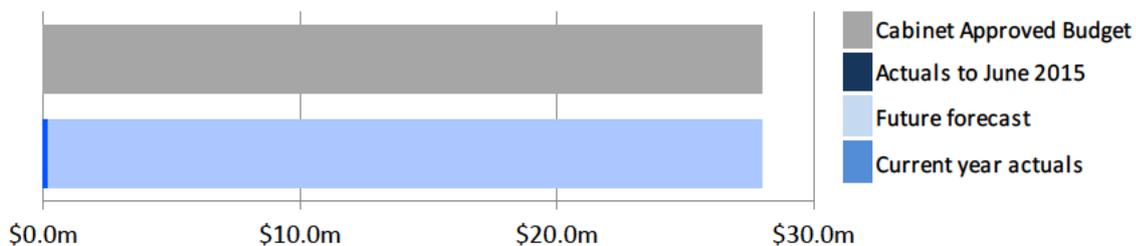


SPECIAL OPERATIONS VEHICLES (SOURCE SELECTION PHASE)

In June 2015, Cabinet approved expenditure of up to \$28 million on Special Operations Vehicles and associated support and infrastructure. Replacing the Pinzgauer Special Operations Vehicle, the project will acquire a mixed fleet, consisting of four vehicle types matched to the core requirements of the Special Operations Forces.

Objectives	Performance
<ul style="list-style-type: none"> Develop and implement procurement strategies (Best and Final Offer, Request for Tender, Sole Source Selection, and Government to Government) for four vehicle types 	<ul style="list-style-type: none"> Proposals received and evaluated for four vehicle types

Total project cost summary as at 30 June 2016	Actual Cost 2015/16 \$000	Actual costs to 30 June 2016 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2016 \$000
Project net expenditure	217	217	27,783	28,000
Cabinet approved cost				28,000
Effect of foreign exchange movements				-
				28,000



STRATEGIC BEARER NETWORK – PHASE 1

Strategic Bearer Network – Phase 1 will deliver global satellite communications services to the New Zealand Defence Force through the United States Department of Defense Wideband Global Satellite System. The Ministry is responsible for acquiring the infrastructure (mobile land based terminals, maritime terminals and fixed anchor stations) required to access the satellites.

Delivery of all capability is expected to be completed by the end of 2017 but the installation of some equipment may not occur until later in 2018.

Objectives	Performance
<ul style="list-style-type: none"> Complete delivery of twelve mobile land based terminals Contract for five Maritime Terminals Contract for second Anchor Station Deliver a Full Operating Capability to the Defence Force 	<ul style="list-style-type: none"> This was achieved in June 2016 Supply will be through Foreign Military Sales. Anticipate contract in August 2016 Anticipate contract in August 2016 Anticipate delivery by the end of 2017 with Full Operating Capability later in 2018

Total project cost summary as at 30 June 2016	Actual cost 2015/16 \$000	Actual costs to 30 June 2016 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2016 \$000
Project net expenditure	1,351	16,483	9,299	25,782
Cabinet approved cost				26,310
Effect of foreign exchange movements				-
				26,310



AIR DOMAIN

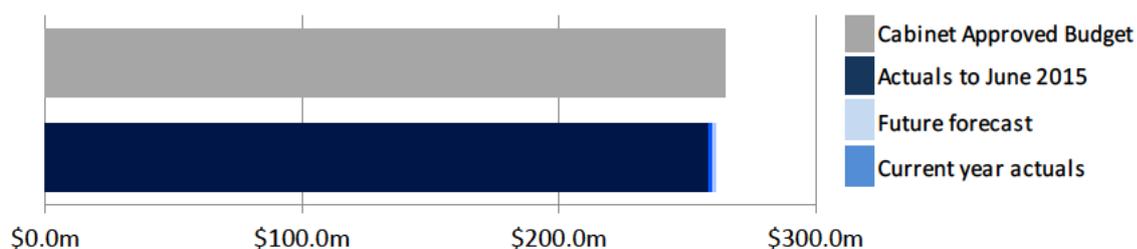
C-130 HERCULES LIFE EXTENSION

This project is extending the life of the five RNZAF C-130 Hercules aircraft by upgrading the fleet's mechanical and electrical equipment, undertaking comprehensive structural refurbishment work and extensively upgrading the communication and navigation systems.

The first four completed aircraft are delivering outputs for the New Zealand Defence Force. The fifth and final aircraft is scheduled to be delivered in September 2016.

Objectives	Performance
<ul style="list-style-type: none"> Deliver the fifth aircraft in early 2016 	<ul style="list-style-type: none"> The final aircraft is now scheduled for delivery in September 2016. Significant additional work has been required due to a greater level of structural refurbishment of the airframe

Total project cost summary as at 30 June 2016	Actual cost 2015/16 \$000	Actual costs to 30 June 2016 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2016 \$000
Project net expenditure	1,810	260,142	940	261,082
Cabinet approved cost				264,789
Effect of foreign exchange movements				(3,698)
				261,091



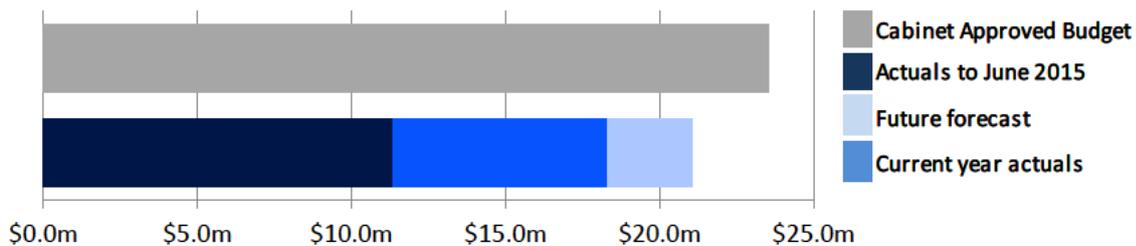
DEFENCE COMMAND AND CONTROL SYSTEM

The Defence Command and Control System will provide the Defence Force with a common operating environment for enhanced access to data and collaboration tools, together with requisite hardware and infrastructure for planning and control of Defence Force operations.

The core of the system is based on the United States Global Command and Control System. This is being procured through the United States Government Foreign Military Sales system.

Objectives	Performance
<ul style="list-style-type: none"> Complete roll-out of the Global Command and Control System (Joint) Complete implementation of the Global Command and Control System (Joint) on Royal New Zealand Navy ships 	<ul style="list-style-type: none"> Roll-out to be completed in December 2016 Trials are to be completed in December 2016

Total project cost summary as at 30 June 2016	Actual cost 2015/16 \$000	Actual costs to 30 June 2016 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2016 \$000
Project net expenditure	6,958	18,308	2,742	21,050
Cabinet approved cost				23,600
Effect of foreign exchange movements				533
				24,133



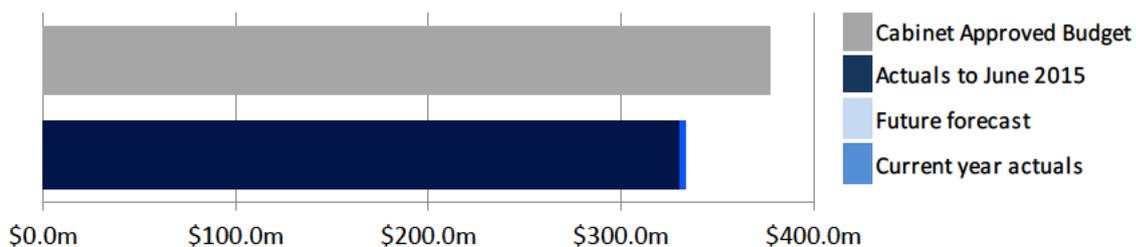
P-3K ORION SYSTEMS UPGRADE

This project is upgrading the sensors, mission management systems, and communication/navigation systems required for the six RNZAF P-3K Orion maritime patrol aircraft to conduct surface surveillance tasks.

The first aircraft was provisionally accepted in April 2011. The five aircraft upgraded in New Zealand were delivered in March 2012, September 2012, April 2013, February 2014 and July 2014. All ground systems associated with the upgrade project were delivered in 2011 and 2012. The subsequent work on this project was the resolution of a relatively small number of software defects by the contractor, under warranty.

Objectives	Performance
<ul style="list-style-type: none"> Close project in third quarter of 2016 	<ul style="list-style-type: none"> Project closure is scheduled for the second half of 2016

Total project cost summary as at 30 June 2016	Actual cost 2015/16 \$000	Actual costs to 30 June 2016 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2016 \$000
Project net expenditure	2,168	333,081	-	333,081
Cabinet approved cost				377,288
Effect of foreign exchange movements				(43,353)
				333,936

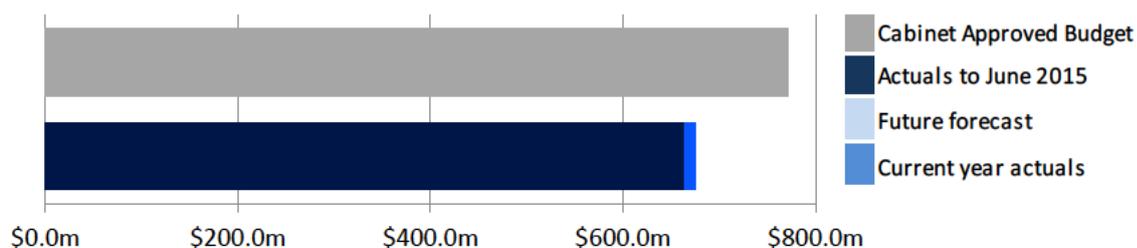


REPLACEMENT HELICOPTER CAPABILITY: MEDIUM UTILITY HELICOPTER

This project covers the acquisition of eight operational NH90 helicopters. These helicopters were delivered to the New Zealand Defence Force between 2011 and 2014. Following the 2015 Exercise Talisman Sabre in Australia, the NH90 helicopters were confirmed as ready to deploy on operations in the South Pacific, and have since been deployed to Fiji in support of relief efforts following Cyclone Winston. The aircraft are also being used for search and rescue missions, transport of personnel, and lifting of equipment, while also providing a counter-terrorism capability.

Objectives	Performance
<ul style="list-style-type: none"> Complete the upgrade from Final Configuration to Final Configuration Plus 	<ul style="list-style-type: none"> The first phase of the Final Configuration Plan upgrade was completed in June 2015 The second phase is now scheduled for the second half of calendar year 2016

Total project cost summary as at 30 June 2016	Actual cost 2015/16 \$000	Actual costs to 30 June 2016 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2016 \$000
Project net expenditure	12,214	675,819	-	675,819
Cabinet approved cost				771,710
Effect of foreign exchange movements				(92,991)
				678,719

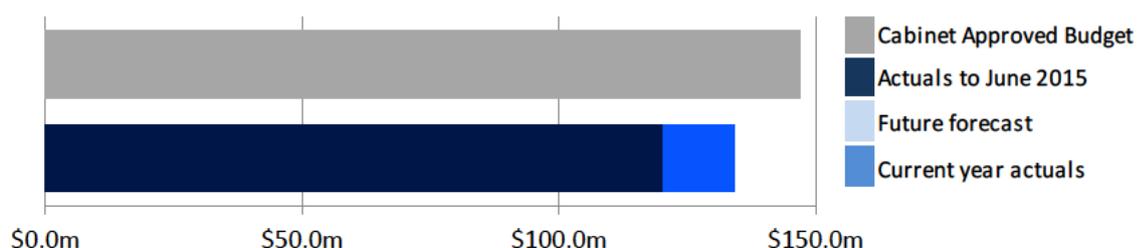


PILOT TRAINING CAPABILITY

This project is providing an upgraded capability for Royal New Zealand Air Force pilot training. It consists of 11 aircraft, two simulators, an integrated training package and on-going logistics support. The project was approved by Cabinet in March 2014 with a total budget of \$142.3 million.⁷ The aircraft are being acquired from Beechcraft LLC, simulators and training packages from CAE and logistics support for the aircraft will be provided by Safe Air Ltd. Beechcraft is the Prime Contractor for both the acquisition and support contracts. The first wings (pilot training) course utilising this capability commenced in February 2016.

Objectives	Performance
<ul style="list-style-type: none"> Final acceptance of the T-6 Simulators, and training by the New Zealand Defence Force. Close the project. 	<ul style="list-style-type: none"> The simulator has been accepted by the New Zealand Defence Force Project closure is scheduled for the second half of 2016

Total project cost summary as at 30 June 2016	Actual cost 2015/16 \$000	Actual costs to 30 June 2016 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2016 \$000
Project net expenditure	13,858	134,076	-	134,076
Cabinet approved cost				146,951
Effect of foreign exchange movements				(385)
				146,566



⁷ The appropriation was subsequently increased through a non-cash technical adjustment to the approved budget, reflecting the effect of hedged foreign exchange movements.

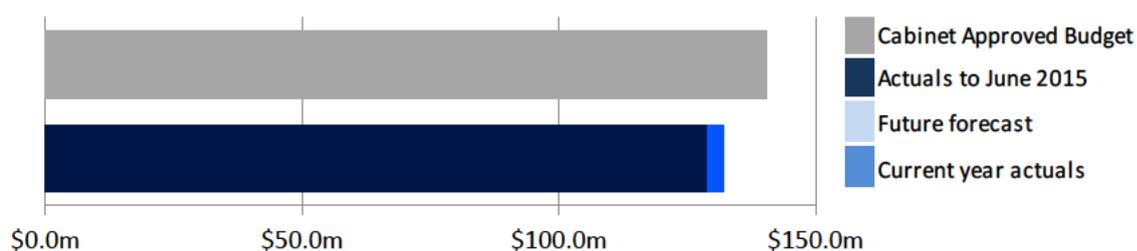
REPLACEMENT HELICOPTER CAPABILITY: TRAINING/LIGHT UTILITY HELICOPTER

This project has replaced the Sioux training helicopter with the AgustaWestland A109 Light Utility Helicopter providing a capability that meets the New Zealand Defence Force's contemporary needs. Five operational training/light utility helicopters and one attrition helicopter to be used for spares have been acquired. A flight training simulator has also been acquired.

Final aspects of the project have been worked through ahead of project closure in the second half of the 2016 calendar year.

Objectives	Performance
<ul style="list-style-type: none"> Resolve issues associated with the installation of cockpit armour Close the project 	<ul style="list-style-type: none"> Outstanding issues with the installation of cockpit armour were resolved in January 2016 Project closure is scheduled for the second half of 2016

Total project cost summary as at 30 June 2016	Actual cost 2015/16 \$000	Actual costs to 30 June 2016 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2016 \$000
Project net expenditure	3,095	132,012	-	132,012
Cabinet approved cost				140,529
Effect of foreign exchange movements				(4,258)
				136,272



PART 3: STATEMENT OF RESPONSIBILITY AND AUDIT REPORT

STATEMENT OF RESPONSIBILITY

I am responsible, as Chief Executive of the Ministry of Defence (the Ministry), for:

- the preparation of the Ministry's financial statements, and statements of expenses and capital expenditure, and for the judgements expressed in them
- having in place a system of internal control designed to provide reasonable assurance as to the integrity and reliability of financial reporting
- ensuring that end-of-year performance information on each appropriation administered by the Ministry is provided in accordance with sections 19A to 19C of the Public Finance Act 1989, whether or not that information is included in this annual report and
- the accuracy of any end-of-year performance information prepared by the Ministry, whether or not that information is included in the annual report.

In my opinion:

- the financial statements fairly reflect the financial position of the Ministry as at 30 June 2016 and its operations for the year ended on that date and
- the forecast financial statements fairly reflect the forecast financial position of the Ministry as at 30 June 2017 and its operations for the year ending on that date.

Signed by:



Helene Quilter
Secretary of Defence

2 September 2016

Countersigned by



Bryan Westbury
**Deputy Secretary (Finance) and
Chief Financial Officer**

2 September 2016

INDEPENDENT AUDITOR'S REPORT

TO THE READERS OF THE MINISTRY OF DEFENCE'S ANNUAL REPORT FOR THE YEAR ENDED 30 JUNE 2016

AUDIT NEW ZEALAND
Mana Arotake Aotearoa

The Auditor-General is the auditor of Ministry of Defence (the Ministry). The Auditor-General has appointed me, Karen Young, using the staff and resources of Audit New Zealand, to carry out the audit on her behalf of:

- the financial statements of the Ministry on pages 59 to 76, that comprise the statement of financial position, statement of commitments, statement of contingent liabilities and contingent assets as at 30 June 2016, the statement of comprehensive revenue and expense, statement of changes in equity, and statement of cash flows for the year ended on that date and the notes to the financial statements that include accounting policies and other explanatory information;
- the performance information prepared by the Ministry for the year ended 30 June 2016 on pages 10 to 24 and 28 to 52; and
- the statements of expenses and capital expenditure of the Ministry for the year ended 30 June 2016 on pages 57 and 58; and
- the schedules of non-departmental activities which are managed by the Ministry on behalf of the Crown on pages 77 to 90 that comprise:
 - the schedules of assets, liabilities, capital commitments, contingent liabilities and assets as at 30 June 2016;
 - the schedules of revenue, expenses, capital receipts and capital expenditure for the year ended 30 June 2016; and
 - the notes to the schedules that include accounting policies and other explanatory information.

OPINION

In our opinion:

- the financial statements of the Ministry:
 - present fairly, in all material respects:
 - its financial position as at 30 June 2016; and
 - its financial performance and cash flows for the year ended on that date;
 - comply with generally accepted accounting practice in New Zealand and have been prepared in accordance with Public Benefit Entity Reporting Standards.
- the performance information of the Ministry:
 - presents fairly, in all material respects, for the year ended 30 June 2016:
 - what has been achieved with the appropriation; and
 - the actual expenses or capital expenditure incurred compared with the appropriated or forecast expenses or capital expenditure.
 - complies with generally accepted accounting practice in New Zealand.

- the statements of expenses and capital expenditure of the Ministry on pages 57 to 58 are presented fairly, in all material respects, in accordance with the requirements of section 45A of the Public Finance Act 1989.
- the schedules of non-departmental activities which are managed by the Ministry on behalf of the Crown on pages 77 to 90 present fairly, in all material respects, in accordance with the Treasury Instructions:
 - the schedules of assets, liabilities, capital commitments, contingent liabilities and assets as at 30 June 2016;
 - the schedules of revenue, expenses, capital receipts and capital expenditure for the year ended 30 June 2016;

Our audit was completed on 2 September 2016. This is the date at which our opinion is expressed.

The basis of our opinion is explained below. In addition, we outline the responsibilities of the Secretary of Defence and our responsibilities, and we explain our independence.

BASIS OF OPINION

We carried out our audit in accordance with the Auditor-General's Auditing Standards, which incorporate the International Standards on Auditing (New Zealand). Those standards require that we comply with ethical requirements and plan and carry out our audit to obtain reasonable assurance about whether the information we audited is free from material misstatement.

Material misstatements are differences or omissions of amounts and disclosures that, in our judgement, are likely to influence readers' overall understanding of the information we audited. If we had found material misstatements that were not corrected, we would have referred to them in our opinion.

An audit involves carrying out procedures to obtain audit evidence about the amounts and disclosures in the information we audited. The procedures selected depend on our judgement, including our assessment of risks of material misstatement of the information we audited, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Ministry's preparation of the information we audited in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Ministry's internal control.

An audit also involves evaluating:

- the appropriateness of accounting policies used and whether they have been consistently applied;
- the reasonableness of the significant accounting estimates and judgements made by the Secretary of Defence;
- the appropriateness of the reported performance information within the Ministry's framework for reporting performance;
- the adequacy of the disclosures in the information we audited; and
- the overall presentation of the information we audited.

We did not examine every transaction, nor do we guarantee complete accuracy of the information we audited. Also, we did not evaluate the security and controls over the electronic publication of the information we audited.

We believe we have obtained sufficient and appropriate audit evidence to provide a basis for our audit opinion.

RESPONSIBILITIES OF THE SECRETARY OF DEFENCE

The Secretary of Defence is responsible for preparing:

- financial statements that present fairly the Ministry's financial position, financial performance, and its cash flows, and that comply with generally accepted accounting practice in New Zealand.
- performance information that presents fairly what has been achieved with each appropriation, the expenditure incurred as compared with the appropriated or forecasted expenses or capital expenditure, and that complies with generally accepted accounting practice in New Zealand.
- statements of expenses and capital expenditure of the Ministry, that are presented fairly, in accordance with the requirements of the Public Finance Act 1989.
- schedules of non departmental activities, in accordance with the Treasury Instructions, that present fairly those activities managed by the Ministry on behalf of the Crown.

The Secretary of Defence's responsibilities arise from the Public Finance Act 1989.

The Secretary of Defence is responsible for such internal control as is determined is necessary to ensure that the annual report is free from material misstatement, whether due to fraud or error. The Secretary of Defence is also responsible for the publication of the annual report, whether in printed or electronic form.

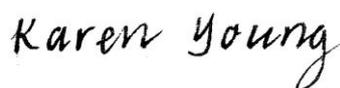
RESPONSIBILITIES OF THE AUDITOR

We are responsible for expressing an independent opinion on the information we are required to audit, and reporting that opinion to you based on our audit. Our responsibility arises from the Public Audit Act 2001.

INDEPENDENCE

When carrying out the audit, we followed the independence requirements of the Auditor-General, which incorporate the independence requirements of the External Reporting Board.

In addition to the audit we have carried out a project administration assurance review, which is compatible with those independence requirements. Other than the audit and the assurance review, we have have no relationship with, or interests in, the Ministry.



Karen Young
Audit New Zealand

On behalf of the Auditor-General
Wellington, New Zealand

PART 4: APPROPRIATION STATEMENTS

STATEMENT OF EXPENSES AND CAPITAL EXPENDITURE AGAINST APPROPRIATIONS

For the year ended 30 June 2016

Actual 2015 \$000		Forecast not audited 2016 \$000	Main estimates 2016 \$000	Supp estimates 2016 \$000	Actual 2016 \$000	Forecast not audited 2017 \$000
	Vote: Defence					
	Departmental Appropriations					
	Appropriations for output expenses					
1,913	Evaluation, audit and assessment of performance	1,927	1,927	2,133	2,128	2,393
3,969	Management of equipment procurement	7,857	7,857	6,863	6,165	8,637
5,882	Total appropriations for output expenses	9,784	9,784	8,996	8,293	11,030
	Multi-category appropriations (MCA)					
	Policy advice and related outputs MCA					
3,576	Policy advice	3,984	3,984	3,903	3,901	4,204
713	Ministerial services	795	795	779	778	839
1,652	Policy support	1,841	1,841	1,803	1,801	1,942
5,941	Total multi-category appropriations	6,620	6,620	6,485	6,480	6,985
	Departmental capital expenditure *					
484	Ministry of Defence – capital expenditure	330	330	480	301	350
484	Total appropriations for capital expenditure	330	330	480	301	350
	Non-Departmental Appropriations					
	Capital expenditure					
386,929	Defence equipment	222,795	222,795	219,837	212,412	260,529
386,929	Total appropriations for non-departmental capital expenditure	222,795	222,795	219,837	212,412	260,529
399,236	Total appropriations administered by the Ministry of Defence	239,529	239,529	235,798	227,486	278,894

Note: * The departmental capital expenditure appropriation is given by permanent legislative authority (PLA) under section 24(1) of the Public Finance Act 1989.

STATEMENT OF EXPENSES AND CAPITAL EXPENDITURE INCURRED WITHOUT, OR IN EXCESS OF, APPROPRIATION OR OTHER AUTHORITY

For the year ended 30 June 2016

The Ministry has no instances of departmental or non-departmental unappropriated expenditure or capital expenditure (2015 – Nil).

STATEMENT OF DEPARTMENTAL CAPITAL INJECTIONS WITHOUT, OR IN EXCESS OF, AUTHORITY

For the year ended 30 June 2016

The Ministry has not received any capital injections during the year without, or in excess of, authority (2015 – Nil).

TRANSFERS UNDER SECTION 26A OF THE PUBLIC FINANCE ACT 1989

The amounts presented as Supplementary Estimates in the Statement of Expenditure Against Appropriations include transfers made under section 26A of the Public Finance Act 1989 as shown in the table below.

	Voted in Suppl. Estimates 2016 \$000	Section 26A transfers 2016 \$000	Total appropriation voted 2016 \$000
Vote: Defence			
Departmental Appropriations			
Appropriations for output expenses			
Evaluation, audit and assessment of performance	2,393	(260)	2,133
Management of equipment procurement	6,603	260	6,863
Total appropriations for output expenses	8,996	-	8,996

PERFORMANCE INFORMATION

Performance information for all departmental appropriations are reported in this annual report.

Performance information for non-departmental capital expenditure is reported on page 35 in this annual report.

Performance information for departmental appropriations and non-departmental capital expenditure is reported in part 2 of this annual report.

PART 5: DEPARTMENTAL FINANCIAL STATEMENTS

STATEMENT OF COMPREHENSIVE REVENUE AND EXPENSE

For the year ended 30 June 2016

Actual 2015 \$000		Note	Forecast not audited 2016 \$000	Main estimates 2016 \$000	Supp estimates 2016 \$000	Actual 2016 \$000	Forecast not audited 2017 \$000
	Revenue						
11,165	Revenue Crown		15,146	15,146	14,223	14,223	18,015
703	Other revenue	2	1,258	1,258	1,258	588	-
11,868	Total revenue		16,404	16,404	15,481	14,811	18,015
	Expenses						
7,444	Personnel expenses	3	9,942	9,942	8,614	8,212	10,114
3,778	Operating expenses	5	5,937	5,937	6,344	6,144	7,268
363	Depreciation and amortisation expense	7,8	252	252	250	223	360
237	Capital charge	4	273	273	273	194	273
11,822	Total expenses		16,404	16,404	15,481	14,773	18,015
46	Surplus/(deficit)		-	-	-	38	-
-	Other comprehensive revenue and expense		-	-	-	-	-
46	Total comprehensive revenue and expense		-	-	-	38	-

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 15.

STATEMENT OF FINANCIAL POSITION

As at 30 June 2016

Actual 2015 \$000		Note	Forecast not audited 2016 \$000	Main estimates 2016 \$000	Supp estimates 2016 \$000	Actual 2016 \$000	Forecast not audited 2017 \$000
	Assets						
	Current assets						
3,575	Cash and cash equivalents		3,751	3,751	2,593	4,643	2,708
406	Receivables from exchange transactions	6	-	-	494	-	494
-	Prepayments		-	-	15	13	15
3,981	Total current assets		3,751	3,751	3,102	4,656	3,217
	Non-current assets						
1,389	Property, plant and equipment	7	1,720	1,720	1,635	1,479	1,486
16	Intangible assets	8	-	-	-	4	34
1,405	Total non-current assets		1,720	1,720	1,635	1,483	1,520
5,386	Total assets		5,471	5,471	4,737	6,139	4,737
	Liabilities						
	Current liabilities						
1,011	Creditors and other payables	9	1,150	1,150	479	1,753	479
46	Return of surplus to the Crown	10	-	-	-	38	-
569	Employee entitlements	11	605	605	510	741	510
1,626	Total current liabilities		1,755	1,755	989	2,532	989
	Non-current liabilities						
344	Employee entitlements	11	300	300	332	191	332
344	Total non-current liabilities		300	300	332	191	332
1,970	Total liabilities		2,055	2,055	1,321	2,723	1,321
3,416	Net assets		3,416	3,416	3,416	3,416	3,416
	Equity						
3,416	General funds	12	3,416	3,416	3,416	3,416	3,416
3,416	Total equity		3,416	3,416	3,416	3,416	3,416

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 15.

STATEMENT OF CHANGES IN EQUITY

For the year ended 30 June 2016

Actual 2015 \$000		Note	Forecast not audited 2016 \$000	Main estimates 2016 \$000	Supp estimates 2016 \$000	Actual 2016 \$000	Forecast not audited 2017 \$000
3,416	Balance at 1 July		3,416	3,416	3,416	3,416	3,416
46	Total comprehensive revenue and expense		-	-	-	38	-
(46)	Return of surplus to the Crown	10	-	-	-	(38)	-
-	Capital injection		-	-	-	-	-
-	Capital withdrawals		-	-	-	-	-
3,416	Balance at 30 June	12	3,416	3,416	3,416	3,416	3,416

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 15.

STATEMENT OF CASH FLOWS

For the year ended 30 June 2016

Actual 2015 \$000		Forecast not audited 2016 \$000	Main estimates 2016 \$000	Supp estimates 2016 \$000	Actual 2016 \$000	Forecast not audited 2017 \$000
	Cash flows from operating activities					
11,165	Receipts from Crown	15,146	15,146	14,223	14,223	18,015
474	Receipts from other revenue	1,258	1,258	1,155	935	-
(7,682)	Payments to employees	(9,810)	(9,810)	(8,537)	(8,172)	(10,037)
(3,966)	Payments to suppliers	(6,069)	(6,069)	(7,110)	(6,015)	(7,345)
(237)	Payments for capital charge	(273)	(273)	(273)	(194)	(273)
(102)	Goods and services tax (net)	-	-	86	638	-
(348)	Net cash flow from operating activities	252	252	(456)	1,415	360
	Cash flows from investing activities					
-	Receipts from sale of property, plant and equipment	-	-	-	-	-
(482)	Purchase of property, plant and equipment	(330)	(330)	(480)	(301)	(300)
(2)	Purchase of intangible assets	-	-	-	-	(50)
(484)	Net cash flow from investing activities	(330)	(330)	(480)	(301)	(350)
	Cash flows from financing activities					
(22)	Return of surplus to the Crown	-	-	(46)	(46)	-
(22)	Net cash flow from financing activities	-	-	(46)	(46)	-
(854)	Net increase/(decrease) in cash	(78)	(78)	(982)	1,068	10
4,429	Cash at the beginning of the year	3,829	3,829	3,575	3,575	2,698
3,575	Cash at the end of the year	3,751	3,751	2,593	4,643	2,708

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 15.

STATEMENT OF COMMITMENTS

As at 30 June 2016

CAPITAL COMMITMENTS

Capital commitments are the aggregate amount of capital expenditure contracted for the acquisition of property, plant and equipment and intangible assets that have not been paid for or not recognised as a liability at the balance sheet date.

The Ministry has no capital commitments (2015 – Nil).

NON-CANCELLABLE OPERATING LEASE COMMITMENTS

The Ministry leases property, plant and equipment in the normal course of its business. The lease of premises in Freyberg House is a non-cancellable lease to 2025.

Actual 2015 \$000		Actual 2016 \$000
	Non-cancellable operating lease commitments	
494	Not later than one year	494
494	Later than one year and not later than two years	494
1,483	Later than two years and not later than five years	1,483
2,307	Later than five years	1,813
4,778	Total non-cancellable operating lease commitments	4,284
4,778	Total commitments	4,284

STATEMENT OF CONTINGENT LIABILITIES AND CONTINGENT ASSETS

As at 30 June 2016

CONTINGENT LIABILITIES

The Ministry has no contingent liabilities (2015 – Nil).

CONTINGENT ASSETS

The Ministry has no contingent assets (2015 – Nil).

GUARANTEES AND INDEMNITIES

No guarantees and indemnities have been given outside the normal course of business (2015 – Nil).

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 15.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1: STATEMENT OF ACCOUNTING POLICIES

REPORTING ENTITY

The Ministry of Defence (the Ministry) is a government department as defined by section 2 of the Public Finance Act 1989 and is domiciled in New Zealand.

In addition, the Ministry has reported on Crown activities which it administers.

The primary objective of the Ministry is to provide services to the public rather than making a financial return. Accordingly, the Ministry has designated itself as a public benefit entity (PBE) for financial reporting purposes.

The financial statements of the Ministry are for the year ended 30 June 2016 and were approved for issue by the Chief Executive of the Ministry on 2 September 2016.

BASIS OF PREPARATION

Statement of compliance

The financial statements of the Ministry have been prepared in accordance with the requirements of the Public Finance Act 1989, which includes the requirement to comply with New Zealand generally accepted accounting practice (NZ GAAP) and Treasury Instructions.

These financial statements have been prepared in accordance with Tier 2 PBE accounting standards. The Ministry is eligible for Tier 2 reporting as its expenses are less than \$30 million and does not have publicly traded debt.

These financial statements comply with PBE accounting standards.

Forecast financial statements have been prepared in accordance with PBE accounting standards, as described in the Forecast section below. The forecast financial statements have not been audited.

MEASUREMENT BASE

The financial statements have been prepared on a historical cost basis, modified by the revaluation of derivative financial instruments to fair value.

Functional and presentation currency

The financial statements are presented in New Zealand dollars and all values are rounded to the nearest thousand dollars (\$000). The functional currency of the Ministry is New Zealand dollars.

Changes in accounting policies

There have been no changes in accounting policies during the financial year.

Budget figures

The budget figures ("Main estimates") are those included in the Information Supporting the Estimates of Appropriations for the Government of New Zealand for the year ending 30 June 2016, which are consistent with the financial information in the Main Estimates.

In addition, the financial statements also present the updated budget information from the Supplementary Estimates ("Supp estimates").

The budget figures have been prepared in accordance with NZ GAAP, using accounting policies that are consistent with those adopted in preparing these financial statements.

Forecast

The Ministry is required by the Public Finance Act to present forecast financial statements for the financial year following the financial year to which the Annual Report relates. The forecast financial statements ("Forecast") are prepared in accordance with PBE FRS 42 Prospective Financial Statements.

The 2017 forecast financial statements are based on the Ministry's budget for 2016/17 as approved in the Estimates of Appropriations for 2016/17.

The significant assumptions underlying the forecast financial statements are:

- the functions performed and the appropriations administered by the Ministry will not change over the forecast period
- the Ministry will not receive any additional funding beyond that voted in the Estimates of Appropriations during the forecast period.

The forecast financial statements were authorised for issue by the Chief Executive of the Ministry on 26 May 2016.

Actual financial results for the forecast period are likely to vary, and may be materially different, from the forecasts presented.

The 2016 forecast financial statements were reported in the Ministry's 2015 Annual Report and were prepared on the basis presented in that Annual Report.

The forecast financial statements have not been audited.

SIGNIFICANT ACCOUNTING POLICIES

Revenue

Revenue is measured at the fair value of consideration received or receivable.

Revenue Crown

The Ministry's funding entitlement is established by Parliament when it passes the Appropriation Acts for the financial year. Revenue from the Crown is classified as non-exchange revenue and is recognised to the level that the funding entitlement is drawn down from Treasury.

There are no conditions attached to the funding from the Crown beyond the requirement that the Ministry may only incur expenses within the scope and limits of its appropriations.

Other Revenue

Costs incurred by the Ministry in the pre-acquisition stages of acquisition projects are recovered from the New Zealand Defence Force. This is classified as an exchange transaction.

Capital charge

The capital charge is recognised as an expense in the period to which the charge relates.

Foreign currency transactions

Foreign currency transactions (including those for which forward foreign exchange contracts are held) are translated into New Zealand dollars using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the surplus or deficit.

Operating leases

An operating lease is a lease that does not transfer substantially all the risks and rewards incidental to ownership of an asset. Lease payments under an operating lease are recognised as an expense on a straight-line basis over the lease term.

Financial instruments

Financial assets and financial liabilities are initially measured at fair value plus transaction costs unless they are carried at fair value through surplus or deficit in which case the transaction costs are recognised in the surplus or deficit.

Cash and cash equivalents

Cash and cash equivalents includes cash on hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less.

Debtors and other receivables

Debtors and other receivables are initially measured at their face value, less any provision for impairment.

Impairment of a receivable is established when there is objective evidence that the Ministry will not be able to collect amounts due according to the original terms of the receivable. Significant financial difficulties of the debtor, probability that the debtor will enter into bankruptcy, receivership or liquidation, and default in payments are considered indicators that the debtor is impaired. The amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted using the original effective interest rate. The carrying amount of the asset is reduced through the use of a provision for impairment account, and the amount of the loss is recognised in the surplus or deficit. Overdue receivables that are renegotiated are reclassified as current (that is, not past due).

Property, plant and equipment

Property, plant and equipment consists of leasehold improvements, furniture and office equipment.

Property, plant and equipment is measured at cost, less accumulated depreciation and impairment losses.

Individual assets, or groups of assets, are capitalised if their cost is greater than \$5,000. The value of an individual asset that is less than \$5,000 and is part of a group of similar assets is capitalised.

Additions

The cost of an item of property, plant and equipment is recognised as an asset if, and only if, it is probable that future economic benefits or service potential associated with the item will flow to the Ministry and the cost of the item can be measured reliably.

Work in progress is recognised at cost less impairment and is not depreciated.

In most instances, an item of property, plant and equipment is recognised at its cost. Where an asset is acquired at no cost, or for a nominal cost, it is recognised at fair value as at the date of acquisition.

Disposals

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount of the asset. Gains and losses on disposals are included in the statement of financial performance.

Subsequent costs

Costs incurred subsequent to initial acquisition are capitalised only when it is probable that future economic benefits or service potential associated with the item will flow to the Ministry and the cost of the item can be measured reliably.

Depreciation

Depreciation is provided on a straight-line basis on all property, plant and equipment at rates that will write off the cost of the assets to their estimated residual values over their useful lives. The useful lives and associated depreciation rates of major classes of assets have been estimated as follows:

Leasehold improvements	5-18 years
Furniture	3-10 years
Office equipment	5-10 years
Computer equipment	3-5 years

Leasehold improvements are depreciated over the unexpired period of the lease or the estimated remaining useful lives of the improvements, whichever is the shorter.

The residual value and useful life of an asset is reviewed, and adjusted if applicable, at each financial year-end.

Intangible assets

Additions

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software.

Staff training costs are recognised as an expense when incurred.

Costs associated with maintaining computer software are recognised as an expense when incurred.

Amortisation

The carrying value of an intangible asset with a finite life is amortised on a straight-line basis over its useful life. Amortisation begins when the asset is available for use and ceases at the date that the asset is derecognised. The amortisation charge for each period is recognised in the surplus or deficit.

The useful lives and associated amortisation rates of major classes of intangible assets have been estimated as follows:

Acquired computer software	3-5 years
----------------------------	-----------

Impairment of property, plant and equipment and intangible assets

Intangible assets that have an indefinite useful life, or are not yet available for use, are tested annually for impairment.

Property, plant and equipment and intangible assets that have a finite useful life are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An

impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

Value in use is depreciated replacement cost for an asset where the future economic benefits or service potential of the asset are not primarily dependent on the asset's ability to generate net cash inflows and where the Ministry would, if deprived of the asset, replace its remaining future economic benefits or service potential.

If an asset's carrying amount exceeds its recoverable amount, the asset is impaired and the carrying amount is written down to the recoverable amount.

Any impairment loss is recognised in the surplus or deficit. The reversal of an impairment loss is recognised in the surplus or deficit.

Creditors and other payables

Short-term creditors and other payables are recorded at their face value.

Employee entitlements

Short-term employee entitlements

Entitlements expected to be settled within twelve months of balance date are measured at nominal values based on accrued entitlements at current rates of pay. These include salaries and wages accrued up to balance date, annual leave earned but not yet taken at balance date, retiring and long service leave entitlements expected to be settled within twelve months, and sick leave.

A liability is recognised to the extent that absences in the coming year are expected to be greater than the sick leave entitlements earned in the coming year. The amount is calculated based on the unused sick leave entitlement that can be carried forward at balance date, to the extent that it will be used by staff to cover those future absences.

Long-term employee entitlements

Employee entitlements that are due to be settled beyond twelve months after the end of the reporting period in which the employee renders the related service, such as long service leave and retiring leave, are calculated on an actuarial basis. The calculations are based on:

- likely future entitlements accruing to staff, based on years of service, years to entitlement, contractual entitlement information and the likelihood that staff will reach the point of entitlement
- the present value of the estimated future cash flows.

Expected future payments are discounted using market yields on government bonds at balance date with terms to maturity that match, as closely as possible, the estimated future cash outflows for entitlements. The inflation factor is based on the expected long-term increase in remuneration for employees.

Presentation of employee entitlements

Sick leave, annual leave, vested long service leave, and non-vested long service leave and retirement gratuities expected to be settled within twelve months of balance date are classified as a current liability. All other employee entitlements are classified as a non-current liability.

Superannuation schemes

Obligations for contributions to the State Sector Retirement Savings Scheme, Kiwisaver and the Government Superannuation Fund are accounted for as defined contribution schemes and are recognised as an expense in the surplus or deficit as incurred.

Provisions

A provision is recognised for future expenditure of uncertain amount or timing when there is a present obligation (either legal or constructive) as a result of a past event, it is probable that an outflow of future economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Provisions are not recognised for future operating losses.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to the passage of time is recognised as a finance cost.

Equity

Equity is the Crown's investment in the Ministry and is measured as the difference between total assets and total liabilities. Equity is disaggregated and classified as taxpayers' funds.

Goods and Services Tax (GST)

All items in the financial statements, including appropriation statements, are stated exclusive of goods and services tax (GST), except for receivables and payables, which are stated on a GST inclusive basis. Where GST is not recoverable as input tax, then it is recognised as part of the related asset or expense.

The net amount of GST recoverable from, or payable to, the Inland Revenue Department (IRD) is included as part of receivables or payables in the statement of financial position.

The net GST paid or received from the IRD, including the GST relating to investing and financing activities, is classified as an operating cash flow in the statement of cash flows.

Commitments and contingencies are disclosed exclusive of GST.

Income tax

Government departments are exempt from income tax as public authorities. Accordingly, no charge for income tax has been provided for.

Statement of cost accounting policies

The Ministry has determined the cost of outputs using the cost allocation system 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 assigned to outputs by charging payments to specific job numbers. Selection of a "general cost" job number within an output class will treat the expense as a direct cost to the output class even though a specific job within the output class has not been identified.

- For the year ended 30 June 2016, direct costs accounted for 73% of the Ministry's costs (30 June 2015 – 66%).
- Basis for assigning indirect and corporate costs to outputs
 - Indirect costs are assigned to outputs by charging payments to a corporate job number. The accounting system is programmed to allocate corporate job costs to the three output classes on a predetermined percentage for each expense item. The percentage number is an assessment of services to be provided to each output class in the ensuing year. The percentage numbers remain constant for the financial year.
 - For the year ended 30 June 2016, indirect costs accounted for 27% of the Ministry's costs (30 June 2015 – 34%).

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

CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS

In preparing these financial statements, estimates and assumptions have been made concerning the future. These estimates and assumptions may differ from the subsequent actual results. Estimates and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. There are no estimates or assumptions that are considered to have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

CRITICAL JUDGEMENTS IN APPLYING THE MINISTRY'S ACCOUNTING POLICIES

Management has not exercised any critical judgements in applying the Ministry's accounting policies for the year ended 30 June 2016.

EVENTS AFTER BALANCE DATE

There have been no significant events after balance date.

NOTE 2: OTHER REVENUE

Actual		Forecast not audited	Main estimates	Actual	Forecast not audited
2015		2016	2016	2016	2017
\$000		\$000	\$000	\$000	\$000
703	Pre-acquisition project costs from New Zealand Defence Force	1,258	1,258	588	-
703	Total other revenue	1,258	1,258	588	-

NOTE 3: PERSONNEL EXPENSES

Actual		Forecast not audited	Main estimates	Actual	Forecast not audited
2015		2016	2016	2016	2017
\$000		\$000	\$000	\$000	\$000
7,108	Salaries and wages	9,498	9,498	7,907	9,766
296	Employer contributions to defined contribution plans	312	312	286	271
40	Increase/(decrease) in employee entitlements	132	132	19	77
7,444	Total personnel expenses	9,942	9,942	8,212	10,114

NOTE 4: CAPITAL CHARGE

The Ministry pays a capital charge to the Crown on its equity as at 30 June and 31 December each year. The capital charge rate for the year ended 30 June 2016 was 8% (2015 – 8%).

NOTE 5: OPERATING EXPENSES

Actual		Forecast not audited	Main estimates	Actual	Forecast not audited
2015		2016	2016	2016	2017
\$000		\$000	\$000	\$000	\$000
100	Audit fees for financial statements	96	96	103	100
-	Fees paid to Audit New Zealand for other services	-	-	14	-
899	Consultancy	873	873	1,967	1,880
228	Professional services	124	124	485	867
630	Travel and related costs	590	590	837	807
208	Courses, conferences and exhibitions	156	156	187	325
532	Rental of premises	588	588	683	572
126	Legal	206	206	167	228
128	Grants and contributions	60	60	236	90
927	Other operating costs	3,244	3,244	1,465	2,399
3,778	Total operating expenses	5,937	5,937	6,144	7,268

During the year Audit New Zealand performed an assurance review of project administration.

Operating expenses have been disaggregated from the presentation in the Information Supporting the Estimates to be consistent with the disclosure in the annual report.

NOTE 6: RECEIVABLES FROM EXCHANGE TRANSACTIONS

Actual 2015 \$000		Main estimates 2016 \$000	Actual 2016 \$000
406	Debtors	-	-
-	Less provision for impairment	-	-
406	Net debtors	-	-
-	GST receivable	-	-
406	Total receivables from exchange transactions	-	-

The carrying value of debtors and other receivables approximates their fair value.

NOTE 7: PROPERTY, PLANT AND EQUIPMENT

	Main estimates 2016 Total \$000	Leasehold improvements \$000	Actual 2016 Office furniture \$000	Office and computer equipment \$000	Total \$000
Cost or valuation					
Balance at 1 July 2014	3,469	2,580	117	772	3,469
Additions	608	194	225	63	482
Disposals	-	-	-	-	-
Balance at 30 June 2015	4,077	2,774	342	835	3,951
Balance at 1 July 2015	4,077	2,774	342	835	3,951
Additions	330	167	134	-	301
Disposals	-	-	-	-	-
Balance at 30 June 2016	4,407	2,941	476	835	4,252
Accumulated depreciation and impairment losses					
Balance at 1 July 2014	2,221	1,410	62	749	2,221
Depreciation expense	214	312	19	10	341
Eliminate on disposal	-	-	-	-	-
Balance at 30 June 2015	2,435	1,722	81	759	2,562
Balance at 1 July 2015	2,435	1,722	81	759	2,562
Depreciation expense	252	161	38	12	211
Eliminate on disposal	-	-	-	-	-
Balance at 30 June 2016	2,687	1,883	119	771	2,773
Carrying amounts					
At 30 June and 1 July 2015	1,642	1,052	261	76	1,389
At 30 June 2016	1,720	1,058	357	64	1,479

There are no restrictions over the title of the Ministry's property, plant and equipment, nor is any property, plant and equipment pledged as security for liabilities.

NOTE 8: INTANGIBLE ASSETS

	Main estimates 2016	Actual 2016	
	Total	Acquired software	Total
	\$000	\$000	\$000
Cost			
Balance at 1 July 2014	956	956	956
Additions	-	2	2
Disposals	-	-	-
Balance at 30 June 2015	956	958	958
Balance at 1 July 2015	956	958	958
Additions	-	-	-
Disposals	-	-	-
Balance at 30 June 2016	956	958	958
Accumulated amortisation and impairment losses			
Balance at 1 July 2014	920	920	920
Amortisation expense	36	22	22
Disposals	-	-	-
Balance at 30 June 2015	956	942	942
Balance at 1 July 2015	956	942	942
Amortisation expense	-	12	12
Disposals	-	-	-
Balance at 30 June 2016	956	954	954
Carrying amounts			
At 30 June and 1 July 2015	-	16	16
At 30 June 2016	-	4	4

There are no restrictions over the title of the Ministry's intangible assets, nor are any intangible assets pledged as security for liabilities.

NOTE 9: CREDITORS AND OTHER PAYABLES

Actual 2015 \$000		Main estimates 2016 \$000	Actual 2016 \$000
390	Creditors	945	588
472	Accrued expenses	-	456
149	GST payable	205	709
1,011	Total creditors and other payables	1,150	1,753

Creditors and other payables are non-interest bearing and are normally settled on 30-day terms, therefore the carrying value of creditors and other payables approximates their fair value.

NOTE 10: RETURN OF OPERATING SURPLUS

Actual 2015 \$000		Actual 2016 \$000
46	Net surplus/(deficit)	38
46	Total repayment of surplus	38

The repayment of surplus is required to be paid by 31 October of each year.

NOTE 11: EMPLOYEE ENTITLEMENTS

Actual 2015 \$000		Main estimates 2016 \$000	Actual 2016 \$000
	Current provisions are represented by:		
542	Annual leave	600	562
1	Sick leave	5	16
26	Retirement and long service leave	-	163
569	Total current provision	605	741
	Non-current employee entitlements are represented by:		
344	Retirement and long service leave	300	191
913	Total employee entitlements	905	932

NOTE 12: EQUITY

Actual 2015 \$000		Actual 2016 \$000
	Taxpayers' funds	
3,416	Balance at 1 July	3,416
46	Net surplus/(deficit)	38
-	Capital contribution from the Crown	-
(46)	Provision for repayment of surplus to the Crown	(38)
3,416	Taxpayers' funds at 30 June	3,416

NOTE 13: RELATED PARTY TRANSACTIONS AND KEY MANAGEMENT PERSONNEL

Related party transactions

The Ministry is a wholly-owned entity of the Crown.

All transactions with related parties have been undertaken either:

- within a supplier/client relationship on terms and conditions no more or less favourable than those it is reasonable to expect of the Ministry would have adopted in dealing with the party on an arm's length basis, and/or
- with other government agencies consistent with the usual operating arrangements between the Ministry and those agencies.

Key management personnel compensation

Actual 2015 \$000		Actual 2016 \$000
	Leadership team, including the Chief Executive	
1,618	Remuneration	1,857
6	Full-time equivalent staff	6

Key management personnel include the Chief Executive and the five members (2015 – five) of the Leadership Team.

The above key management personnel compensation excludes the remuneration and other benefits received by the Minister of Defence. The Minister's remuneration and other benefits are not received only for his role as a member of key management personnel of the Ministry. The Minister's remuneration and other benefits are set by the Remuneration Authority under the Civil List Act 1979 and are paid under Permanent Legislative Authority, and not paid by the Ministry of Defence.

NOTE 14: FINANCIAL INSTRUMENTS

The carrying amounts of financial assets and financial liabilities in each of the financial instrument categories are as follows:

Actual 2015 \$000		Actual 2016 \$000
	Loans and receivables	
3,575	Cash and cash equivalents	4,643
406	Debtors and other receivables	-
-	Prepayments	13
3,981	Total loans and receivables	4,656
	Financial liabilities measured at amortised cost	
1,011	Creditors and other payables	1,752

NOTE 15: EXPLANATION OF MAJOR VARIANCES AGAINST BUDGET

The major variances from Actuals to the Main and Supplementary Estimates are as follows:

Revenue Crown

Revenue Crown decreased during the year as some of the costs relating to the implementation of the Enhancements to Defence Capability Development and Acquisition initiative were deferred to 2016/17 along with the related funding.

Other revenue

The Forecast and both Estimates included the budgeted costs of the pre-acquisition stages of three acquisition projects as approved by Cabinet. Actual costs were lower than the Supplementary Estimates as cost assumptions from the original budgets did not eventuate.

Personnel expenses

Personnel expenses are lower than Forecast and both Estimates due to delays in recruiting staff to fill vacancies.

Operating expenses

The increase in operating expenses from the Main to Supplementary Estimates reflects the utilisation of the above personnel variance to fund increased international defence relations activity and other Ministry priorities. The subsequent decrease in Actual costs reflects the reduced pre-acquisition costs as described above.

Cashflow

Variances in cashflows largely reflect the above reasons. Further variances arise from the timing of payment following invoicing as reflected by variances in the debtors and creditors balances.

PART 6: NON-DEPARTMENTAL STATEMENTS AND SCHEDULES

The following non-departmental statements and schedules record the revenue, expenses, assets, liabilities, commitments, contingent liabilities and contingent assets that the Ministry manages on behalf of the Crown.

SCHEDULE OF NON-DEPARTMENTAL REVENUE

For the year ended 30 June 2016

Actual 2015 \$000		Note	Main estimates 2016 \$000	Supp estimates 2016 \$000	Actual 2016 \$000
40,512	Realised foreign exchange gains		-	1,683	869
7,185	Realised gains on derivatives		-	2,414	2,646
20,956	Unrealised gains on derivatives		-	-	-
-	Unrealised foreign exchange gains		-	-	22
495	Interest		-	89	225
69,148	Total non-departmental revenue	4	-	4,186	3,762

SCHEDULE OF NON-DEPARTMENTAL EXPENSES

For the year ended 30 June 2016

Actual 2015 \$000		Main estimates 2016 \$000	Supp estimates 2016 \$000	Actual 2016 \$000
1,180	Realised foreign exchange losses	-	5,276	14,174
126	Realised losses on derivatives	-	518	4,528
131	Unrealised losses on derivatives	-	12,523	3,870
156	Unrealised foreign exchange losses	-	22	-
53,174	GST input expense	11,403	18,736	16,246
54,767	Total non-departmental expenses	11,403	37,075	38,818

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 4. 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 Financial Statements of the Government for the year ended 30 June 2016.

SCHEDULE OF NON-DEPARTMENTAL ASSETS

As at 30 June 2016

Actual 2015 \$000		Note	Main estimates 2016 \$000	Supp estimates 2016 \$000	Actual 2016 \$000
	Current assets				
201,300	Cash and cash equivalents	4	124,512	213,120	235,754
201,723	Receivables from exchange transactions	2,4	126,003	159,824	156,250
17,175	Derivatives in gain		84	96	-
420,198	Total current assets		250,599	373,040	392,004
	Non-current assets				
1,421	Derivatives in gain		-	-	-
1,421	Total non-current assets		-	-	-
421,619	Total non-departmental assets		250,599	373,040	392,004

SCHEDULE OF NON-DEPARTMENTAL LIABILITIES

As at 30 June 2016

Actual 2015 \$000		Note	Main estimates 2016 \$000	Supp estimates 2016 \$000	Actual 2016 \$000
	Current liabilities				
66,024	Creditors and other payables	3	16,435	20,847	41,055
1,953	Derivatives in loss		41	1,302	2,248
67,977	Total current liabilities		16,476	22,149	43,303
	Non-current liabilities				
-	Derivatives in loss		-	225	201
-	Total non-current liabilities		-	225	201
67,977	Total non-departmental liabilities		16,476	22,374	43,504

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 4. 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 Financial Statements of the Government for the year ended 30 June 2016.

SCHEDULE OF NON-DEPARTMENTAL CAPITAL RECEIPTS

For the year ended 30 June 2016

Actual 2015 \$000		Note	Main estimates 2016 \$000	Supp estimates 2016 \$000	Actual 2016 \$000
10,095	ANZAC Frigate Platform Systems Upgrade		7,420	10,873	11,585
135,559	ANZAC Frigate Systems Upgrade		103,740	99,257	103,402
(14)	Boeing 757 Modification		-	-	-
4,532	C-130 Hercules Life Extension		3,276	2,699	1,810
2,230	Defence Command and Control System		7,474	8,582	6,958
-	Individual Weapons Replacement		140	15,002	15,539
128,953	Maritime Helicopter		16,953	29,110	28,675
-	Maritime Sustainment Capability		783	783	204
15,391	Medium-Heavy Operational Vehicles		8,328	4,519	2,950
(870)	Medium Range Anti-Armour Weapon		-	-	-
26,153	Medium Utility Helicopter		4,956	12,258	12,214
32	Network Enabled Army		45,600	20,815	3,507
5,487	P-3K Orion Missions Systems Upgrade		159	1,887	2,168
46,276	Pilot Training Capability		6,243	14,207	13,858
7	Project Protector Vessels		-	1	2
9,181	Protector Remediation		8,343	4,513	4,677
-	Special Operations Vehicles		-	605	217
3,972	Strategic Bearer Network		7,180	5,551	1,351
(55)	Training/Light Utility Helicopter		-	975	3,095
-	Underwater Intelligence, Surveillance and Reconnaissance		200	200	200
-	Portfolio adjustment		2,000	(12,000)	-
386,929	Total non-departmental capital receipts	4	222,795	219,837	212,412

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 4. 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 Financial Statements of the Government for the year ended 30 June 2016.

SCHEDULE OF NON-DEPARTMENTAL CAPITAL EXPENDITURE

For the year ended 30 June 2016

Actual 2015 \$000		Note	Main estimates 2016 \$000	Supp estimate 2016 \$000	Actual 2016 \$000
10,095	ANZAC Frigate Platform Systems Upgrade		7,420	10,873	11,585
135,559	ANZAC Frigate Systems Upgrade		103,740	99,257	103,402
(14)	Boeing 757 Modification		-	-	-
4,532	C-130 Hercules Life Extension		3,276	2,699	1,810
2,230	Defence Command and Control System		7,474	8,582	6,958
-	Individual Weapons Replacement		140	15,002	15,539
128,953	Maritime Helicopter		16,953	29,110	28,675
-	Maritime Sustainment Capability		783	783	204
15,391	Medium-Heavy Operational Vehicles		8,328	4,519	2,950
(870)	Medium Range Anti-Armour Weapon		-	-	-
26,153	Medium Utility Helicopter		4,956	12,258	12,214
32	Network Enabled Army		45,600	20,815	3,507
5,487	P-3K Orion Missions Systems Upgrade		159	1,887	2,168
46,276	Pilot Training Capability		6,243	14,207	13,858
7	Project Protector Vessels		-	1	2
9,181	Protector Remediation		8,343	4,513	4,677
-	Special Operations Vehicles		-	605	217
3,972	Strategic Bearer Network		7,180	5,551	1,351
(55)	Training/Light Utility Helicopter		-	975	3,095
-	Underwater Intelligence, Surveillance and Reconnaissance		200	200	200
-	Portfolio adjustment		2,000	(12,000)	-
386,929	Total non-departmental capital expenditure	4	222,795	219,837	212,412

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 4. 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 Financial Statements of the Government for the year ended 30 June 2016.

SCHEDULE OF NON-DEPARTMENTAL CAPITAL COMMITMENTS

As at 30 June 2016

Actual 2015 \$000		Actual 2016 \$000
	Non-cancellable capital commitments	
179,859	Not later than one year	140,420
120,931	Later than one year and not later than two years	36,234
20,046	Later than two years and not later than five years	4,767
-	Later than five years	-
320,836	Total non-cancellable capital commitments	181,421

SCHEDULE OF NON-DEPARTMENTAL CONTINGENT LIABILITIES AND CONTINGENT ASSETS

As at 30 June 2016

CONTINGENT LIABILITIES

The Ministry on behalf of the Crown has no contingent liabilities (2015 – Nil).

CONTINGENT ASSETS

The Ministry on behalf of the Crown has no contingent assets (2015 – Nil).

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 4. 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 Financial Statements of the Government for the year ended 30 June 2016.

NOTES TO THE NON-DEPARTMENTAL SCHEDULES

NOTE 1: STATEMENT OF ACCOUNTING POLICIES

Reporting entity

These non-departmental statements and schedules present financial information on public funds managed by the Ministry on behalf of the Crown.

These non-departmental balances are consolidated into the Financial Statements of the Government for the year ended 30 June 2016. For a full understanding of the Crown's financial position, results of operations and cash flows for the year, reference should also be made to the Financial Statements of the Government.

Basis of preparation

The non-departmental statements and schedules have been prepared in accordance with the accounting policies of the Financial Statements of the Government, Treasury Instructions, and Treasury Circulars.

Measurement and recognition rules applied in the preparation of these non-departmental statements and schedules are consistent with New Zealand generally accepted accounting practice (Tier 1 Public Sector Public Benefit Entity Accounting Standards) as appropriate for public benefit entities.

Changes in accounting policies

These non-departmental statements and schedules are the first prepared in accordance with the new PBE accounting standards. Apart from some changes in terminology, there were no differences on transition from the NZ IFRS previously used to the PBE accounting standards.

Budget figures

The budget figures ("Main estimates") are those included in the Information Supporting the Estimates of Appropriations for the Government of New Zealand for the year ending 30 June 2015, which are consistent with the financial information in the Main Estimates.

In addition, the financial schedules and statements also present the updated budget information from the Supplementary Estimates ("Supp estimates"). Where applicable, this includes transfers made under section 26A of the Public Finance Act 1989.

The budget figures have been prepared in accordance with NZ GAAP, using accounting policies that are consistent with those adopted in preparing these financial statements.

Significant Accounting Policies

Revenue

Interest income is recognised using the effective interest method.

Foreign currency transactions

Foreign currency transactions (including those for which forward foreign exchange contracts are held) are translated into New Zealand dollars using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the schedule of non-departmental income or expenses.

Goods and Services Tax

All items in the financial statements, including appropriation statements, are stated exclusive of goods and services tax (GST), except for receivables and payables, which are stated on a GST inclusive basis. In accordance with Treasury instructions, GST is returned on revenue received on behalf of the Crown, where applicable. However, an input tax deduction is not claimed on non-departmental expenditure. Instead, the amount of GST applicable to non-departmental expenditure is recognised as a separate expense and eliminated against GST revenue on consolidation of the Financial Statements of the Government.

Receivables from exchange transactions

Short-term debtors and other receivables are recorded at their face value, less any provision for impairment.

Impairment of a receivable is established when there is objective evidence that the Ministry will not be able to collect amounts due according to the original terms of the receivable. Significant financial difficulties of the debtor, probability that the debtor will enter into bankruptcy, receivership or liquidation, and default in payments are considered indicators that the debtor is impaired. The amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted using the original effective interest rate. The carrying amount of the asset is reduced through the use of a provision for impairment account, and the amount of the loss is recognised in the schedule of non-departmental expenses. Overdue receivables that are renegotiated are reclassified as current (that is, not past due).

Derivative financial instruments

The Ministry uses derivative financial instruments to hedge its exposure to foreign exchange movements. In accordance with its Foreign Exchange Management policy, the Ministry does not hold or issue derivative financial instruments for trading purposes. The Ministry has not adopted hedge accounting.

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value at each balance date. Movements in the fair value of derivative financial instruments are recognised in the schedule of non-departmental income or schedule of non-departmental expenses.

The full fair value of a foreign exchange derivative is classified as current if the contract is due for settlement within 12 months of balance date. Otherwise, foreign exchange derivatives are classified as non-current.

Commitments

Expenses yet to be incurred on non-cancellable contracts that have been entered into on or before balance date are disclosed as commitments to the extent that there are equally unperformed obligations.

Cancellable commitments that have penalty or exit costs explicit in the agreement on exercising that option to cancel are included in the statement of commitments at the value of that penalty or exit cost.

Comparative information

Comparatives have been restated where necessary to maintain consistency with current year amounts.

NOTE 2: RECEIVABLES FROM EXCHANGE TRANSACTIONS

Actual 2015 \$000		Actual 2016 \$000
201,723	Debtors	156,250
-	Less provision for impairment	-
201,723	Net debtors	156,250
-	Receivables written off during period	-
201,723	Balance at 30 June	156,250

The carrying value of receivables from exchange transactions approximates their fair value.

	2015			2016		
	Gross \$000	Impairment \$000	Net \$000	Gross \$000	Impairment \$000	Net \$000
Not past due	201,723	-	201,723	156,250	-	156,250
Past due 1-30 days	-	-	-	-	-	-
Past due 31-60 days	-	-	-	-	-	-
Past due 61-90 days	-	-	-	-	-	-
Past due > 91 days	-	-	-	-	-	-
Total	201,723	-	201,723	156,250	-	156,250

NOTE 3: CREDITORS AND OTHER PAYABLES

Actual 2015 \$000		Actual 2016 \$000
65,729	Creditors	41,055
295	Monies received in advance	-
66,024	Total creditors and other payables	41,055

NOTE 4: EXPLANATION OF MAJOR VARIANCES AGAINST BUDGET

The major variances from Actuals to the Main and Supplementary Estimates are as follows:

Non-departmental income and expenses

- **Foreign exchange impact**

The gains or losses from movements in foreign exchange rates are not budgeted.

- **GST input expense**

GST input expense was higher than the Main Estimates due changes in the timing and assessed value of the importation of military equipment into New Zealand.

Non-departmental assets

- **Cash and cash equivalents**

The cash holdings are higher than both Estimates due to the requirement to purchase foreign currency for capital expenditure contracted in 2016/17.

- **Debtors**

The Ministry invoices NZDF on a six-monthly basis for non-departmental capital expenditure. The variance in the year-end debtors balance reflects the timing of project expenditure across the year and the resultant timing of invoicing to NZDF.

Non-departmental liabilities

- **Creditors**

The higher creditors balance at 30 June 2016 from that presented in both Estimates reflects the effect of accrued work in progress by suppliers at year-end plus an increased GST liability resulting from invoicing of capital expenditure to NZDF as described in the debtors section above.

NOTE 5: FINANCIAL INSTRUMENTS

Financial instrument categories

The carrying amounts of financial assets and financial liabilities in each of the financial instrument categories are as follows:

Actual 2015 \$000		Actual 2016 \$000
	Loans and receivables	
201,300	Cash and cash equivalents	235,754
201,723	Debtors and other receivables	156,250
403,023	Total loans and receivables	392,004
	Fair value through profit and loss – designated as such upon initial recognition	
18,596	Derivative financial instrument assets	-
1,953	Derivative financial instrument liabilities	2,449
	Financial liabilities measured at amortised cost	
66,024	Creditors and other payables	41,055

The notional principal amount of outstanding forward exchange contract derivatives at 30 June 2016 is NZD 40.2 million (2015 – NZD 207.0 million). The contracts consist of the purchase of (amounts in foreign currency):

Actual 2015 \$000		Actual 2016 \$000
14,670	Australian dollars	-
37,500	British pounds	1,500
89,300	Canadian dollars	16,000
23,600	Euros	-
87,990	Norwegian krone	-
41,500	Swedish krona	-
50,080	United States dollars	12,161

Fair value hierarchy disclosures

For those instruments recognised at fair value in the statement of financial position, fair values are determined according to the following hierarchy:

- Quoted market price (level 1) – Financial instruments with quoted prices for identical instruments in active markets.
- Valuation technique using observable inputs (level 2) – Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.
- Valuation techniques with significant non-observable inputs (level 3) – Financial instruments valued using models where one or more significant inputs are not observable.

The following table analyses the basis of the valuation of classes of financial instruments measured at fair value in the statement of financial position.

	Total \$000	Valuation technique		
		Quoted market price \$000	Observable inputs \$000	Significant non- observable inputs \$000
2015				
Financial assets				
Foreign exchange derivatives	18,596	-	18,596	-
Financial liabilities				
Foreign exchange derivatives	1,953	-	1,953	-
2016				
Financial assets				
Foreign exchange derivatives	-	-	-	-
Financial liabilities				
Foreign exchange derivatives	2,449	-	2,449	-

There were no transfers between the different levels of the fair value hierarchy.

Financial instrument risks

The Ministry's activities expose it to a variety of financial instrument risks, including market risk, credit risk and liquidity risk. The Ministry has a series of policies to manage the risks associated with financial instruments and seeks to minimise exposure from financial instruments. These policies do not allow any transactions that are speculative in nature to be entered into.

Market risk

Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The Ministry purchases capital equipment internationally and is exposed to currency risk arising from various currency exposures, primarily with respect to the United States, Canadian and Australian dollars, British pounds and Euro. Currency risk arises from future capital purchases and recognised liabilities, which are denominated in a foreign currency.

The Ministry's Foreign Exchange Management Policy requires the Ministry to manage currency risk arising from future transactions and recognised liabilities by entering into foreign exchange forward contracts to hedge the entire foreign currency risk exposure. The Ministry's policy has been approved by the Treasury and is in accordance with the requirements of the Treasury Guidelines for the Management of Crown and Departmental Foreign Exchange Exposure.

Interest rate risk

Interest rate risk is the risk that the fair value of a financial instrument will fluctuate, or the cash flows from a financial instrument will fluctuate, due to changes in market interest rates.

The Ministry has no exposure to interest rate risk because it has no interest-bearing financial instruments.

Credit risk

Credit risk is the risk that a third party will default on its obligation to the Ministry, causing the Ministry to incur a loss. In the normal course of its business, credit risk arises from debtors, deposits with banks and derivative financial instrument assets.

The Ministry is only permitted to deposit funds and enter into foreign exchange forward contracts with approved counterparties. These entities have high credit ratings. For its other financial instruments, the Ministry does not have significant concentrations of credit risk.

The Ministry's maximum credit exposure for each class of financial instrument is represented by the total carrying amount of cash and cash equivalents, net debtors (note 2), and derivative financial instrument assets. There is no collateral held as security against these financial instruments, including those instruments that are overdue or impaired.

Liquidity risk

Liquidity risk is the risk that the Ministry will encounter difficulty raising liquid funds to meet commitments as they fall due.

In meeting its liquidity requirements, the Ministry closely monitors its forecast cash requirements with expected cash draw downs from the New Zealand Debt Management Office. The Ministry maintains a target level of available cash to meet liquidity requirements.

The table below analyses the Ministry's financial assets and liabilities into relevant maturity groupings based on the remaining period at balance date to the contractual maturity date. The amounts disclosed are the contractual undiscounted cash flows.

At 30 June 2016	Less than 6 months \$000	6-12 months \$000	1-5 years \$000	Over 5 years \$000	Total \$000
Assets					
Current assets					
Cash and cash equivalents	235,754	-	-	-	235,754
Debtors and other receivables	156,250	-	-	-	156,250
Derivative financial instruments	-	-	-	-	-
Total current assets	392,004	-	-	-	392,004
Non-current assets					
Derivative financial instruments	-	-	-	-	-
Total non-current assets	392,004	-	-	-	392,004
Total assets					
Liabilities					
Current liabilities					
Creditors and other payables	41,055	-	-	-	41,055
Derivative financial instruments	-	2,589	-	-	2,589
Total current liabilities	41,055	2,589	-	-	43,644
Non-current liabilities					
Derivative financial instruments	-	-	288	-	288
Total non-current liabilities	-	-	288	-	288
Total liabilities	41,055	2,589	288	-	43,932
Net liquidity of continuing operations	350,949	(2,589)	(288)	-	348,072

At 30 June 2015	Less than 6 months \$000	6-12 months \$000	1-5 years \$000	Over 5 years \$000	Total \$000
Assets					
Current assets					
Cash and cash equivalents	201,300	-	-	-	201,300
Debtors and other receivables	201,723	-	-	-	201,723
Derivative financial instruments	6,746	8,266	-	-	15,012
Total current assets	409,769	8,266	-	-	418,035
Non-current assets					
Derivative financial instruments	-	-	565	(22)	543
Total non-current assets	-	-	565	(22)	543
Total assets	409,769	8,266	565	(22)	418,578
Liabilities					
Current liabilities					
Creditors and other payables	52,273	-	-	-	52,273
Derivative financial instruments	870	1,856	-	-	2,726
Total current liabilities	53,143	1,856	-	-	54,999
Non-current liabilities					
Derivative financial instruments	-	-	-	-	-
Total non-current liabilities	-	-	-	-	-
Total liabilities	53,143	1,856	-	-	54,999
Net liquidity of continuing operations	356,626	6,410	565	(22)	363,579

Contractual maturity analysis of derivative financial instrument liabilities

The table below analyses the Ministry's forward exchange contract derivatives into relevant maturity groupings based on the remaining period at balance date to the contractual maturity date. The amounts disclosed are the contractual undiscounted cash flows.

	Liability carrying amount \$000	Asset carrying amount \$000	Contractual cash flows NZ \$000	Less than 6 months NZ \$000	6-12 months NZ 000	1-2 years NZ \$000	2-5 years NZ \$000
Gross settled forward foreign exchange contracts:							
2015	1,953	18,596					
- outflow			206,922	67,494	117,601	18,496	3,331
- inflow			219,749	73,369	124,011	19,060	3,309
2016	2,449	-					
- outflow			40,208	18,381	18,496	3,331	-
- inflow			37,332	17,108	17,181	3,043	-

Sensitivity analysis

The table below shows the net effect on the reported gains and losses from movements in exchange rates and derivative values if the New Zealand dollar had been either 5% stronger or weaker at balance date.

	2015			2016		
	Cash and cash equivalents \$000	Derivatives \$000	Net gain/(loss) \$000	Cash and cash equivalents \$000	Derivatives \$000	Net gain/(loss) \$000
Effect on surplus if NZ dollar strengthened by 5%						
AUD	(254)	(429)	(683)	(198)	-	(198)
CAD	(1,649)	(3,469)	(5,118)	(2,030)	(828)	(2,858)
EUR	(1,008)	(1,055)	(2,063)	(956)	-	(956)
GBP	(660)	(3,000)	(3,660)	(1,788)	(135)	(1,923)
NOK	(58)	(198)	(256)	(10)	-	(10)
SEK	(1)	(216)	(217)	(11)	-	(11)
USD	(2,035)	(1,937)	(3,972)	(1,301)	(815)	(2,116)
Total	(5,665)	(10,304)	(15,969)	(6,294)	(1,778)	(8,072)
Effect on surplus if NZ dollar weakened by 5%						
AUD	281	474	755	219	-	219
CAD	1,822	3,835	5,657	2,244	915	3,159
EUR	1,114	1,167	2,281	1,057	-	1,057
GBP	729	3,316	4,045	1,976	149	2,125
NOK	64	219	283	11	-	11
SEK	1	238	239	13	-	13
USD	2,249	2,141	4,390	1,438	900	2,338
Total	6,260	11,390	17,650	6,958	1,964	8,922

