

Annual Report

for the year ended 30 June 2003

*Presented to the House of Representatives
Pursuant to section 39 of the Public Finance Act 1989*



MINISTRY OF
DEFENCE

MANATU KAUPAPA WAONGA

Acts Administered

The Ministry of Defence administers the Defence Act 1990.

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Part 1 : Overview



Secretary of Defence's overview

Introduction

The roles of the Ministry of Defence, which are founded on section 24 of the Defence Act 1990, are to:

- provide timely high-quality advice to help the Government make well-informed decisions about the defence of New Zealand and its interests
- conduct audits and assessments of the New Zealand Defence Force and the acquisition activities of the Ministry of Defence
- arrange for the acquisition of significant items of military equipment needed to meet New Zealand Defence Force capability requirements.

The Ministry's *Statement of Intent* reflects these roles. The high-level outcome is: **a secure New Zealand that contributes to international security.**

This high-level outcome, which is shared with other key government agencies, is based on a simple aphorism: security underpins all the Government's social and economic goals. New Zealand's present and future prosperity is predicated on a peaceful and stable international and regional environment. Without international and regional peace and stability, New Zealand cannot derive maximum benefit from relations with other countries.

The Ministry's performance in progressing the high-level outcome is measured against an intermediate outcome: **Ministry of Defence advice and action are credible and respected, and the Government's defence policy objectives are achieved.**

The Ministry contributes to this outcome in a number of ways. In concert with the New Zealand Defence Force and other key government agencies, the Ministry actively contributes to and promotes New Zealand's security and defence interests. We participate in global and regional efforts to reduce security risks and confront challenges to peace and stability.

Participating in this process is not enough. The Ministry's key objective is to advance the specific outcomes sought by the Government, currently expressed in the defence policy objectives.

The Government's defence policy objectives are set out in *The Government's Defence Policy Framework* (June 2000) and the *Government Defence Statement – A Modern, Sustainable Defence Force Matched to New Zealand's Needs* (8 May 2001). The objectives also formed the basis for the *2002 Defence Long-term Development Plan*

(*LTDP*) that was updated in June 2003. This is a planning tool to enable decisions on defence capability acquisitions to be taken over the next ten years.

The Ministry is an integral part of New Zealand's national security architecture. Defence policy has a solid empirical basis. As defence policy-makers we seek to comprehend the risks and challenges in our strategic environment and how they affect New Zealand's defence and security interests. The unpredictable world in which New Zealand pursues its interests complicates this responsibility.

While New Zealand may not face a direct military threat from another country in the foreseeable future, our interests continue to face a wide range of security challenges. Not all of these challenges are of a military nature. The terrorist attacks on 11 September 2001, the Bali bombings on 12 October 2002, and the outbreak of Severe Acute Respiratory Syndrome (SARS) earlier this year confirm this constant judgment. Such unexpected events serve to remind us that geographical distance does not by itself offer absolute protection; does not absolve us from maintaining defence forces that are fully trained for all contingencies, including combat; and does require us to be actively engaged in shaping and influencing attitudes and policies in our region and elsewhere.

The deployment of competent New Zealand Defence Force personnel to various trouble spots around the world is the most tangible sign of New Zealand's commitment to international peace and security. In the past year, New Zealand Defence Force elements have been deployed to Afghanistan, the Arabian Sea, and the Gulf of Oman in the fight against terrorism. The proposed New Zealand Defence Force deployment to Iraq will assist post-war reconstruction and rehabilitation efforts. More than 100 New Zealand Defence Force personnel will take part in the Regional Assistance Mission in Solomon Islands. The longer-term policy challenge for the Ministry is to maintain our focus on existing and emerging security threats including terrorism, transnational crime, illegal movement of people and goods, and civil instability; identifying New Zealand interests; and formulating appropriate and realistic response options.

The Ministry's ability to respond effectively to meet these new challenges depends on two principal factors: our proficiency at working more closely with other New Zealand agencies and with governments in the region; and the New Zealand Defence Force's capacity to undertake a variety of operations. The Ministry attaches great importance to building greater inter-agency coordination in New Zealand on defence and wider security issues; to supporting a whole-of-government approach to security issues; and to ensuring effective engagement with our neighbours in the Asia-Pacific region. A key aim is to enhance the capabilities of the New Zealand Defence Force across all three services to undertake a range of combat and peace support operations, through the implementation of the *Long-term Development Plan*. This will improve the ability of the New Zealand Defence Force both to defend New Zealand's interests and to contribute effectively to international and regional peace and security.

Policy and Planning

The Secretary of Defence is the principal civilian advisor on defence matters to the Minister of Defence and to the Government. The Chief of Defence Force, who commands the New Zealand Defence Force, is the principal military advisor. The two advisory roles are complementary. There is considerable overlap on defence, security and New Zealand Defence Force capability issues and this requires close cooperation and consultation between the Ministry and the New Zealand Defence Force. This coordination takes place on a regular basis through the Office of Chief Executives, which brings the Secretary of Defence and the Chief of Defence Force together to discuss policy issues of mutual interest, and on the Executive Governance Boards, which oversee major capital acquisition projects.

Another important point of consultation and on-going cooperation between the two defence organisations is the Defence Policy and Planning Unit. The Unit is a seamless Ministry and New Zealand Defence Force policy unit. Its principal role is to provide a single stream of information and policy advice to the Chief of Defence Force and to the Secretary of Defence, and through them to the Minister of Defence and the Government. The Defence Policy and Planning Unit consists of the International Defence Relations Branch and the Strategic Policy Branch and is staffed by personnel from both organisations.

Implementing the Government's defence policy

In the past year, a major focus of the Defence Policy and Planning Unit's work programme, particularly for the Strategic Policy Branch, has been the implementation of the *Government Defence Statement*. The Statement sets out the Government's priorities for rebuilding the New Zealand Defence Force as being:

- a joint approach, structure and operational orientation
- a modernised Army
- a practical Navy fleet matched to New Zealand's wider security needs
- a refocused and updated Air Force
- a funding commitment to provide financial certainty.

The implementation of the Statement has involved a number of reviews – both policy and capability – and updating the *Long-term Development Plan* in June 2003.

Capability development

In the last twelve months, the Defence Policy and Planning Unit has concentrated on a range of capability development work including:

Fixed Wing Transport Review

In November 2002 the Ministry and the New Zealand Defence Force completed the Fixed Wing Transport Review. Prepared in consultation with relevant government agencies, this review considered the policy and capability requirements for the Royal New Zealand Air Force's fixed wing transport fleet (i.e. the C-130 Hercules aircraft and the Boeing 727 transport aircraft). Following the completion of the review, in December 2002 the Government agreed to the life extension of the C-130 Hercules aircraft and the acquisition of two second-hand Boeing 757-200 aircraft to replace the Boeing 727 aircraft.

P-3 Orion Upgrade

The Ministry and the New Zealand Defence Force, in consultation with other government agencies, completed in November 2002 a significant investigation into the P-3 Orion aerial patrol capabilities to meet both civilian and military needs. As a result, the Government agreed in December 2002 that the P-3 Orion mission systems and communication and navigation systems should be upgraded.

Special Operations Capability Review

A review has developed the policy requirements for Special Operations against the Government's defence and security policies and, from this analysis, derived the required military capabilities to undertake such operations. The Government is considering the review's key findings.

Hydrography Review

A review of the hydrographic survey capability was one of the initiatives announced in the *Government Defence Statement*. An independent consultant, Mr Ross Tanner, was commissioned to undertake the review and government and non-government agencies were consulted as part of the review process. The purpose of the review was to provide advice on the need for the Government to retain ownership of such a capability and, if so, whether Navy was the most appropriate provider. The review examined the present funding-provider arrangement between the New Zealand Defence Force and Land Information New Zealand. The Government is considering the review's recommendations.

The Capability Management Framework

A key development in the past year has been the formulation of a Capability Management Framework, a joint project of the Ministry and the New Zealand Defence Force. The Capability Management Framework is a process of management and governance for defence capability work that will replace the inadequate existing Defence Planning

System. When completed, the Framework will incorporate management systems for both operational and financial risks, to ensure that long-term investments in defence capabilities provide the best value for money and are matched to New Zealand's defence needs. In adopting the Framework, the Ministry and the New Zealand Defence Force are demonstrating a serious commitment to a transparent and accountable process for defence acquisitions. The Capability Management Framework will help ensure that the capabilities acquired by the New Zealand Defence Force are consistent with the Government's defence policy as well as being affordable and sustainable.

Long-term Development Plan update June 2003

First released on 11 June 2002, the *Long-term Development Plan* is a planning tool to enable decisions on defence acquisitions to be assessed, prioritised and measured in the context of current defence policy and affordability. The Plan links defence policy objectives with capability requirements in the *Government Defence Statement* and contains a comprehensive list of major projects (projects over \$7 million), with preliminary costings, timings, and priorities.

In June 2003 the *Long-term Development Plan* was reviewed and updated to reflect progress made over the last twelve months implementing the defence acquisitions programme. The Government has endorsed action on a number of projects including:

- P-3 Orion Mission Systems Upgrade
- C-130 Hercules Life Extension
- P-3 Orion Communications and Navigation Systems Upgrade
- C-130 Hercules Communications and Navigation Systems Upgrade
- Boeing 727 Replacement
- Direct Fire Support Weapon – Area (automatic grenade launchers)
- Medium Range Anti-Armour Weapon (Javelin missiles).

The projects to reconstruct Whenuapai's runway surface and hard standing area have been removed from the *Long-term Development Plan* in accordance with the Government's decision to consolidate Royal New Zealand Air Force operations at Ohakea. The Ohakea runway project has now been completed. While no projects have been reprioritised, there have been some changes to the range of project costs in the *Long-term Development Plan* update.

The Government has directed that the *Long-term Development Plan* be managed within three financial parameters, which are:

- up to \$1 billion, in nominal terms, in capital injections over the next 10 years, which, with retained depreciation, will provide at least \$2 billion in total for new acquisitions

- any inflationary pressure to be managed within these constraints until 2005/06
- leasing options may be considered where there is a neutral trade-off between capital and operating expenditure.

The Government has also decided that one *Long-term Development Plan* funding parameter agreed in 2002, that “current operating baselines set to 2005/06 with adjustments for unfunded depreciation thereafter”, should no longer apply. Consequently, this funding parameter has been removed in the *Long-term Development Plan* update.

The funding in the *Long-term Development Plan* incorporates Government commitments including new capital injections. It is over and above the money already spent (nearly \$1 billion) on re-equipping the New Zealand Defence Force through the acquisition of the light armoured vehicles, Seasprite helicopters, and new Army radios.

The *Long-term Development Plan* does not give Defence authority to proceed with any of the projects set out in the Plan. Every project will be brought forward for approval and will be judged in the context of the Government’s defence policy, the priority of that project in terms of the *Long-term Development Plan*, and the affordability of that project within the overall context of the *Long-term Development Plan*.

Developing appropriate business plans and implementation of the *Long-term Development Plan* will continue to comprise an important part of the Defence Policy and Planning Unit’s work in the coming year. This will include work on projects such as the New Zealand Defence Force helicopter capability and Special Operations capability.

The *Long-term Development Plan* will be reviewed and updated on a regular basis. This will particularly be the case with the availability of new and more accurate information and whenever there is a significant change in the Government’s financial circumstances, a change in policy, or a revaluation of the New Zealand Defence Force’s assets.

Policy development

Pacific Review

In response to a wider review of New Zealand’s relations with the Pacific region, the Defence Policy and Planning Unit has updated a whole-of-government review of Defence engagement in the Pacific. The review, entitled *New Zealand and the Pacific Islands: Security Through Partnership*, examined the four main aspects of New Zealand’s defence and security engagement with the Pacific: strategic policy; New Zealand Defence Force capabilities; New Zealand’s engagement with regional disciplined forces; and maritime patrol. The review found that New Zealand’s current engagement with the Pacific on defence and security issues is aligned with Government defence policy and the strategic elements of the Ministry of Foreign Affairs and Trade’s *Pacific Policy Review 2001*. The review recommends that New Zealand should enhance

its defence and security engagement in partnership with Pacific Island governments in a number of areas, particularly in terms of interdepartmental coordination and the establishment of a targeted regional law and order enforcement programme.

Arms control and disarmament, Antarctica and oceans policy

The Unit has also been involved in policy development on a range of issues with other agencies. Arms control and disarmament continues to be of interest to Defence and the Defence Policy and Planning Unit worked with Ministry of Foreign Affairs and Trade on the issues of small arms and the Certain Conventional Weapons Convention. The Defence Policy and Planning Unit participated in Officials' Antarctic Committee meetings, hosted by Ministry of Foreign Affairs and Trade, and contributed to the development of the new strategic interests statement and fishing policy for the Southern Ocean and Ross Sea. The Ministry has also been involved in the inter-agency Oceans Policy process.

International Defence Relations

A stable and peaceful Asia-Pacific region is central to New Zealand's interests. Since 11 September 2001 and the Bali bombings in October 2002, terrorism has emerged as a major security problem in the region. The Bali bombings sharpened awareness both in New Zealand and in the Pacific region that our interests and citizens may not be immune from such attacks. Terrorist networks thrive in communities under stress from civil instability and divided by religious, ethnic and political differences. In cooperation with our security partners, the difficult challenge for New Zealand defence policy and the New Zealand Defence Force is to help prevent those conditions that allow terrorist networks to prosper.

In our Pacific neighbourhood, a recurring pattern of social, economic and political disorder has continued, particularly in Melanesia. The political and security crises in Fiji and Solomon Islands in 2000 obliged countries in the region to re-evaluate existing policy settings and engagement strategies. The breakdown of law and order in Solomon Islands over the past five years undermined its viability as a functioning nation-state. Development prospects in some Pacific Island countries, particularly Papua New Guinea and Vanuatu, continue to be hindered by ethnic tensions, widening socio-economic disparities, pervasive corruption, problems of governance, susceptibility to transnational crime, tribal differences based on land grievances and urban drift, and under performing economies.

New Zealand is a strong supporter of regional efforts to enhance stability and security in Southeast Asia. The Association of Southeast Asian Nations (ASEAN) Regional Forum, with its broad membership, provides opportunities for New Zealand to work with other Asia-Pacific countries in promoting regional security. New Zealand is committed to the Five Power Defence Arrangements. This provides a major point of

defence contact with Singapore and Malaysia, and underlines New Zealand's contribution to confidence building and diplomacy in the region. The United Nations Mission of Support in East Timor (now known as Timor-Leste), and its predecessor missions, to which New Zealand made a meaningful and long-standing troop contribution, is one of the most successful operations of its type.

New Zealand is committed to playing an active role in the maintenance of international peace and stability. The deployment of New Zealand Defence Force personnel in support of multilateral peacekeeping and peace support missions reinforces New Zealand's wider commitment to collective security and our credentials as a good international citizen. Participation in such missions complements and strengthens New Zealand's profile in areas of considerable international tension. It also strengthens our voice in calling for widespread participation in missions of importance to us in the Asia-Pacific region. Our contributions in support of the fight against terrorism demonstrate New Zealand's preparedness to uphold the principles of international law and collective responsibility.

For a defence force of our size, New Zealand has maintained a high level of commitment to the campaign against terrorism, through the deployment of ground, naval and air assets in Afghanistan and the Gulf of Oman. The deployment of a P-3 Orion maritime surveillance aircraft to the Gulf of Oman has been a significant deployment over a sustained period of time. Following the direct employment of combat assets in 2002, we are currently preparing for further contributions to Afghanistan, including leading a Provincial Reconstruction Team and training the Afghan National Army.

New Zealand has been closely monitoring developments in the Middle East. New Zealand has significant interests in the stability of this region. We are heavily dependent on the Middle East for oil supplies and the region contains some valuable markets for New Zealand producers. New Zealand provides considerable support to peace and security in the region contributing more than thirty New Zealand Defence Force personnel to United Nations peace support missions in Egypt, Israel, Jordan and Syria. We will be involved in the post-conflict rebuilding of Iraq. New Zealand has also welcomed renewed efforts to resolve the Israeli-Palestinian conflict with the release of the United States, Europe, United Nations and Russian "road map" to peace by 2005. It remains to be seen, however, whether or not the roadblocks to a final Israeli-Palestinian settlement can be overcome. The May terrorist attacks on western compounds in Saudi Arabia are a salient reminder that the Middle East will remain a fractured region for some time to come.

Closer defence relations with Australia

Australia is New Zealand's closest defence partner. This partnership is based on mutual interests and a long association of defence cooperation dating back to the Boer War and to the Gallipoli landings. A close defence relationship with Australia in support of

common interests for a secure and peaceful region is a key policy objective in *The Government's Defence Policy Framework*. Both countries share a strong commitment to the security and stability of the Asia-Pacific region as reflected in our combined efforts in Bougainville, and East Timor.

Regular meetings take place at several levels, the most important being the annual meeting of Defence Ministers and the concurrent meeting of Secretaries of Defence and Chiefs of Defence Force. At this year's meeting in Canberra, coinciding with the 20th Anniversary of Closer Economic Relations, Defence Ministers adopted a revised Closer Defence Relations Statement. This update involved the simplification and reduction of the eleven Closer Defence Relations Outcomes to five. The revised statement recalls the historic, longstanding and close links between our people and Defence Forces, and points to the future by:

- acknowledging that we are sovereign countries working together for our mutual security
- emphasising the need for our Defence Forces to be interoperable so that they can work together effectively, particularly in pursuit of shared strategic interests within our immediate region
- acknowledging our responsibility to support the principles of the United Nations Charter
- setting out the principles which guide the defence relationship
- defining the practical outcomes we seek.

Ministers also noted good progress in other areas of collaboration including: training opportunities and exchanges; enhancement of command and control of joint and combined operations between the Australian and New Zealand Defence Forces; complementary patrol capabilities; intelligence, surveillance and reconnaissance in the Pacific; complementarity of Army equipment; learning from each other on capability issues such as Australia's P-3 Orion systems upgrade and New Zealand's C-130 Hercules life of type study; and sharing information on rotary wing requirements.

Pacific

New Zealand has very close links with the Pacific, especially Polynesia. The Pacific region is a part of our heritage. The combination of history, geographic proximity, community links, commercial interests, and humanitarian concern means that the region will remain a central part of our security and defence policy. New Zealand shares many security interests with the Pacific Islands. They comprise a wide range of responsibilities and, more recently, the need to address an emergent range of risks such as illegal movement of people and goods, international terrorism and other transnational security threats.

One of New Zealand's primary mechanisms for defence engagement with the Pacific is the Mutual Assistance Programme. The main objective of the Mutual Assistance Programme is to assist Pacific disciplined forces with law and order issues and emerging security challenges – “security through partnership”. The New Zealand Defence Force has Mutual Assistance Programme activities with Papua New Guinea, Vanuatu, Solomon Islands, Tonga, Samoa, and Cook Islands. Some of the major developments over the last twelve months in terms of New Zealand's defence relations with the Pacific include the following:

Papua New Guinea

New Zealand's defence assistance to Papua New Guinea has been limited while the Papua New Guinea Defence Force works through issues relating to retrenchment and reform processes and funding. This aside, there has been a reinvigoration of the bilateral defence relationship. New Zealand Defence Force Mutual Assistance Programme talks with the Papua New Guinea Defence Force were held in Port Moresby in April 2003, the first such talks for more than three years. A New Zealand Defence Force officer participated in a peacekeeping seminar hosted by the Papua New Guinea Defence Force in Port Moresby in March 2003. This might be an area in which the New Zealand Defence Force could provide future assistance. A New Zealand Defence Force officer, who had been seconded to the Papua New Guinea Defence Force for the last four years to assist them in the area of commercialism, completed his posting. The New Zealand Defence Force is looking at other ways to support the Papua New Guinea Defence Force in this area.

The New Zealand Defence Force's direct participation in the efforts to bring peace to Bougainville ended officially with the withdrawal of the Peace Monitoring Group on 30 June 2003. New Zealand's involvement in the peace process dates back to peace talks on HMNZS *Endeavour* in 1990. The establishment of the Bougainville Transition Team, a civilian team made up of personnel from the Peace Monitoring Group contributing countries, is intended to assist the people of Bougainville so they can assume greater control of the peace process and the transition to autonomous government.

Solomon Islands

A continued decline in respect for the rule of law in Solomon Islands and the inability of the Royal Solomon Islands Police to reform itself into an effective and trusted force have been a source of growing concern over the last twelve months. New Zealand and Australia have consulted closely about responses and the New Zealand Defence Force will deploy 105 personnel, including a detachment of four Iroquois helicopters, to Solomon Islands as part of the Regional Assistance Mission. Army engineers successfully completed Exercise Tropic Twilight in Western Province, which involved the conduct of civil aid tasks in support of NZAID objectives. New Zealand Defence

Force personnel also participated in Operation Tardis, an NZAID-Mutual Assistance Programme jointly funded mission involving the construction of community police posts in Honiara.

Fiji

Although the sanctions imposed by New Zealand against Fiji following the events of May 2000 have been lifted, bilateral defence cooperation has not resumed. The New Zealand Defence Force continued to provide a limited amount of funding and training support for Republic of Fiji Military Forces and ni-Vanuatu personnel who were deployed to Bougainville as part of the Peace Monitoring Group. A Republic of Fiji Military Forces company also served with our battalion in East Timor.

Southeast Asia

The campaign against terrorism in Southeast Asian countries assumed new urgency in the aftermath of the Bali bombings. Indonesia, Malaysia, Singapore and the Philippines have taken a number of steps to reduce the scope and capability of militant groups willing to undertake large-scale terrorist attacks on targets associated with the West. It would be a mistake to assume, however, that our Southeast Asian neighbours have the capacity or the resources to eliminate totally such terrorist networks. Regional cooperation on counter-terrorism is, therefore, crucial in the fight against regional militant groups. The region's economic well being depends on combating this threat and dealing with other risks to development arising from such issues as Severe Acute Respiratory Syndrome (SARS), ethnic and religious intolerance, corruption, and transnational crime.

With this in mind, New Zealand maintains important bilateral and multilateral defence and security relationships in Southeast Asia.

Five Power Defence Arrangements

The Five Power Defence Arrangements continue to make an important contribution to regional security by enhancing defence cooperation among its members: Singapore, Malaysia, Australia, New Zealand and the United Kingdom. New Zealand is involved in Five Power Defence Arrangements activities, especially through the New Zealand Defence Force's regular participation in Five Power Defence Arrangements exercises. In June, the Minister of Defence, Hon Mark Burton, attended the Formal Ministers' Meeting in Malaysia. New Zealand supported organisational changes to the Five Power Defence Arrangements such as the establishment of the joint headquarters, mechanisms for policy development, and arrangements for more effective integration of activities. We also support the continued evolution of the Five Power Defence Arrangements including the June 2003 agreement between the Five Power Defence Arrangements Defence Ministers that consideration should be given to future Five Power Defence Arrangements activities incorporating non-conventional threats such as terrorism and piracy.

ASEAN Regional Forum

New Zealand is committed to the Association of Southeast Asian Nations (ASEAN) Regional Forum process. The ASEAN Regional Forum is the only pan-regional forum devoted to discussing security issues. Contrary to some predictions, the ASEAN Regional Forum has developed into a valuable forum and it is looking to enhance its role in regional security dialogue. New Zealand supports this initiative and the role of the ASEAN Regional Forum in regional counter-terrorism efforts. New Zealand led the development of the electronic register for ASEAN Regional Forum confidence building measures, which is now operational. New Zealand also supported efforts to enhance defence participation in the ASEAN Regional Forum process, which is now gathering momentum. With Laos, New Zealand co-hosted the two most recent Inter-Sessional Group meetings on confidence building measures in Wellington in November 2002 and Vientiane in March 2003. New Zealand defence officials participated in these meetings as well as the Senior Officials' Meeting in Cambodia in April 2003 and the ASEAN Regional Forum Ministerial Meeting held in Cambodia in June 2003.

Singapore

New Zealand has an active and close defence partnership with Singapore. The Minister of Defence, Hon Mark Burton, met his Singaporean counterpart, Dr Tan, in June 2003 at the 2nd International Institute of International Affairs Asia Security Conference in Singapore and then at the Five Power Defence Arrangements Formal Defence Ministers' Meeting in Penang, Malaysia. He also met Singapore's incoming Minister for Defence, Rear Admiral Teo. Senior meetings reinforce the extensive range of defence cooperation both bilaterally, through regular exercises, training, and exchanges, and multilaterally, through groups such as the Five Power Defence Arrangements and ASEAN Regional Forum.

Malaysia

New Zealand values its close bilateral defence relationship with Malaysia. As with Singapore, we welcome opportunities to cooperate bilaterally through meetings, exercises, and exchanges, and in multilateral cooperation through the Five Power Defence Arrangements and ASEAN Regional Forum. The Minister of Defence, Hon Mark Burton, met his Malaysian counterpart, Minister Najib, in June 2003 at the 2nd International Institute of International Affairs Asia Security Conference in Singapore, and then at the Five Power Defence Arrangements Formal Defence Ministers' meeting in Penang.

Thailand

New Zealand has good defence relations with Thailand. In East Timor both countries worked closely together. Thailand assumed responsibility for our area of operations in East Timor when the New Zealand contingent withdrew in November 2002. In addition

to peacekeeping, we have an active bilateral training programme facilitated by the New Zealand Defence Force's Mutual Assistance Programme. The Minister of Defence, Hon Mark Burton, made his first bilateral visit to Thailand in June this year, where he received a very warm welcome from his Thai counterpart, General Thammarat. As a result of this visit, consideration is being given to closer cooperation in areas such as preparation for participation in, and lessons learned from, peace support operations.

East Timor

Despite the withdrawal of the New Zealand battalion group and Iroquois helicopters in November 2002, New Zealand continues to make an important military contribution to the newly independent nation of East Timor. At present, the New Zealand Defence Force contributes approximately 26 personnel to East Timor. Most of these personnel are involved in providing training and advisory support to the nascent East Timor Defence Force. This assistance will be the focus of any ongoing military commitment New Zealand makes to East Timor. A small number of staff officers and military observers are also attached to the peacekeeping force. This contingent is scheduled to be withdrawn by June 2004.

Other Southeast Asian Nations

New Zealand maintains limited, but positive defence relations with Brunei and the Philippines. The basis of this defence cooperation is the New Zealand Defence Force's Mutual Assistance Programme. New Zealand remains committed to the demining process in Cambodia, where New Zealand Defence Force Technical Advisors are deployed. The New Zealand Defence Force's commitment to the demining programme in Laos ended in June 2003. New Zealand's most recent defence relationship in the region is with Vietnam. The New Zealand Defence Attaché based in Bangkok was cross-accredited to Hanoi in 2001. This cross-accreditation has enabled New Zealand to establish good contacts with the Vietnamese defence authorities.

North Asia

The key development in the strategic environment in North Asia over the last twelve months has been heightened tensions on the Korean Peninsula. The situation on the Peninsula has brought together many aspects of the complex North Asia security environment. These include North Korea's claim in October 2002 that it has reactivated its nuclear programme, the United States military presence in Asia, an evolving Sino-American relationship, and Japan's increasing regional security engagement. New Zealand has a role in supporting diplomatic efforts towards resolution of current security problems on the Peninsula, and through supporting United Nations Command activities.

While China opposed the United States-led invasion of Iraq, this issue has not upset the evident warming of Sino-American relations since 11 September 2001. China has

supported the United States in its anti-terrorist campaign, sharing intelligence information on potential militant groups and giving tacit acquiescence to the basing of United States military forces in Central Asian countries close to Chinese borders. Symbolising the positive shift in Sino-American relations has been the growing personal linkages at the highest political level. In October 2002, then President Jiang Zemin visited President George W. Bush, the third such summit inside twelve months.

On the economic side, the Severe Acute Respiratory Syndrome (SARS) outbreak spiked North Asia's recovery from the economic crisis of 1997. A number of countries were directly affected, while the economic consequences spread rapidly through the region. Combined with the effects of 11 September 2001 and the conflict in Iraq, SARS affected tourist numbers and delayed foreign direct investment in the region. There are now signs of recovery in most countries in the region, particularly in China.

North Asia will continue to be an important region of security and defence engagement for New Zealand. North Asia is a primary destination for New Zealand products and is worth over \$7.6 billion for New Zealand exporters. (Source: Statistics New Zealand.) Japan, China, the Republic of Korea, and Taiwan are all ranked in New Zealand's top 10 bilateral trading partners. North Asia is, therefore, a region where strategic realities, uncertainties and market opportunities combine to compel a strategy of greater engagement.

China

Relations between New Zealand and China have never been closer. This is reflected in the degree of trust and familiarity that is now developing between the defence forces of New Zealand and China. Last year the frigate HMNZS *Te Kaha* visited Shanghai. The Chief of Defence Force plans to visit China later this year. General Guo Boxiong, Vice Chairman of the Central Military Commission, and Vice President of the Academy of Military Science, Lieutenant General Xu Genchu, plan to make separate visits to New Zealand shortly. Two People's Liberation Army officers are currently studying at different military educational institutions in New Zealand. New Zealand Defence Force officers continue to gain great benefit from attendance at the excellent international security seminars hosted by the People's Liberation Army National Defence University. The New Zealand Defence Force Command and Staff College senior course visited China last year. In a new development, in July 2002 the Ministry hosted a council member of the Red Cross Society of China and two People's Liberation Army officers to exchange information on the dissemination of the Law of Armed Conflict information. New Zealand also hopes to cooperate more in other areas such as logistics management, peacekeeping operations techniques and demining.

Republic of Korea

New Zealand and the Republic of Korea share a mutual commitment to regional security. Our armed forces gain professional benefit from deepening defence and security links.

This interaction is important and complements the growth in other areas of a bilateral relationship that is of growing importance to New Zealand. The frigate HMNZS *Te Kaha* completed a very successful visit to Chinhae last October. In November 2002 the Commander of the Republic of Korea's Special Warfare Command, Lt Gen Kim Yun Suk, visited New Zealand.

New Zealand made a second contribution of an eleven strong contingent to the United Nations Command Honour Guard in Seoul for six months in March this year. This reaffirmed the value that New Zealand places on its broader relationship with the Republic of Korea. It also underlines our support for the role of the United Nations as expressed in the armistice agreement, while also demonstrating New Zealand's ongoing commitment to peace and stability on the Korean Peninsula and in the wider Asian region.

Given the importance of New Zealand's overall relationship with the Republic of Korea, the Prime Minister, Rt Hon Helen Clark, accompanied by the Chief of Navy, visited Seoul in July 2003 to attend the commemorations on the 50th Anniversary of the Signing of Korean War Armistice. Following the very successful political-military talks held in Seoul in November 2002, the Ministry plans to host the fifth round of consultations in Wellington later this year. Defence academic links are also growing. In a new development, the New Zealand Defence Force is participating in the Korea National Defence University 'Visiting Professor Programme' this year. The New Zealand Defence Force Staff College senior course will visit Korea in September.

Japan

Japan and New Zealand continue to develop closer defence relations. Both countries share a deep commitment to regional stability and security. This was highlighted by Japan's provision of refuelling assistance to the Royal New Zealand Navy frigates operating in support of maritime interdiction operations in the Arabian Sea and the Gulf of Oman.

Personal linkages between the two defence communities have grown stronger. The Secretary of Defence made his first official visit to Japan in May 2003. The Minister of Defence, Hon Mark Burton, will make his second visit to Japan in August. A second round of bilateral security talks between New Zealand and Japan were held in Tokyo last December. Former Minister of State for Defence and Director General of the Defence Agency, Mr Tsutomu Kawara, met the Minister, Secretary of Defence and the Chief of Defence Force in Wellington in April 2003.

The Chief of Navy visited Tokyo for the 8th Western Pacific Naval Symposium and the Japan Maritime Self Defence Forces 50th Anniversary International Fleet Review in October 2002. The frigate HMNZS *Te Kaha* had a very successful tour of Japan (5–21 October 2002) visiting Fukuoka, Tokyo and Okinawa. The Royal New Zealand Navy appreciated the opportunity to provide reciprocal hospitality in June 2003 for three training ships of the Japan Training Squadron.

The United Kingdom and North America

United Kingdom

The defence relationship with the United Kingdom is close and long-standing. Cooperation with the British Armed Forces extends across a wide range of activities, including joint and multinational exercises, individual and unit exchanges, specialist training, and defence agreements. Our contributions with the British to peace support operations in Bosnia, Sierra Leone and Afghanistan and also our commitment later this year of a light engineering group to the reconstruction effort in Iraq have further advanced the defence relationship. The Minister of Defence, Rt Hon Geoffrey Hoon, visited New Zealand in June 2003.

United States

Having established common cause with the United States on counter-terrorism, a key component of the bilateral defence dialogue is related to counter-terrorism. New Zealand is one of a handful of countries committed to stabilisation efforts in Afghanistan, a fact that is recognised and appreciated by the United States as is our continuing role in Operation Enduring Freedom. The United States has also welcomed New Zealand's offer to assist the Iraqi people with post-war reconstruction and rehabilitation efforts, and has recognised our contributions in the Pacific region.

Canada

New Zealand has a close defence relationship with Canada. It centres on cooperation in peacekeeping, participation in multilateral exercises, and an annual three-month exchange of around 20 personnel from each country. The defence relationship has been further strengthened by our contributions to maritime interdiction operations in the Gulf of Oman as part of the Canadian-led Coalition Task Group.

New Zealand is purchasing 105 light armoured vehicles from General Dynamics Land Systems in Canada to replace the Army's obsolete M113 Armoured Personnel Carriers. The first tranche of light armoured vehicles will arrive in New Zealand in August. The light armoured vehicles has a high degree of commonality with the Canadian Army vehicle, and the purchase has brought increased contacts and interoperability between the two armed forces, adding a further dimension to the overall defence relationship.

Afghanistan and Iraq

Afghanistan

As a direct consequence of the terrorist attacks of 11 September 2001, New Zealand has been a strong supporter of international efforts to help Afghanistan eliminate terrorist

groups through the deployment of our Special Air Services, contributions to the International Security Assistance Force, and the deployment of a C-130 Hercules for transport duties. Other contributions to Operation Enduring Freedom, aimed at countering terrorism, mentioned elsewhere in this report, also directly contribute to peace and security efforts in the region. New Zealand is now looking to contribute further to the stabilisation efforts in Afghanistan, offering to lead a Provincial Reconstruction Team to enhance the security environment and provide humanitarian support for the Afghan people.

Iraq

The major political and military issue that has dominated the international agenda over the past twelve months has been Iraq. As a strong supporter of international efforts to eliminate weapons of mass destruction, New Zealand supported the efforts of the United Nations to disarm Iraq in accordance with United Nations Security Council Resolution 1441 and previous United Nations resolutions going back to 1991. We demonstrated our commitment to the disarmament process with the contribution of thirteen New Zealand Defence Force personnel to the United Nations weapons inspection teams in Iraq.

While New Zealand, like many countries, opposed direct military action in Iraq without a United Nations mandate, we have responded quickly to the humanitarian needs of the Iraqi people in the post-war period. Two New Zealand Defence Force personnel have been deployed to Iraq as part of the United Nations Mine Action Service operations. Under United Nations Security Council Resolution 1483 passed on 22 May 2003 New Zealand will help rebuild civil society with the deployment of 61 New Zealand Defence Force engineers and support staff to work with British forces in southern Iraq.

Peacekeeping

New Zealand has been committed to peacekeeping missions since the 1950s and taken part in over thirty-five different missions in the last fifteen years. Recently, there has been a greater concentration of resources in the Asia-Pacific region through large deployments to East Timor and Bougainville. The Asia-Pacific region will remain New Zealand's first priority, although our commitment to collective security and the rule of law will require ongoing contributions beyond the region. Reflecting the shift towards regional responses, only a small proportion of New Zealand Defence Force personnel are currently deployed on United Nations-led missions. At present, New Zealand has military commitments to twelve international peace support operations carrying out peacekeeping or mine action activities in the Pacific, Middle East, Asia, Europe, and Africa as well as the various contributions to Operation Enduring Freedom. In total, about 380 New Zealand Defence Force personnel are deployed on these missions.

Acquisition

The Ministry, through the Acquisition Division, is responsible for procuring all major items of capital equipment for the New Zealand Defence Force. The procurement process is often lengthy. It commences with the Government giving approval in principle to the acquisition process on the basis of concepts of operations and functional performance specifications. The Acquisition Division takes the functional performance specifications and develops the necessary documentation for tender purposes. The Division undertakes risk assessments, invites tenders, evaluates tender responses and identifies preferred bidders. Once Government approval is given, the Division negotiates and manages the contract arrangements through to the delivery of the equipment to the New Zealand Defence Force.

Major projects for the Acquisition Division currently include the light armoured vehicles, the light operational vehicles, new naval vessels, maritime helicopters, tactical communications equipment, C-130 Hercules aircraft life of type extension, P-3 Orion maritime patrol aircraft mission system, C-130 Hercules and P-3 Orion communication and navigation system upgrades, joint command and control system project definition study and three weapons systems for the Army.

Upgrading the army

Vehicles

Light armoured vehicles – All pre-production activities are complete and the vehicle production is well advanced with seven vehicles prepared and positioned in Canada for shipping to New Zealand. Approximately twenty five percent of the vehicles are complete and at various stages of being made ready for shipping. Training of Army teams has commenced in Canada with driver and crew training being carried out on completed New Zealand vehicles. Maintenance and support facilities at various Army bases are close to completion ready for the delivery of the first vehicles. The first batch of vehicles is due for acceptance by the Ministry in October 2003 with the last batch due in November 2004.

Light operational vehicles – Tenders have been received and consideration is being given to the selection of a preferred supplier.

Tactical communications

This project covers tactical communications for the Army and supporting RNZAF units. The project has progressed as planned with deliveries of significant elements of the project being undertaken in the past twelve months allowing the fielding of the equipment by the New Zealand Defence Force. The need for additional radios was identified which could be purchased within the approved budget due to savings generated during the life of the project. The Government approved the purchase of this additional equipment.

Weapons

Requests for proposal have been placed with selected suppliers for the direct fire support weapon (area) and radar system for the very low-level air defence system purchased in 1996. A request had been made through the United States of America foreign military sales programme for the supply of the medium range anti-armour weapons.

New naval vessels

Following the Government's endorsement of the Maritime Forces Review, Project Protector was initiated to purchase new vessels for the Royal New Zealand Navy. Six companies selected from a registration of interest process have received the request for proposal in May 2003 and responses are required in October 2003.

Air transport capabilities

Fixed wing transport

Marshall of Cambridge Aerospace Limited of the United Kingdom completed a life of type study on the C-130 Hercules aircraft fleet. The study was used to determine the configuration and condition of the aircraft and identify the feasibility and costs of extending their life. The study allowed the Government to make informed decisions on the fixed wing transport fleet. In November 2002 the Government approved the commencement of a project to extend the life of the C-130 Hercules aircraft. As a result of a registration of interest process five companies were selected to tender for the life extension project and were provided with the tender documentation in July 2003. The request for tender closes in October 2003.

Concurrent with the Government approval to extend the life of the C-130 Hercules aircraft, the Government also approved a project to acquire two used Boeing 757-200 aircraft to replace the two RNZAF Boeing 727 aircraft. Two Boeing 757-200 aircraft were identified, purchased and introduced into service by the New Zealand Defence Force in mid June 2003 in a passenger configuration. Modifications to each aircraft (cargo door, strengthened floor, air stairs and long range fuel tanks), necessary to meet full capability requirements, are in the planning phase.

Maritime surveillance aircraft

P-3 Orion

In December 2003 the Government approved the initiation of a project to upgrade the mission systems and the communication and navigation systems on the P-3 Orion aircraft. A registration of interest process facilitated the selection of four companies with the required experience to undertake this project. The tender documentation was released to these companies in June 2003 and tenders close in September 2003.

Maritime helicopters

The fifth aircraft (NZ3605) was delivered to the New Zealand Defence Force in early 2003. This project is now complete with project closure activities underway.

A joint approach

Joint command and control system

The selection of a contractor to undertake the project definition study for this project was made in October 2002 and work is proceeding satisfactorily.

New Zealand industry involvement

Defence Technologies New Zealand Joint Action Group

The Ministry has continued to support local companies seeking to obtain defence work from major acquisition projects and through exports. The main conduit for this assistance had been through the group of local companies, Defence Technologies New Zealand Joint Action Group, which is now the New Zealand Defence Industries Association, who have a focus on defence work. The Ministry provided regular briefings at New Zealand Defence Industries Association meetings. Assistance is also provided to New Zealand Defence Industries Association as sponsors of the annual Defence Industry Seminar.

Defence Industry Committee of New Zealand

The Ministry provided support for the Defence Industry Committee of New Zealand. This ministerial appointed committee provides industry feedback into Defence and briefs the Minister on issues relating to industry. The Defence Industry Committee of New Zealand established the Defence Industry Committee Awards of Excellence. These are awarded annually to companies that have provided Defence with excellence in service or products. The awards are presented at the Defence Industry Seminar dinner.

There has been a restructuring of the awards to allow for the recognition of smaller organisations in the provision of excellent service to the New Zealand Defence Force as well as the larger procurement projects.

Defence industry policy

A review of the Defence policy with respect to support for New Zealand industry through the acquisition of equipment was undertaken. Ministers agreed that the Government policy on procurement published by the Ministry of Economic Development would be applied to Defence procurement. This policy requires that Defence give “full and fair” opportunity for local suppliers to participate in Defence projects. Under the trade

relationships with Australia and Singapore, local industry is defined as industries from New Zealand as well as Australia and Singapore. To facilitate fair and full opportunity for local, and in particular New Zealand domestic industries, the Ministry has engaged with the Industrial Capability Network. This is to ensure that the Network can promote domestic industry capabilities to the major international companies being considered for the supply of equipment being purchased for the New Zealand Defence Force by the Acquisition Division.

Evaluation

Under section 24(2)(e) of the Defence Act 1990, the statutory role of the Evaluation Division is to carry out assessments and audits of any function, duty or project of the New Zealand Defence Force. The Division also conducts audits of the Ministry of Defence's activities relating to the procurement of major military capability.

These assessments and audits are undertaken when required by the Minister of Defence, or to a programme approved under authority delegated by the Minister to the Secretary of Defence and the Chief of Defence Force. Reports of completed audits are submitted to the Minister and chief executives. Reports are available in the Defence Library, the Parliamentary Library and the National Library.

The Secretary of Defence and Chief of Defence Force, together with an external member, met twice during the year as the Defence Evaluation Board, to approve the programme of work for the Evaluation Division, receive reports on audits completed, and to monitor follow up action on past audits. The Evaluation Division also undertakes internal audits of the Ministry for the Secretary of Defence.

During the year the Evaluation Division completed reports on:

- a replacement autopilot system for the P-3 Orion aircraft
- the procurement of new light operational vehicles for the Army
- the procurement of new tactical radios for the Army
- Defence Attachés and Advisers
- the purchase of rigid hull inflatable boats by the Navy
- the Defence safe hand distribution system
- the relocation of the Special Air Service from Hobsonville to Papakura
- disposal of Aermacchi and Skyhawk aircraft
- planning for the introduction into service of the light armoured vehicle
- selection of an intercom system for the light armoured vehicle
- Crown capital funds forecasting in Defence
- the delivery of New Zealand Defence Force Output D12 – Maritime Patrol Force.

In addition to undertaking audits to meet the Secretary of Defence's responsibilities under the Defence Act, the Evaluation Division undertakes audits under section 3(6) of the Hazardous Substances and New Organisms Act 1996. During the year the Division examined the New Zealand Defence Force's implementation of systems for controlling hazardous substances not contained in weapon systems. The report of this audit will be issued early in 2003/04.

Corporate

The Corporate Division provides support services and policy advice in the areas of human resources, information management and technology, communications, and legal. The Corporate Division is responsible for all aspects of Ministerial services and support including the handling of Ministerial correspondence, requests under the Official Information Act of 1982, and miscellaneous inquiries.

Over the last twelve months, the Corporate Division has introduced a series of improvements and enhancements to the Ministry's management systems. A new financial management system has been implemented to improve financial management and forecasting for acquisition projects.

The Corporate Division also played a leading role in developing the Ministry's first *Statement of Intent*, published in May 2003. As noted earlier, the *Statement of Intent* sets out the Ministry's strategic, outcome-focused approach to planning, management and reporting, and its accountability for the delivery of outputs.

Review of accountabilities and structural arrangements between the Ministry of Defence and the New Zealand Defence Force

In March 2003 the Government considered the review into the accountabilities and structural arrangements between the Ministry and the New Zealand Defence Force. The Government agreed that the objective is to achieve a greater degree of "jointness" within the New Zealand Defence Force and between the New Zealand Defence Force and the Ministry. At this stage, legislative amendments to the Defence Act 1990 have been ruled out. The Government has directed that greater "jointness" be achieved by reinforcing and cementing in place existing initiatives designed to support cooperation and collaboration between the two defence organisations. There is a requirement for further work and the Government will consider advice from the defence organisations in the coming year.

Conclusion

The last year has been a challenging one for the work of the Ministry. New Zealand's involvement in the international counter-terrorism campaign and efforts to improve international peace and stability has led to a significant number of New Zealand Defence Force deployments overseas. These commitments have had a major impact on the work of the Ministry and will require ongoing monitoring to ensure that they are meeting the Government's objectives.

The implementation of the *Long-term Development Plan* is progressing well. Following advice, including that from the Ministry, the Government has been able to make a number of decisions on upgrading existing equipment or purchasing new equipment for the New Zealand Defence Force's three services. The main challenge for the Ministry will be to ensure that capability development remains consistent with the Government's defence policy and plan for rebuilding the New Zealand Defence Force and within budget. A modern and sustainable New Zealand Defence Force will enable New Zealand to meet its own defence and security needs and contribute appropriately and effectively to regional stability and global security.

In the future, the implementation of the Hunn Review will present new opportunities for the Ministry and the New Zealand Defence Force. It will be important to achieve outcomes that optimise the delivery of high quality policy advice on defence issues and improves the effectiveness of the two organisations.

A handwritten signature in blue ink that reads "Graham Fortune". The signature is written in a cursive style with a large, sweeping initial 'G'.

Graham Fortune
Secretary of Defence
25 September 2003

Part 2 : Statement of responsibility and audit report



Statement of responsibility


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

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

In my opinion, these financial statements fairly reflect the financial position and operations of the Ministry for the year ended 30 June 2003.

Signed by:

Countersigned by:



Graham Farrant
Secretary of Defence
25 September 2003

S J Patterson
Assistant Secretary of Defence (Finance)
25 September 2003



Audit New Zealand

REPORT OF THE AUDITOR-GENERAL TO THE READERS OF THE FINANCIAL STATEMENTS OF THE MINISTRY OF DEFENCE FOR THE YEAR ENDED 30 JUNE 2003

We have audited the financial statements on pages 30 to 82. The financial statements provide information about the past financial and service performance of the Ministry of Defence and its financial position as at 30 June 2003. This information is stated in accordance with the accounting policies set out on pages 54 to 57.

Responsibilities of the Secretary of Defence

The Public Finance Act 1989 requires the Secretary of Defence to prepare financial statements in accordance with generally accepted accounting practice in New Zealand that fairly reflect the financial position of the Ministry of Defence as at 30 June 2003, the results of its operations and cash flows and service performance achievements for the year ended on that date.

Auditor's responsibilities

Section 15 of the Public Audit Act 2001 and section 38(1) of the Public Finance Act 1989 require the Auditor-General to audit the financial statements presented by the Secretary of Defence. It is the responsibility of the Auditor-General to express an independent opinion on the financial statements and report that opinion to you.

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

Basis of opinion

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

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

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

A staff member from the Office of the Controller and Auditor-General was seconded to the Ministry of Defence as Acting Deputy Secretary of Defence (Evaluation) from 18 February 2002 to 2 September 2002, following which the staff member was appointed to the permanent position of Deputy Secretary of Defence (Evaluation). We also provided a resource to assist the Ministry of Defence Evaluation Division in an assignment looking

at the New Zealand Defence Force minor capital programme. Other than this and in our capacity as auditor acting on behalf of the Auditor-General, we have no relationship with or interests in the Ministry of Defence.

Unqualified opinion

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

In our opinion the financial statements of the Ministry of Defence on pages 30 to 82:

- ▲ comply with generally accepted accounting practice in New Zealand; and
- ▲ fairly reflect:
 - the Ministry of Defence’s financial position as at 30 June 2003;
 - the results of its operations and cash flows for the year ended on that date; and
 - its service performance achievements in relation to the performance targets and other measures set out in the forecast financial statements for the year ended on that date.

Our audit was completed on 25 September 2003 and our unqualified opinion is expressed as at that date.



Chris Fabling
Audit New Zealand
On behalf of the Auditor-General
Wellington, New Zealand

Matters relating to the electronic presentation of the audited financial statements

This audit report relates to the financial statements of the Ministry of Defence for the year ended 30 June 2003 included on the Ministry of Defence’s web site. The Secretary of Defence is responsible for the maintenance and integrity of the Ministry of Defence’s web site. We have not been engaged to report on the integrity of the Ministry of Defence’s web site. We accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.

We have not been engaged to report on any other electronic versions of the Ministry of Defence’s financial statements, and accept no responsibility for any changes that may have occurred to electronic versions of the financial statements published on other web sites and/or published by other electronic means.

The audit report refers only to the financial statements named above. It does not provide an opinion on any other information which may have been hyperlinked to/from these financial statements. If readers of this report are concerned with the inherent risks arising from electronic data communication they should refer to the published hard copy of the audited financial statements and related audit report dated 25 September 2003 to confirm the information included in the audited financial statements presented on this web site.

Legislation in New Zealand governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Part 3 : Departmental financial statements



Statement of objectives and service performance

For the year ended 30 June 2003

Objectives

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

Quality assurance

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

Output class performance

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

Output class performance statements

Output Class D1 – Policy advice

Description

Under this output class the Minister of Defence will purchase:

- advice on defence policy matters. This includes advice on:
 - changes in the strategic environment
 - defence and security policies
 - goals and outcomes, together with strategies for achievement
 - the military capabilities required to meet defence policy goals, broad resource implications and the relative merits and risks associated with proposed capability options
- management of bilateral and multilateral defence relations
- responses to ministerial and parliamentary questions; Official Information Act inquiries, Ombudsman correspondence and public affairs advice.

Outcome

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

Service performance

Quantity and timeliness

Target

Delivered

- | Target | Delivered |
|--|---|
| 1. <i>Undertake analysis of significant issues that have an impact on the Government's defence and security policies</i> | <ul style="list-style-type: none"> • A paper on post-11 September 2001 implications for defence policy was completed in September 2002 with the circulation to interested agencies of the key themes from the agency discussions. • The Pacific Defence and Security Policy Review was substantially completed by 30 June 2003. • Papers were prepared for the Minister in early 2003 on the Australian 2003 Defence Update and on depleted uranium. |

2. *Undertake capability reviews to identify the options for achieving the Government's defence policy goals*

- Policy input was provided for:
 - the development of the options for the upgrade of the P-3 Orion aircraft;
 - the upgrade of the C-130 Hercules aircraft;
 - the replacement of the Boeing 727 transport aircraft with Boeing 757 aircraft; and
 - the Cabinet papers on the medium range anti armour weapon and the direct fire support weapon for the Army.

The Government made decisions on all these projects in November-December 2002.

- In combination with the New Zealand Defence Force, the Government's *Long-term Development Plan* was updated in June 2003.
- The key findings report on the special operations capability review was provided to the Minister in November 2002.
- Policy input is continuing in the development of the options for the Government concerning the replacement of the Iroquois and Sioux helicopters.
- The Ministry has been leading the inter-agency process for a final report back to Cabinet on the Hydrographic Survey Review undertaken by Mr Ross Tanner.
- Substantial progress had been made by 30 June 2003 in developing the substance of the Capability Management Framework. This is a process of management and governance in respect of the long term investment in New Zealand Defence Force capabilities.

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

- *General:*
 - Provided policy analysis, evaluation and position papers on current issues and provided briefing input for all major visits to the region.
 - Participated in all regional Mutual Assistance Programme policy discussions.
 - Prepared all ministerial submissions on New Zealand's peacekeeping commitments on behalf of defence.

-
- *Australia:*
 - Redrafted the Closer Defence Relations joint statement for the annual Defence Ministers’ meeting and contributed to the drafting of the quarterly report as requested by Ministers.
 - *Pacific:*
 - Provided policy input in respect of key relationships.
 - Helped to facilitate major projects such as the building of police posts in Solomon Islands.
 - *South East Asia:*
 - Provided policy input during the Minister’s visit to International Institute of Strategic Studies Dialogue in Singapore, Thailand and the Five Power Defence Arrangements’ Ministers’ Meeting in June 2003.
 - Attended the bilateral Defence Cooperation Group meetings with Singapore and Malaysia.
 - *North Asia:*
 - Provided briefing and facilitated the visit of the Secretary of Defence to Japan in May 2003.
 - Participated in Political-Military talks in Japan and South Korea.
 - *Middle East and Central Asia:*
 - Provided policy input in respect of all regional relationships associated with New Zealand’s deployments and peacekeeping activities.

4. *Participate in the regional multilateral security dialogue*

- Contributed to the hosting of the Intersessional Support Group of the ASEAN Regional Forum held in Wellington in November 2002.
 - Attended the ASEAN Regional Forum Senior Officials’ Meeting and the ASEAN Regional Forum Ministers’ Meeting – Defence Dialogue.
 - With Singapore, drafted a concept paper on greater defence dialogue within the ASEAN Regional Forum.
 - In conjunction with Ministry of Foreign Affairs and Trade, developed a register for Confidence Building Measures which was adopted by the ASEAN Regional Forum.
-

-
5. *Host the annual meeting of Australian and New Zealand Defence Ministers and senior officials*
- Hosted the annual Australia – New Zealand Defence Cooperation Group meeting in Wellington and participated in the Consultative Committee and Ministerial meetings held in Canberra.
-
6. *Provide the following Ministerial services:*
- *Responses to Ministerial Correspondence. Replies to ministerial correspondence will be actioned within fourteen working days of receipt by the Ministry*
 - 105 Ministerial letters of reply were completed for the reporting year ended 30 June 2003. One response was outside the timeframe, as an agency contributing to a reply was not able to provide that information in time to meet the deadline.
 - *Responses Parliamentary questions. Parliamentary questions will be actioned within time frames set by Standing Orders of the House of Representatives*
 - 188 Parliamentary Questions were answered during the reporting period. Delayed advice from external contributing agencies meant that five of the responses were outside the timeframe.
 - *Official Information Act requests. Official Information Act enquiries will be actioned within statutory requirements*
 - 17 Official Information Act requests were responded to during the reporting period. Delay in advice from one external agency meant that one response fell outside the timeframe.
-
7. *Produce publications in accordance with an agreed programme*
- 10 issues of *Defence Update* were published.
-

Quality

- The Ministry has maintained quality control procedures to support the expectations for policy advice delivered under this output class. The 2002 Departmental Forecast Report detailed the quality standards intended.
- ISO 9001 certification has been maintained.

Financial performance (GST exclusive)

For the year ended 30 June 2003

30/6/2002 Actual \$000		30/6/2003 Actual \$000	30/6/2003 Main estimates \$000	30/6/2003 Supp. estimates \$000
	Revenue			
3,116	Crown	2,782	2,936	2,936
3	Other	–	–	–
3,119	Total revenue	2,782	2,936	2,936
2,905	Expenditure	2,564	2,936	2,936
214	Surplus	218	–	–

Output Class D2 – Audit and assessment of performance

Description

Under this output class the Minister of Defence will purchase:

- independent evaluations of the New Zealand Defence Force
- independent reviews of the efficiency and effectiveness of the New Zealand Defence Force management systems and resources utilisation
- internal audits and reviews of the Ministry’s acquisition, policy and corporate activities
- audits of the controls on hazardous substances under the control of the Minister of Defence, as required by the Hazardous Substances and New Organisms Act 1996.

Outcome

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

Service performance

Quantity and timeliness

Target	Delivered
<p>1. <i>Complete satisfactorily an agreed programme of evaluations</i></p>	<ul style="list-style-type: none"> • The following evaluations of the New Zealand Defence Force were completed during the year: <ul style="list-style-type: none"> – Report 5/2002 Orion Replacement Autopilot System Procurement – Report 6/2002 Light Operational Vehicle Replacement – Report 7/2002 Tactical Mobile Communications System Procurement – Report 8/2002 Review of Defence Attachés and Advisers – Report 10/2002 Defence Safe Hand Service – Report 1/2003 Planning for introduction into service of the New Zealand Light Armoured Vehicle (NZLAV) – Report 2/2003 Selection of a vehicle intercom system for the New Zealand Light Armoured Vehicle (NZLAV)

-
- Report 3/2003
Crown Capital Forecasting in Defence
 - Report 4/2003
Evaluation of New Zealand Defence Force Output D12 – Maritime Patrol Forces.
-

2. *Conduct other assessments and audits of the New Zealand Defence Force as and when directed*
- The following unprogrammed audits were completed during the year:
 1. Requested by the Minister of Defence:
 - Report 9/2002
Purchase of six rigid hull inflatable boats by the Navy
 - Report 12/2002
Sale of Aermacchi and Skyhawk Aircraft
 2. Requested by the Chief of Defence Force:
 - Report 11/2002
Relocation of 1 NZSAS Group to Papakura Camp
-

Quality

- Evaluations were conducted in accordance with the Ministry's Evaluation Manual.
- Evaluations met the Defence Evaluation Board's expectations.
- All reports were reviewed for accuracy and logic by auditees and management.
- Managerial review was maintained throughout the evaluation process.

Financial performance (GST exclusive)

For the year ended 30 June 2003

30/6/2002 Actual		30/6/2003 Actual	30/6/2003 Main estimates	30/6/2003 Supp. estimates
\$000		\$000	\$000	\$000
	Revenue			
1,849	Crown	1,740	1,668	1,748
2	Other	–	–	–
1,851	Total revenue	1,740	1,668	1,748
1,533	Expenditure	1,606	1,668	1,748
318	Surplus	134	–	–

Output Class D3 – Management of equipment procurement

Description

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

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

Outcome

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

Service performance

Quantity, quality and timeliness

Target	Delivered																		
1. <i>Continue management of the Anzac ship project</i>	<ul style="list-style-type: none"> • Due to Anzac ship treaty arrangements the Ministry of Defence continues to maintain an interest in this project and is contributing financially in accordance with the contract and treaty arrangements. • Cost summary – <i>Anzac ship</i> A GST inclusive summary of project expenditure charged to non-departmental appropriations, and a forecast of future costs to complete, is: <table style="width: 100%; border-collapse: collapse;"> <tr> <td></td> <td style="text-align: right;">\$(000)</td> </tr> <tr> <td>Expenditure to 30 June 2002</td> <td style="text-align: right;">1,356,885</td> </tr> <tr> <td>Expenditure 2002/03</td> <td style="text-align: right;">35,640</td> </tr> <tr> <td>Future commitments and forecasts</td> <td style="text-align: right;">25,862</td> </tr> <tr> <td>Forecast cost to complete</td> <td style="text-align: right; border-top: 1px dotted black;">1,418,387</td> </tr> <tr> <td>Project approval</td> <td style="text-align: right; border-top: 1px dotted black;">1,056,315</td> </tr> <tr> <td>Cost escalations to date and forecast to complete</td> <td style="text-align: right;">257,810</td> </tr> <tr> <td>Foreign exchange variances to date and forecast to complete</td> <td style="text-align: right;">124,714</td> </tr> <tr> <td></td> <td style="text-align: right; border-top: 1px dotted black; border-bottom: 1px dotted black;">1,438,839</td> </tr> </table>		\$(000)	Expenditure to 30 June 2002	1,356,885	Expenditure 2002/03	35,640	Future commitments and forecasts	25,862	Forecast cost to complete	1,418,387	Project approval	1,056,315	Cost escalations to date and forecast to complete	257,810	Foreign exchange variances to date and forecast to complete	124,714		1,438,839
	\$(000)																		
Expenditure to 30 June 2002	1,356,885																		
Expenditure 2002/03	35,640																		
Future commitments and forecasts	25,862																		
Forecast cost to complete	1,418,387																		
Project approval	1,056,315																		
Cost escalations to date and forecast to complete	257,810																		
Foreign exchange variances to date and forecast to complete	124,714																		
	1,438,839																		

2. *Progress Light
Operational Vehicles
(LOV) for the Army*

Subject to Government approval, the intention is to:

- complete tender documents and issue the Request For Tender in the 2nd quarter of 2002; and
 - following evaluation and selection of a preferred vehicle type and supplier, seek Government approval to negotiate a contract for the purchase of the LOV in the 3rd quarter of 2002.
- The Request For Tender was issued on 27 June 2002 and closed in October 2002 after an extension was sought from a selected supplier.
 - The tender evaluation required due diligence visits and further tender clarification resulting in a need for the New Zealand Defence Force to review the overall capability, in particular potential fleet mixes. Further re-pricing has been sought as a result of the capability considerations and budget constraints.
 - Cost summary – *Light Operational Vehicles*
The Government approved *Long-term Development Plan* for Defence has set the upper limit for this project budget at \$110 million. Initial project costs (GST inclusive) charged to departmental appropriations is:

	\$(000)
Expenditure to 30 June 2002	280
Expenditure 2002/03	224

Expenditure to 30 June 2003	504

Budget for initial costs	556

3. *Progress new maritime forces vessels for the Navy*

Subject to Government approval, the intention is to:

- issue an Invitation To Register in the 2nd quarter of 2002;
 - issue a Request For Proposal in the 3rd quarter of 2002;
- The Invitation To Register was released on 26 July 2002 and closed on 13 September 2002.
 - Following approval from Cabinet on 9 December 2002 of the short-listed six respondents, the Request For Proposals was released on 26 May 2003 and closes on 27 October 2003. Due to the complexity of the project, three ship types and the more complex capability options required in respect of the multi role vessel, the functional performance specifications took considerably longer to develop and finalise than anticipated.

Subject to the range and scope of responses, further definition of milestones will be decided at a later date.

- Project budget guidance was provided in the approved *Long-term Development Plan* with the budget being set at \$500M. No expenditure forecast can be provided until contract negotiations are completed and Government approval to commit to the purchase of these ships for the New Zealand Defence Force is obtained.
- Cost summary – *Maritime forces vessels*
A GST inclusive summary of initial project costs charged to departmental appropriations is:

	\$(000)
Expenditure to 30 June 2002	21
Expenditure 2002/03	963
	984
Expenditure to 30 June 2003	984
	1,125
Budget for initial costs	1,125

4. *Complete tactical communications for the Army and the Air Force*

The following milestones were planned for 2002/03

- complete delivery of 1853 radios by the 3rd quarter 2002;
 - pay all outstanding costs by 4th quarter 2002;
 - complete final closure report by the 4th quarter 2002; and
 - complete project within Cabinet approval of \$134.2 million (inclusive of GST) after allowing for foreign exchange variance.
- The delivery of 1853 radios was achieved in December 2002.
 - Costs are being paid in accordance with the Foreign Military Sales Case billing profile.
 - The project remains active as a result of Government approval to acquire additional radios for the New Zealand Defence Force. These radios were purchased from savings generated in the project and will be used for future approved weapons and transport systems.
 - Completion has been delayed because of processing problems by United States Foreign Military Sales and approval to acquire additional radios. The revised completion date is now the 2nd quarter of 2005.
 - Cost summary – *Tactical communications (including special operations communications systems)*.

A GST inclusive summary of project expenditure charged to non-departmental appropriations, and a forecast of future costs to complete is:

	\$(000)
Expenditure to 30 June 2002	112,743
Expenditure 2002/03	7,807
Future commitments and forecasts	18,713
Forecast cost to complete	139,263
Project approval	134,126
Foreign exchange variances to date and forecast to complete	5,178
	139,304

5. *Continue management of Light Armoured Vehicles (LAV) for the Army*

The following milestones were planned for 2002/03

- complete system design reviews in the 3rd quarter of 2002;
 - complete first of type vehicle testing in the 4th quarter of 2002; and
 - commence full vehicle production in the 1st quarter of 2003.
- The critical design review for the Infantry Mobility Vehicle (IMV) was conducted over the period 12–16 August 2002.
 - First production vehicle inspection commenced on 16 December 2002 and was completed in January 2003.
 - Full vehicle production commenced in February 2003.
 - *Cost Summary – Light Armoured Vehicles*
A GST inclusive summary of project expenditure charged to non-departmental appropriations, and a forecast of future costs to complete is:

	\$(000)
Expenditure to 30 June 2002	90,850
Expenditure 2002/03	212,403
Future commitments and forecasts	380,258
Forecast cost to complete	683,511
<hr/>	
Project approval	652,834
Foreign exchange variances to date and forecast to complete	30,977
	683,811
<hr/>	

6. *Continue management of maritime helicopters for the Navy*

The following milestones were planned for 2002/03

- complete delivery of five naval helicopters by 4th quarter of 2002;
 - pay all outstanding costs by the 1st quarter 2003;
 - complete final closure report in the 1st quarter 2003; and
 - complete project within Cabinet approval of \$380.8 million (inclusive of GST) after allowing for foreign exchange variance.
- The delivery of the fifth and final aircraft was achieved on 3 February 2003.
 - All outstanding costs with the exception of the cost recovery for some minor activity still underway by the New Zealand Defence Force has been achieved by June 2003.
 - Minor systems certification remain to be completed and these are being handled by the New Zealand Defence Force. Project closure reports are work in progress.
 - The project has been delivered \$6 million (GST inclusive) below the approved budget.
 - Cost summary – *Maritime helicopters*
A GST inclusive summary of project expenditure charged to non-departmental appropriations, and a forecast of future costs to complete is:

	\$(000)
Expenditure to 30 June 2002	402,332
Expenditure 2002/03	21,904
Future commitments and forecasts	4,012
Forecast cost to complete	428,248
Project approval	380,782
Foreign exchange variances to date and forecast to complete	53,497
	434,279

7. *Progress Joint Command and Control System (JCCS)*

Subject to Government approval, the intention is to:

- identify a suitable contractor to undertake the project definition study in the 3rd quarter of 2002; and
 - obtain Ministers’ approval to proceed and commence the project definition study in the 3rd quarter of 2002.
- A suitable contractor to undertake a Project Definition Study was selected in September 2002.
 - Ministers’ approval was obtained on 8 September 2002 and a contract awarded on 31 October 2002. Two of three reports were delivered by the end of June 2003. The third and final report is due in October 2003.
 - Cost summary – *Joint Command and Control System*
A GST inclusive summary of initial project costs charged to departmental appropriations is:

	\$(000)
Expenditure to 30 June 2002	62
Expenditure 2002/03	1,405

Expenditure to 30 June 2003	1,467

Budget for initial costs	2,160

8. *Complete life of type study of Air Force C-130H transport aircraft*

- No milestones were included in the 2002 Departmental Forecast Report for this project.
- A life of type study was completed to allow decisions to be made by Government in late 2002 on the future needs of the New Zealand Defence Force fixed wing transport fleet. The study provided the necessary information for the Government's decision to undertake a life of type extension on the C-130 Hercules fleet.
- Finalisation of the report was achieved by June 2003 and the project is now complete.
- Cost Summary – *C-130H Life of type study*
A GST inclusive summary of initial project costs charged to departmental appropriations is:

	\$(000)
Expenditure to 30 June 2002	1,218
Expenditure 2002/03	1,607
	2,825
Expenditure to 30 June 2003	2,825
Budget for initial costs	3,223

9. Purchase of Boeing 757 aircraft for the Air Force

- No milestones were included in the 2002 Departmental Forecast Report for this project.
- In November 2002 the Government instructed the Ministry of Defence to acquire two Boeing 757-200 aircraft for the New Zealand Defence Force to replace the Boeing 727 aircraft. The approved budget included all necessary training, ground support equipment, aircraft purchase and modification for the cargo carrying capability.
- The two aircraft were identified, and joint Ministers approval to purchase was granted on 18 February 2003.
- The aircraft were delivered on 8 April 2003 and 8 June 2003.
- The New Zealand Defence Force commenced a review of the scope of work for cargo conversion ahead of the Ministry of Defence commencing an acquisition process for that conversion.
- Cost Summary – *Boeing 757 aircraft*
A GST inclusive summary of initial costs charged to departmental appropriations is:

	\$(000)
Expenditure 2002/03	768
Expenditure to 30 June 2003	768
Budget for initial costs	490

A GST inclusive summary of project expenditure charged to non-departmental appropriations, and a forecast of future costs to complete is:

	\$(000)
Expenditure 2002/03	104,830
Future commitments and forecasts	88,437
Forecast cost to complete	193,267
Project approval	196,794
Foreign exchange variances to date and forecast to complete	(1,835)
	194,959

10. *Complete Orion aircraft autopilot for the Air Force*

The following milestones were planned for 2002/03

- complete the installation of the sixth (final) aircraft in the 3rd quarter of 2002;
 - complete the delivery of spares and documentation by the 4th quarter 2002;
 - pay all outstanding costs by the 1st quarter 2003;
 - complete final closure report by the 1st quarter 2003; and
 - complete project within Cabinet approval of NZ\$9.56 million (inclusive of GST) after allowing for foreign exchange variance.
- Acceptance of the installation of the autopilot in the sixth and final aircraft was completed in November 2002.
 - Delivery of the documentation and spares was completed in November 2002.
 - Payment of all outstanding costs was completed in April 2003.
 - The closure report is still under preparation.
 - The financial closure shows the project being delivered for NZ\$8,627,846 (GST inclusive). The approved budget was NZ\$9,560,000.
 - Cost summary – *Orion aircraft autopilot*
A GST inclusive summary of project expenditure charged to non-departmental appropriations is:

	\$(000)
Expenditure to 30 June 2002	7,440
Expenditure 2002/03	1,188
Future commitments and forecasts	–
Final cost	8,628
Project approval	9,560
Foreign exchange variances	(28)
	9,532

11. *Upgrade of P-3 Orion aircraft systems and cockpit*

- No milestones were included in the 2002 Departmental Forecast Report for this project.
- Government approval to proceed with this project was obtained in December 2002.
- The Registration of Interest was issued on 28 January 2003 and closed on 28 February 2003.
- The short-listing of four companies to be invited to respond to a Request For Tender was completed and announced in April 2003.
- The Request For Tender documentation was forwarded to the short-listed companies on 24 June 2003 and is planned to close on 8 October 2003.
- The Government approved *Long-term Development Plan* has identified an upper limit of \$320M for this project.
- Cost Summary – *P-3 Orion aircraft systems and cockpit*

A GST inclusive summary of initial project costs charged to departmental appropriations is:

	\$(000)
Expenditure 2002/03	72
Expenditure to 30 June 2003	72
Budget for initial costs	416

12. *Life of type extension to C-130 Hercules aircraft, including cockpit upgrade.*

- No milestones were included in the 2002 Departmental Forecast Report for this project.
- Government approval to proceed with this project was obtained in November 2002.
- The Registration of Interest was issued on 28 January 2003 and closed on 28 February 2003.
- The short-listing of five companies to be invited to respond to a Request For Tender was completed and announced in April 2003.
- The Request For Tender document was issued on 15 July 2003 and is proposed to close on 15 October 2003.
- The Government approved *Long-term Development Plan* has identified an upper budget limit of \$320M for this project.

• Cost Summary – *Life of type extension to C-130 Hercules aircraft*

A GST inclusive summary of initial project costs charged to departmental appropriations is:

	\$(000)
Expenditure 2002/03	38
Expenditure to 30 June 2003	38
Budget for initial costs	416

13. *Medium range anti armour weapon*

- No milestones were included in the 2002 Departmental Forecast Report for this project.
- Cabinet approved proceeding with this project on 9 December 2002.
- Purchase of medium range anti-armour weapons has commenced through the United States Foreign Military Sales programme. An offer was still to be received at 30 June 2003.

-
14. *Direct Fire Support Weapon (Area)*
- No milestones were included in the 2002 Departmental Forecast Report for this project.
 - Cabinet approved proceeding with this project on 9 December 2002.
 - Request for proposals (RFP) for direct fire support weapon were prepared and issued to short-listed suppliers on 22 May 2003 for closure on 28 July 2003.
 - The Government approved *Long-term Development Plan* has identified a budget of \$37M for this project.
-
15. *Maintain close links with New Zealand's industry and provide support for the Defence Industry Committee of New Zealand*
- The Ministry supported meetings of the Defence Industry Committee of New Zealand (DICNZ) on 27 February 2003 and 5 June 2003.
-
16. *Ensure New Zealand companies are given maximum opportunity to compete for work from projects managed by the Ministry*
- To afford opportunities to local industry the Ministry has adopted the New Zealand Government Procurement Policy issued by the Ministry of Economic Development. The Industry Capability Network now participates in the defence acquisition process.
-

-
17. *Complete material for the Australia and New Zealand Industry Defence Equipment and Capability Catalogue database and update databases on industrial capability*
- No material was provided for the databases in this financial year.
 - Evolving arrangements with the Industry Capability Network will require the Ministry to review the continuation of this activity.
-
18. *Conduct industry briefing sessions on current defence projects and activities*
- Briefings have been conducted with the Defence Industry Committee of New Zealand at meetings held on 27 February 2003 and 5 June 2003, and the New Zealand Defence Industry Association on 8 April 2003.
 - The Industry Capability Network, in conjunction with the Ministry, held an evening briefing for domestic companies to meet representatives of the six consortia responding to the new maritime forces Request for Proposal (RFP) which was attended by approximately 150 people.
-

Project financial performance

For the year ended 30 June 2003

Project payments capitalised against Crown appropriations in 2002/03, and recoveries from New Zealand Defence Force, were:

	Expenditure			Recoveries from NZ Defence Force	
	2002/03		30/6/2003	2002/03	30/6/2003
	Main estimates \$000	Supp. estimates \$000	Actual \$000	Supp. estimates \$000	Actual \$000
Anzac ships	16,012	29,992	35,453	37,235	37,235
Maritime helicopter	6,331	33,409	15,745	35,001	35,001
P3 Orion autopilot	–	1,370	1,177	2,333	2,333
B-757 aircraft	–	121,373	93,694	–	–
Light armoured vehicles	169,790	196,778	210,522	31,142	31,142
Tactical communications	8,532	22,890	7,306	19,077	19,077
Other projects	28	–	81	87	87
GST on imported goods and NZ payments	11,718	40,116	19,881		
TOTAL	212,411	445,928	383,859	124,875	124,875

(Figures are GST exclusive)

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

Financial performance (GST exclusive)

For the year ended 30 June 2003

30/6/2002 Actual \$000		30/6/2003 Actual \$000	30/6/2003 Main estimates \$000	30/6/2003 Supp. estimates \$000
	Revenue			
3,138	Crown	3,375	3,667	3,613
1,073	Other	4,338	2,146	3,990
4,211	Total revenue	7,713	5,813	7,603
4,002	Expenditure	7,441	5,813	7,603
209	Surplus/(deficit)	272	-	-

The appropriation (GST inclusive) for this output class was increased by \$2,014,000 for:

	\$(000) (GST incl)
Tender phase costs for Light Operational Vehicles. This is an expense transfer final adjustment approved by the Minister of Finance on 15 April 2002 and is time-limited to 30 June 2003. Funded by Revenue Crown.	29
Project Definition Study to investigate, provide advice and options, and make recommendations on how best to deliver, establish and sustain a cost effective, fit for purpose, Joint Command and Control System for the NZ Defence Force. Approved by Joint Ministers September 2002. Funded by recovery from NZ Defence Force as Revenue Other.	949
Forecasting change for final costs of Life of Type Study C-130 Hercules aircraft. Funded by recovery from NZ Defence Force as Revenue Other.	158
Initial project costs for purchase of B-757 aircraft. Funded by recovery from NZ Defence Force as Revenue Other.	552
Initial project costs for upgrade of mission systems and communications/navigation systems on the P3K Orion aircraft (Project GUARDIAN) approved by Joint Ministers. Funded by recovery from NZ Defence Force as Revenue Other.	208
Initial project costs for life extension of the C-130 Hercules aircraft. (Project PEGASUS) approved by Joint Ministers. Funded by recovery from NZ Defence Force as Revenue Other.	208
A fiscally neutral adjustment from output class D3 Management of Equipment Procurement to output class D2 Audit and Assessment of Performance to allow for a small rebuilding of evaluation work.	(90)
TOTAL	2,014

Statement of accounting policies

For the year ended 30 June 2003

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

The Ministry's financial statements have been prepared in accordance with section 35 of the Public Finance Act 1989, and generally accepted accounting practice.

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

The following general accounting policies have been adopted in the preparation of these financial statements:

- The Ministry is assumed to be a going concern.
- The Ministry has accepted historical cost as a measurement base.

Accounting policies

The following particular accounting policies which materially affect the measurement of financial results and financial position have been applied:

Budget figures

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

Revenue recognition

The Ministry derives revenue through the provision of outputs to the Crown and for services to third parties. Such revenue is recognised when earned and is reported in the financial period to which it relates.

Interest income

Interest income is recognised in the period in which it is earned.

Receivables

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

Cost allocation

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

- *Criteria for direct and indirect costs*

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

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

- *Direct costs assigned to outputs*

Direct costs are 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 2003, direct costs accounted for 65% of the Ministry’s costs (30 June 2002= 67%).

- *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 a subjective 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 2003, indirect costs accounted for 35% of the Ministry’s costs (30 June 2002= 33%).

Expenses

Expenses are recognised when incurred and are reported in the financial period to which they relate.

Property, plant and equipment

All fixed assets costing more than \$5,000 are capitalised and recorded at cost. Any write-down of an item to its recoverable amount is recognised in the statement of financial performance.

Depreciation

Depreciation is provided on a straight line basis at a rate which will write off the cost (or valuation) of the assets to their estimated residual value over their useful lives.

The useful lives of major classes of assets have been estimated as follows:

Office equipment	3–10 years
Office furniture	5–10 years
Computer equipment	3 years
Information management systems	5 years

The cost of leasehold improvements is capitalised and depreciated over the estimated remaining useful life of the improvement.

Employee entitlements

Provision is made in respect of the Ministry's liability for annual, long service and retirement leave and time off in lieu. Annual leave, time off in lieu and other entitlements that are expected to be settled within 12 months of reporting date, are measured at nominal values on an actual entitlement basis at current rates of pay.

Entitlements that are payable beyond 12 months, such as long service leave and retirement leave, have been calculated on an actuarial basis based on the present value of expected future entitlements.

Commitments

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

Contingent liabilities

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

Statement of cash flows

Cash means balances on hand and held in bank accounts.

Operating activities include cash received from all income sources of the Ministry and record the cash payments made for the supply of goods and services.

Investing activities are those activities relating to the acquisition and disposal of non-current assets.

Financing activities comprise capital injections by, or repayment of capital to, the Crown.

Foreign currencies

Foreign currency transactions are converted into New Zealand dollars at the exchange rate at the date of the transaction. Where a forward exchange contract has been used to establish the price of a transaction, the forward rate specified in that foreign exchange

contract is used to convert that transaction to New Zealand dollars. Consequently, no exchange gain or loss resulting from the difference between the forward exchange contract rate and the spot exchange rate on date of settlement is recognised.

Monetary assets and liabilities are translated to New Zealand dollars at the closing exchange rate. The resulting unrealised exchange gain or loss is recognised in the statement of financial performance. Other exchange gains or losses, whether realised or unrealised, are recognised in the statement of financial performance in the period to which they relate.

Financial instruments

The Ministry is party to financial instruments as part of its normal operations. These financial instruments include bank accounts, short-term deposits, debtors, creditors and foreign currency forward contracts. The Ministry enters into foreign currency forward contracts to hedge currency transactions. Any exposure to gains or losses on those contracts is generally offset by a related loss or gain on the item being hedged. Apart from foreign currency forward contracts, all financial instruments are recognised in the statement of financial position and all revenues and expenses in relation to financial instruments are recognised in the statement of financial performance.

Except for those items covered by a separate accounting policy all financial instruments are shown at their estimated fair value.

Goods and services tax (GST)

The statement of financial performance, statement of movements in taxpayers' funds and statement of cash flows, are exclusive of GST. The statement of financial position is also exclusive of GST except for the amount of GST owing to or from the Inland Revenue Department at balance date, being the difference between output GST and input GST, is included in payables and provisions or receivables and advances as appropriate.

Taxation

Government Departments are exempt from the payment of income tax in terms of the Income Tax Act 1994. Accordingly, no charge of income tax has been provided for.

Taxpayers' funds

This is the Crown's net investment in the Ministry.

Changes in accounting policies

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

Statement of financial performance

For the year ended 30 June 2003

30/6/2002 Actual		Note	30/6/2003 Actual	30/6/2003 Main estimates	30/6/2003 Supp. estimates
\$000			\$000	\$000	\$000
Revenue					
8,103	Crown	2	7,897	8,271	8,297
1,081	Other	3	4,338	2,146	3,990
14	Interest	5	40	–	–
9,198	Total revenue		12,275	10,417	12,287
Expenditure					
3,716	Personnel costs	6	3,947	4,371	4,347
4,289	Operating costs	7	7,301	5,564	7,568
295	Depreciation	8	231	350	240
140	Capital charge	9	132	132	132
8,440	Total expenses		11,611	10,417	12,287
758	Net operating surplus		664	–	–

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

Statement of movements in taxpayers' funds

For the year ended 30 June 2003

30/6/2002 Actual \$000		30/6/2003 Actual \$000	30/6/2003 Main estimates \$000	30/6/2003 Supp. estimates \$000
1,555	Taxpayers' funds brought forward as at 1 July	1,555	1,555	1,555
758	Net operating surplus/(deficit)	664	–	–
758	Total recognised revenues and expenses for the year	664	–	–
(758)	Provision for repayment of surplus to the Crown	(664)	–	–
1,555	Taxpayers' funds as at 30 June	1,555	1,555	1,555

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

Statement of financial position

As at 30 June 2003

30/6/2002 Actual		Note	30/6/2003 Actual	30/6/2003 Main estimates	30/6/2003 Supp. estimates
\$000			\$000	\$000	\$000
Taxpayers' funds					
1,555	Taxpayers' funds		1,555	1,555	1,555
1,555	Total taxpayers' funds		1,555	1,555	1,555
Represented by:					
Current assets					
1,711	Cash		2,016	1,577	1,541
37	Prepayments		24	14	14
1,286	Debtors and receivables	10	1,808	2	2
3,034	<i>Total current assets</i>		3,848	1,593	1,557
Non-current assets					
666	Property, plant and equipment	11	529	620	656
666	<i>Total non-current assets</i>		529	620	656
3,700	Total assets		4,377	2,213	2,213
Current liabilities					
1,034	Creditors and payables	12	1,797	335	335
758	Provision for repayment of surplus to the Crown		664	–	–
187	Provision for employee entitlements	13	223	200	200
1,979	<i>Total current liabilities</i>		2,684	535	535
Non-current liabilities					
166	Provision for employee entitlements	13	138	123	123
2,145	Total liabilities		2,822	658	658
1,555	Net assets		1,555	1,555	1,555

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

Statement of cash flows

For the year ended 30 June 2003

30/6/2002 Actual \$000		30/6/2003 Actual \$000	30/6/2003 Main estimates \$000	30/6/2003 Supp. estimates \$000
	Cash flows – operating activities			
	Cash provided from:			
8,103	Crown	7,897	8,271	8,297
–	Customers	3,628	2,146	3,990
14	Interest	38	–	–
8,117		11,563	10,417	12,287
	Cash disbursed to:			
	Produce outputs			
(3,718)	Personnel	(3,917)	(4,371)	(4,347)
(4,138)	Operating	(6,282)	(5,564)	(6,990)
140	Net GST paid	(75)	–	–
(140)	Capital charge	(132)	(132)	(132)
(7,856)		(10,406)	(10,067)	(11,469)
261	Operating activities net cash flows	1,157	350	818
	Cash flows – investing activities			
	Cash provided from:			
23	Sale of fixed assets	–	20	20
	Cash disbursed for:			
(303)	Purchase of fixed assets	(94)	(350)	(250)
(280)	Investing activities net cash flows	(94)	(330)	(230)
	Cash flows – financing activities			
	Cash disbursed for:			
(545)	Repayment of surplus	(758)	(315)	(758)
(545)	Financing activities net cash flows	(758)	(315)	(758)
(564)	Net increase/(decrease) in cash held	305	(295)	(170)
2,275	Add opening cash and deposits	1,711	1,872	1,711
1,711	Closing cash and deposits	2,016	1,577	1,541

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

Reconciliation of net operating surplus to net cash flow from operating activities

For the year ended 30 June 2003

30/6/2002 Actual \$000		30/6/2003 Actual \$000	30/6/2003 Main estimates \$000	30/6/2003 Supp. estimates \$000
758	Net operating surplus/(deficit)	664	–	–
	Add/(Less) non-cash items			
295	Depreciation	231	350	240
30	Inc/(Dec) in non-current employee entitlements	(28)	–	–
325	Total non-cash items	203	350	240
	Working capital movements			
(1,232)	(Inc)/Dec in debtors and receivables	(522)	–	1,284
–	(Inc)/Dec in prepayments	13	–	23
440	Inc/(Dec) in creditors and payables	763	–	(699)
(22)	Inc/(Dec) in current employee entitlements	36	–	(30)
(814)	Working capital movements – net	290	–	578
	Add/(Less) investing activity items			
(8)	(Gain)/Loss on sale of fixed assets (Note 4)	–	–	–
(8)	Total investing activity items	–	–	–
261	Net cash flow from operating activities	1,157	350	818

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

Statement of commitments

As at 30 June 2003

The Ministry has no commitments for future payments and expenditure to be incurred on contracts that have been entered into at balance date. (30 June 2002 = \$1.424 million.)

Statement of contingent assets and liabilities

As at 30 June 2003

The Ministry does not have any contingent assets as at 30 June 2003. (30 June 2002 = nil.)

No guarantees and indemnities have been given outside the normal course of business. (30 June 2002 = nil.)

There are no claims against the Ministry at balance date. (30 June 2002 = nil.)

Statement of unappropriated expenditure

For the year ended 30 June 2003

No expenditure has been made or costs incurred in excess of or without appropriation by Parliament. (There was no unappropriated expenditure at 30 June 2002.)

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

Statement of departmental expenditure and appropriations

For the year ended 30 June 2003

	30/6/2003 Expenditure actual \$000	30/6/2003 Appropriation voted \$000
Vote: Defence		
Appropriations for classes of outputs		
D1 – Policy advice	2,912	3,303
D2 – Audit and assessment of performance	1,824	1,967
D3 – Management of equipment procurement	8,405	8,553
TOTAL	13,141	13,823

(Figures are GST inclusive)

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

Notes to the financial statements

For the year ended 30 June 2003

Note 1: Budget composition

	Note	30/6/2003 Main estimates \$000	30/6/2003 Supp. estimates changes \$000	30/6/2003 Budget total \$000
Revenue				
Crown	2	8,271	26	8,297
Other	3	2,146	1,844	3,990
Total revenue		10,417	1,870	12,287
Expenditure				
Personnel costs	6	4,371	(24)	4,347
Operating costs	7	5,564	2,004	7,568
Depreciation	8	350	(110)	240
Capital charge	9	132	–	132
Total expenses		10,417	1,870	12,287
Net operating surplus		–	–	–

Note 2: Revenue – Crown

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

Note 3: Other revenue

30/6/2002 Actual \$000		30/6/2003 Actual \$000	30/6/2003 Main estimates \$000	30/6/2003 Supp. estimates \$000
8	Net gain on sale of assets (Note 4)	–	–	–
1,073	New Zealand Defence Force for initial project costs	4,338	2,146	3,990
1,081	Total other revenue	4,338	2,146	3,990

Notes to the financial statements

For the year ended 30 June 2003

Note 4: Gain on sale of property, plant and equipment

30/6/2002 Actual \$000		30/6/2003 Actual \$000
5	Computer equipment	–
3	Office furniture	–
8	Net gain on sale of property, plant and equipment	–

Note 5: Interest revenue

The Ministry invests foreign currency cash held prior to making payments with financial institutions that the Ministry deals with. All interest earned on short-term deposits is returned to the Crown.

Note 6: Personnel costs

30/6/2002 Actual \$000		30/6/2003 Actual \$000	30/6/2003 Main estimates \$000	30/6/2003 Supp. estimates \$000
3,686	Salaries and wages	3,921	4,359	4,335
30	Retirement and resigning leave	26	12	12
3,716	Total personnel costs	3,947	4,371	4,347

Notes to the financial statements

For the year ended 30 June 2003

Note 7: Operating costs

30/6/2002 Actual \$000		30/6/2003 Actual \$000	30/6/2003 Main estimates \$000	30/6/2003 Supp. estimates \$000
177	Consultancy	–	–	–
217	Professional services	20	80	80
75	Audit fees for financial statements	70	70	70
–	Fees to auditors for other services	30	–	–
534	Share of NZDF costs for maintaining services	595	521	580
77	Grants and contributions	76	98	85
185	Inventory items	142	200	101
110	General maintenance and servicing	102	141	142
314	Travel and related costs	305	501	479
136	Courses, conferences and exhibitions	98	137	137
722	Rental of premises	722	722	722
	Initial project costs			
1,068	C130 aircraft life of type study	1,428	1,751	1,836
55	Joint command and control system	1,260	–	844
24	Light operational vehicles	199	–	244
19	New naval ships	856	–	450
14	P-3 mission system upgrade	64	–	185
–	C-130 H life extension	34	–	185
–	Replacement jet aircraft	682	–	490
–	Other projects	–	395	–
562	Other operating costs	618	948	938
4,289	Total operating costs	7,301	5,564	7,568

Notes to the financial statements

For the year ended 30 June 2003

Note 8: Depreciation

30/6/2002 Actual \$000		30/6/2003 Actual \$000	30/6/2003 Main estimates \$000	30/6/2003 Supp. estimates \$000
56	Leasehold improvements	89	106	100
80	Office and computer equipment	67	107	65
1	Motor vehicles	–	–	–
158	Other assets	75	137	75
295	Total depreciation charge	231	350	240

Note 9: Capital charge

The Ministry pays a capital charge to the Crown on its average taxpayers' funds as at 30 June and 31 December each year. The capital charge rate for the year ended 30 June 2003 was 8 percent (30 June 2002 = 9 percent).

Note 10: Debtors and receivables

30/6/2002 Actual \$000		30/6/2003 Actual \$000
1,276	Sundry debtors – department	1,789
10	– non department	19
1,286	Total debtors and receivables	1,808

Notes to the financial statements

For the year ended 30 June 2003

Note 11: Property, plant and equipment

30/6/2002 Actual \$000		30/6/2003 Actual \$000
	Leasehold improvements	
491	At cost	511
(234)	Accumulated depreciation	(322)
257	Leasehold improvements – net book value	189
	Office and computer equipment	
793	At cost	837
(682)	Accumulated depreciation	(749)
111	Office and computer equipment – net book value	88
	Office furniture	
262	At cost	262
(262)	Accumulated depreciation	(262)
–	Office furniture – net book value	–
	Other assets	
895	At cost	925
(597)	Accumulated Depreciation	(673)
298	Other assets – net book value	252
	Total property, plant and equipment	
2,441	At cost	2,535
(1,775)	Accumulated depreciation	(2,006)
666	Total carrying amount of property, plant and equipment	529

Notes to the financial statements

For the year ended 30 June 2003

Note 12: Creditors and payables

30/6/2002 Actual \$000		30/6/2003 Actual \$000
75	Trade creditors	1,080
744	Accrued expenses	578
215	GST payable	139
1,034	Total creditors and payables	1,797

Note 13: Provision for employee entitlements

30/6/2002 Actual \$000		30/6/2003 Actual \$000
	Current liabilities	
187	Annual Leave	223
187	Total current portion	223
	Non current liabilities	
166	Long service, retirement and resigning leave	138
166	Total non-current portion	138
353	Total provision for employee entitlements	361

Notes to the financial statements

For the year ended 30 June 2003

Note 14: Financial instruments

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

Credit risk

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

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

Fair value

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

Currency risk and interest rate risk

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

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

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

Foreign exchange contracts (departmental)

The Ministry had no departmental foreign exchange contracts as at 30 June 2003. (30 June 2002 = \$1.862 million.)

Notes to the financial statements

For the year ended 30 June 2003

Note 15: Related party information

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

The Ministry enters into transactions with other Government Departments, Crown agencies and state-owned enterprises on an arms length basis. Where these parties are acting in the course of normal dealings with the Ministry, related party disclosures have not been made for transactions of this nature.

Note 16: Major budget variations

The major variations from the prospective financial information previously published in the 2002 Departmental Forecast Report are:

Statement of financial performance

- Operating costs were increased \$1,870,000 of which \$1,844,000 is to meet initial costs of new projects being developed. These initial costs are recovered from New Zealand Defence Force through Revenue Other and are fiscally neutral to Vote Defence. The projects in 2002/2003 were:
 - Joint command and control system
 - Replacement jet aircraft
 - New naval ships
 - P-3 Orion aircraft mission system upgrade
 - C-130 Hercules aircraft life of type study
 - C-130 Hercules aircraft mission system upgrade
- Revenue Other was increased \$1,844,000 for recovery of the above estimated costs from New Zealand Defence Force.
- The personnel budget was reduced because of the change to recognise employee entitlements beyond twelve months on a present value basis.

Statement of financial position (and cash flows)

- Debtors and receivables were higher than forecast because of initial project costs unpaid by New Zealand Defence Force at balance date.
- Creditors and payables were greater than forecast because of a higher level of trade creditors, and a larger liability for GST at balance date.

Part 4 : Non-departmental schedules



Statement of non-departmental accounting policies

Measurement and recognition rules applied in the preparation of these non-departmental financial statements and schedules are consistent with generally accepted accounting practice and Crown accounting policies.

These non-departmental balances are consolidated into the Crown Financial Statements and therefore readers of these statements and schedules should also refer to the Crown Financial Statements for 2002/03.

The following accounting policies have been applied:

Budget figures

The budget figures are those presented in the budget estimates (main estimates) and those amended by the supplementary estimates (supplementary estimates) and any transfer made by Order in Council under section 5 of the Public Finance Act 1989.

Revenue recognition

Military equipment is sold at cost to New Zealand Defence Force in July and January each year. Revenue is recognised and reported in those months.

Interest income

Interest income is recognised in the period in which it is earned.

Goods and services tax (GST)

Input GST on the procurement or refurbishment of military equipment is expensed.

Work in progress

Work in progress comprises project expenditure to be recovered from the New Zealand Defence Force for the six months preceding balance date, plus accruals at balance date.

Foreign currency

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

Monetary assets and liabilities are translated to New Zealand dollars at the closing exchange rate. The resulting unrealised exchange gain or loss is recognised in the schedule of non-departmental forecast expenses. Other exchange gains or losses, whether realised or unrealised, are recognised in the schedule of non-departmental expenses in the period to which they relate.

Schedule of non-departmental revenues and receipts

For the year ended 30 June 2003

Non-departmental revenues and receipts are administered by the Ministry on behalf of the Crown.

As these revenues and receipts are not established by the Ministry nor earned in the production of the Ministry's outputs, they are not reported in the Ministry's departmental financial statements.

30/6/2002 Actual \$000		Note	30/6/2003 Actual \$000	30/6/2003 Main estimates \$000	30/6/2003 Supp. estimates \$000
Administered on behalf of the Minister of Defence					
Sales of military equipment, at cost, to New Zealand Defence Force					
The individual projects are:					
81,170	Maritime helicopters		35,001	44,724	35,001
1,446	Orion autopilot		2,333	2,556	2,333
37,336	Anzac ships		37,235	45,589	37,235
70,144	Tactical communications equipment		19,077	36,305	19,077
86,497	Light armoured vehicles		31,142	68,783	31,142
3,479	Other projects		87	28	87
280,072	Total sales to New Zealand Defence Force		124,875	197,985	124,875
665	Interest on foreign currency investments	C1	392	600	350
115	Other revenue	C2	–	–	–
280,852	Total revenues and receipts administered on behalf of the Minister of Defence		125,267	198,585	125,225

(Figures are GST exclusive)

Schedule of non-departmental expenses

For the year ended 30 June 2003

Non-departmental expenses are administered by the Ministry on behalf of the Crown.

As these expenses are not spent in the production of the Ministry's outputs, they are not reported in the Ministry's departmental financial statements.

This schedule includes both capital and operating expenses.

30/6/2002 Actual \$000		30/6/2003 Actual \$000	30/6/2003 Main estimates \$000	30/6/2003 Supp. estimates \$000
Administered on behalf of the Minister of Defence				
	Purchase of military equipment			
The individual projects are:				
45,787	Maritime helicopters	15,745	6,331	33,409
2,531	Orion autopilot	1,177	–	1,370
32,944	Anzac ships	35,453	16,012	29,992
4,318	Light armoured vehicles	210,522	169,790	196,778
–	B-757 aircraft	93,694	–	121,373
40,469	Tactical communications equipment	7,306	8,532	22,890
2,070	Other	81	28	–
128,119	Total purchases of military equipment	363,978	200,693	405,812
34,350	GST input tax expensed	19,881	11,718	40,116
5	Other operating expenses	3	–	–
4,980	Unrealised exchange losses/(gains)	1,652	–	–
167,454	Total expenses administered on behalf of the Minister of Defence	385,514	212,411	445,928

(Figures are GST exclusive)

Schedule of non-departmental assets

For the year ended 30 June 2003

Non-departmental assets are administered by the Ministry on behalf of the Crown.

As these assets are neither controlled by the Ministry nor used in the production of the Ministry's outputs, they are not reported in the Ministry's departmental statement of financial position.

30/6/2002 Actual \$000		30/6/2003 Actual \$000	30/6/2003 Main estimates \$000	30/6/2003 Supp. estimates \$000
Administered on behalf of the Minister of Defence				
64,057	Crown bank accounts	49,321	66,055	70,704
140	Debtors and receivables	116	–	–
57,738	Work in progress	296,841	109,612	338,675
121,935	Total assets administered on behalf of the Minister of Defence	346,278	175,667	409,379

(Figures are GST exclusive)

Schedule of non-departmental liabilities

For the year ended 30 June 2003

Non-departmental liabilities are administered by the Ministry on behalf of the Crown.

As these liabilities are neither controlled by the Ministry nor used in the production of the Ministry's outputs, they are not reported in the Ministry's departmental statement of financial position.

30/6/2002 Actual \$000		30/6/2003 Actual \$000	30/6/2003 Main estimates \$000	30/6/2003 Supp. estimates \$000
Administered on behalf of the Minister of Defence				
3,079	Creditors and payables	11,568	9,586	9,586
3,079	Total liabilities administered on behalf of the Minister of Defence	11,568	9,586	9,586

(Figures are GST exclusive)

Schedule of non-departmental commitments

For the year ended 30 June 2003

Non-departmental commitments are administered by the Ministry on behalf of the Crown.

As these commitments are not incurred in the production of the Ministry's outputs, they are not reported in the Ministry's departmental statement of commitments..

30/6/2002 Actual \$000		30/6/2003 Actual \$000
Capital commitments		
164,332	Less than one year	281,370
310,574	One to two years	6,033
9,976	Two to five years	–
–	More than five years	–
484,882	Total non-departmental capital commitments	287,403

(Figures are GST exclusive)

These figures exclude the non-recoverable GST payable to the New Zealand Customs Service on the import of military equipment.

Statement of non-departmental expenditure and appropriations

For the year ended 30 June 2003

The statement of expenditure and appropriations details expenditure incurred against appropriations. The Ministry administers these appropriations on behalf of the Crown.

30/6/2002 Actual \$000		30/6/2003 Actual \$000	30/6/2003 Main estimates \$000	30/6/2003 Supp. estimates \$000
Vote Defence				
<i>Purchase or development of capital assets by the Crown</i>				
128,119	Defence equipment	363,978	200,693	405,812
34,350	GST on defence equipment	19,881	11,718	40,116
162,469	Total purchase or development of capital assets by the Crown	383,859	212,411	445,928

(Figures are GST exclusive)

Statement of non-departmental contingencies

As at 30 June 2003

There are no non-departmental contingent assets or contingent liabilities at 30 June 2003. (30 June 2002 = nil.)

Notes to the non-departmental schedules

For the year ended 30 June 2003

Note C1: Interest revenue

The Ministry invests foreign currency cash held prior to making payments with financial institutions that the Ministry deals with. All interest earned on short-term deposits is returned to the Crown.

Note C2: Other revenue

30/6/2002 Actual \$000		30/6/2003 Actual \$000
115	Refunds from foreign military sales cases following the decision to exit the arrangement to lease F-16 aircraft.	–
115	Total other revenue	–

Note C3: Budget composition

	30/6/2003 Main estimates \$000	30/6/2003 Supp. estimates changes \$000	30/6/2003 Budget total \$000
Current non tax revenue			
Crown interest	600	(250)	350
Capital receipts			
Defence equipment	197,985	(73,110)	124,875
Expenditure			
Defence equipment	200,693	205,119	405,812
GST on defence equipment	11,718	28,398	40,116

Notes to the non-departmental schedules

For the year ended 30 June 2003

Note C4: Major budget variations

Purchase or development of capital assets by the Crown – defence equipment

The appropriation was increased by \$205.119 million to recognise timing changes in existing contract payments, and new projects approved by Government during the financial year, not provided for in approved baselines. The projects involved were:

	\$(000)
Timing changes	
– Anzac ships	13,980
– Light armoured vehicles	26,988
– Orion autopilot	1,370
– Tactical communications	14,358
– Other	(28)
– Naval helicopters	27,078
New projects	
– Boeing 757 aircraft	121,373
	205,119

GST on defence equipment

The appropriation was increased by \$28.398 million to meet timing changes in import GST charges not provided for in approved baselines. The projects involved were:

	\$(000)
Timing changes	
– Anzac ships	136
– Light armoured vehicles	784
– Naval helicopters	8,455
– Orion autopilot	728
– Tactical communications	3,125
New projects	
– Boeing 757 aircraft	15,170
	28,398

Notes to the non-departmental schedules

For the year ended 30 June 2003

Note C5: Financial instruments

Currency risk

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

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

Foreign exchange contracts (Crown)

The Ministry had Crown foreign exchange contracts with a face value of \$224.295 million at 30 June 2003. (30 June 2002 = \$428.866 million.)

Part 5 : Other information



Equal employment opportunities

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

An EEO advisory group operates in the Ministry, with a responsibility to provide senior management with a regular state-of-EEO-health report.

Management performance

Good employer practices and staff development

The Ministry reinforces to staff the value and importance of maintaining and refining an effective performance management system. The performance management system provides professional feedback and development opportunities for the continuous improvement of staff performance. This is to ensure that staff performance remains a critical success factor in meeting the Government's defence goals.

Public service integrity

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

Quality

The Ministry is ISO 9001 certified. This means that it implements continuous improvements to its management, policies and procedures.

Disability

The Ministry has a Disability Strategy Implementation Work Plan. This covers the 2003/2004 year.

E-government

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

Organisation chart



Staff numbers at 30 June 2003 were 53 (excluding the Chief Executive).

Financial performance

	2002/03 Supp estimates \$000	2002/03 Estimated actual \$000	2002/03 Actual \$000
Departmental activities			
Revenue: crown	8,297	7,897	7,897
Revenue: other	3,990	3,990	4,338
Output expenses	12,287	11,887	11,611
Net operating surplus/(deficit)	–	35	664
Receipts from the sale of property, plant and equipment	20	–	–
Expenditure on property, plant and equipment	250	150	94
Taxpayers' funds	1,555	1,555	1,555
Net cash flows from operating, investing and financing activities	(170)	(55)	305
Non-departmental activities			
Purchase or development of capital assets on behalf of the crown	445,928	445,928	383,859
Total non-departmental revenue and receipts	125,225	125,225	125,267

Summary of appropriations

	Policy advice \$000	Audit and assessment of performance \$000	Management of equipment procurement \$000	Purchase or development of capital assets by the Crown \$000	GST on defence equipment \$000
Main estimates appropriation	3,303	1,877	6,539	200,693	11,718
Supplementary estimates change	–	90	2,014	205,119	28,398
Change by order in council under section 5 of the Public Finance Act 1989	–	–	–	–	–
Total amount appropriated for 2002/2003	3,303	1,967	8,553	405,812	40,116
Estimated actual outturn for 2002/2003 as reported in 2003/2004 estimates	3,129	1,958	8,285	405,812	40,116
Audited actual outturn for 2002/2003	2,912	1,824	8,405	363,978	19,881
Unappropriated expenditure, expenses or liabilities approved under section 12 of the Public Finance Act 1989	–	–	–	–	–
Unappropriated expenditure, expenses or liabilities requiring validating legislation	–	–	–	–	–

Historical financial performance of historical financial performance of significant items: Payments on behalf of the Crown

(a) Defence equipment

	2002–03 \$(000)	2001–02 \$(000)	2000–01 \$(000)	1999–00 \$(000)	1998–99 \$(000)	1997–98 \$(000)
Voted in Estimates	405,812	177,361	342,488	248,534	222,128	261,236
Actual Expenditure	363,978	128,119	316,435	214,820	197,388	165,366
Variance	41,834	49,242	26,053	33,714	24,740	95,870

(b) GST on defence equipment

	2002–03 \$(000)	2001–02 \$(000)	2000–01 \$(000)	1999–00 \$(000)	1998–99 \$(000)	1997–98 \$(000)
Voted in Estimates	40,116	35,424	41,202	85,673	8,850	80,280
Actual Expenditure	19,881	34,350	25,234	83,487	7,794	76,365
Variance	20,235	1,074	15,968	2,186	1,056	3,915

Historical financial performance of significant items: Receipts on behalf of the Crown

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

	2002–03 \$(000)	2001–02 \$(000)	2000–01 \$(000)	1999–00 \$(000)	1998–99 \$(000)	1997–98 \$(000)
Planned	124,875	280,071	189,075	230,741	196,028	226,359
Actual	124,875	280,072	189,076	194,886	196,007	157,130
Variance	–	(1)	(1)	35,855	21	69,229