



MINISTRY OF
DEFENCE

MANATU KAUPAPA WAONGA

Annual Report

2002



Report of the Ministry of Defence

for the year ended 30 June 2002

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MINISTRY OF
DEFENCE

MANATU KAUPAPA WAONGA

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Secretary of Defence's Overview

Introduction

The roles of the Ministry of Defence are to provide timely high-quality advice to help the Government make well-informed judgements in the defence of New Zealand and its interests, to arrange for the acquisition of significant items of military equipment needed to meet capability requirements, and to conduct audits and assessments of the New Zealand Defence Force (NZDF) and the major procurement activities of the Ministry.

The key objective over the last year has been the continued implementation of the Government's defence policy, as 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). This activity produced the Defence Long-Term Development Plan (LTDP) (11 June 2002) – a planning tool to enable decisions on defence capability acquisitions to be taken over the next ten years.

Policy has not been developed, implemented or evaluated in a vacuum. The terrorist attacks in the United States on 11 September 2001 reminded us that we have not reached the 'end of history' and the triumph of liberal democracy and free markets. While direct military threats to New Zealand may not have increased, we continue to face a variety of security challenges that require multifaceted responses. With a sizeable commitment to East Timor, and other commitments elsewhere in the world, NZDF personnel have been deployed to Afghanistan in support of United States and international forces. Policy will continue to evolve in response to these events and deployments.

One outcome has been a greater importance attached to New Zealand's international defence relations, particularly with countries engaged in the Asia-Pacific region. The ongoing development and management of these relations will be crucial for advancing New Zealand's security interests in the future.

Defence will continue to support a broader approach to security and work with civilian agencies such as the Police, Customs, and Fisheries to deal with challenges facing New Zealand. Enhancing the capabilities of the NZDF across all three services, through the implementation of the LTDP, will improve the ability of the NZDF to meet defence policy goals and contribute to wider government goals as well.

Policy and Planning

Development of defence and security policy is a key activity for the Ministry. The Secretary of Defence is the principal civilian advisor on defence matters to the Minister of Defence and other ministers. The Chief of Defence Force (CDF), who commands the NZDF, is the principal military advisor.

The Defence Policy and Planning Unit (DPPU), a combined Ministry and NZDF policy unit, has continued to evolve in its role of providing a single stream of policy advice to the CDF and to the Secretary, and through them to the Government. The DPPU consists of the International Defence Relations (IDR) Branch and the Strategic Policy (SP) Branch.

IMPLEMENTING THE GOVERNMENT'S DEFENCE POLICY

The DPPU's work has been focused on the implementation of the *Government Defence Statement*. The Statement sets out the Government's priorities for rebuilding the NZDF 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; and
- A funding commitment to provide financial certainty.

The implementation of the Statement has involved a number of reviews, both policy and capability, culminating in the Government's release of the LTDP – a planning tool to enable decisions on defence capability acquisitions to be taken over the next ten years.

POLICY REVIEWS

Pacific Review

In response to a prime ministerial directive about the need to review relations with the Pacific Islands region, the DPPU has completed a review of Defence engagement in the Pacific, *New Zealand and the Pacific Islands: Security Through Partnership*, setting out New Zealand's defence obligations, responsibilities, and interests in the Pacific. External agencies consulted during the Review included the Ministry of Foreign Affairs and Trade (MFAT), the Ministry of Pacific Island Affairs, the Treasury, the Police, the Department of Prime Minister and Cabinet (DPMC), the Ministry of Fisheries, and the New Zealand Customs Service. The Review recommends greater levels of defence and security engagement, including through the NZDF Mutual Assistance Programme. The Review awaits consideration by the Government.

Defence Implications of 11 September

The DPPU considered the defence implications of the 11 September 2001 terrorist attacks in the United States and consulted with other agencies, including the NZDF, MFAT, DPMC (External Assessments Bureau, and Domestic and External Security Secretariat), and the Police. Themes from this consultation process have been incorporated into thinking on the LTDP.

Arms Control and Disarmament, Antarctica, and Oceans Policy

The DPPU has also been involved in policy development with other agencies. Arms control and disarmament continues to be of interest to Defence and the DPPU worked with MFAT on the issues of small arms and the Certain Conventional Weapons Convention. The DPPU participated in the Officials' Antarctic Committee meetings, hosted by MFAT, and contributed to the development of the new strategic interests statement and fishing policy for the Southern Ocean and Ross Sea. Defence will also contribute, as appropriate, to the inter-agency oceans policy process.

CAPABILITY REVIEWS

The Maritime Forces Review

The Maritime Forces Review was released in January 2002. In addition to the military and foreign policy uses of naval vessels, the Review took into account the recommendations of the *Maritime Patrol Review* (February 2001), in particular:

- the civilian requirement for coastal and mid-range offshore capabilities;
- the roles to be performed in conjunction with New Zealand's responsibilities and obligations in respect to the Southern Ocean and Ross Dependency;
- the need for an appropriate sealift capability, including the use of such a capability for disaster relief and other tasks in the South Pacific; and
- the need for, and priority to be accorded to, the roles performed by the Royal New Zealand Navy Volunteer Reserve.

The Government's objective is to equip the Navy with a practical fleet that is modern, sustainable and matched to New Zealand's needs. To meet this objective, the Review recommended that the Naval Surface Fleet comprise:

- the Naval Combat Force to meet military tasks;
- the Naval Support Force consisting of the underway replenishment ship and a new multi-role vessel for tactical sealift, patrol, and training;
- a Naval Patrol Force with inshore and offshore capabilities;
- the Clearance Diving Support and Mine Countermeasures Force; and
- a hydrographic survey capability (subject to separate review, see below).

During the course of the Review, the Ministry undertook extensive consultation with external agencies, such as Customs, the Ministry of Fisheries, the Department of Conservation, the Maritime Safety Authority, and the Police, to assess their requirements.

The Government agreed to the Review recommendations. It directed the Ministry, in consultation with the NZDF and other departments and agencies as appropriate, to canvass proposals from industry to meet the requirements for tactical sealift, training, and offshore and inshore patrol capabilities at a cost not exceeding NZ\$500 million.

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 the Navy was the most appropriate provider; and, examine the present funding-provider arrangement between the NZDF and Land Information New Zealand (LINZ). The review was submitted to the Minister of Defence in July 2002.

Long-Term Development Plan

The LTDP is a planning tool to enable decisions on defence acquisitions to be taken in the context of current defence policy, the priority of projects, and affordability. The Plan links the defence policy objectives with the 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. It is a major policy document and, along with *The Government's Defence Policy Framework* and the *Government Defence Statement*, completes a phase of significant policy development.

Capability projects have been prioritised and categorised to reflect their relationship to meeting current defence policy objectives. The categories are: projects approved in principle by government; projects necessary to avoid the failure of policy; projects necessary to provide a well-equipped land force; projects necessary to avoid significant risks to policy; and, projects that have benefit but are less critical to achieving policy objectives.

The LTDP will be updated regularly as projects are completed. The Ministry and the NZDF are now developing planning and decision-making processes which will incorporate management of both operational and financial risks to ensure that investment in defence provides the best value for money.

The LTDP will be managed within approved financial parameters, which are:

- up to \$1 billion, in nominal terms, in capital injections over the next 10 years, which, with depreciation, will provide at least \$2 billion for new acquisitions;
- current operating baselines set to 2005/06 with adjustments for unfunded depreciation thereafter;
- any inflationary pressure to be managed within these constraints until 2005/06; and
- leasing options may be considered where there is a neutral trade-off between capital and operating expenditure.

The LTDP 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 LTDP, and the affordability of that project within the overall context of the LTDP. The \$2 billion cap does not include those projects already funded and underway: light armoured vehicles, Seasprite helicopters, and Army radios.

Implementation of the LTDP will comprise a significant proportion of the DPPU's work in the coming year. This will include work on projects such as the Ohakea runway upgrade, the P-3 Orion mission systems upgrade, and the C-130 and B727 replacement projects.

International Defence Relations

Developments in the Asia-Pacific region influence New Zealand's security and well-being. We are strongly committed to playing a meaningful role in the maintenance of regional peace and security. New Zealand considers defence and foreign policy to be a partnership working in a comprehensive way to secure our territorial, economic, social and cultural interests and to meet our collective and global responsibilities. The demands on New Zealand are likely to intensify as we play a meaningful part in the campaign against international terrorism and deal with its root causes.

In the South Pacific, heightened ethnic and nationalist tensions continue to have a destabilising influence, particularly in Melanesia. In Solomon Islands, a failing peace process, the law and order crisis, and the damage it has inflicted on the country's weak institutional foundations, threaten to produce the region's first failed state. Elsewhere in our neighbourhood, peace and security are being undermined by the spread of trans-national crime, problems of governance, and intractable land grievances. The peace process in Bougainville, in which New Zealand continues to take a prominent role, represents one of the few optimistic spots in an otherwise problematic region.

New Zealand is an active participant in measures designed to reinforce stability in Southeast Asia. The ASEAN Regional Forum, with its broad membership, provides opportunities for New Zealand to work with other Forum members in promoting regional security. We are committed to the Five Power Defence Arrangements. This is our major point of defence contact with Singapore and Malaysia, and is tangible evidence of New Zealand's contribution to confidence building and preventive diplomacy in the region. The UN Mission of Support in East Timor and its predecessor missions, to which New Zealand has made a meaningful and long-standing troop contribution, is one of the most successful operations of its type.

The 11 September 2001 terrorist attacks on the United States have heightened our understanding of the threat to regional security posed by trans-national actors. We need to be alert to the linkages between terrorism and other trans-national threats such as piracy, illegal seaborne immigration, drug trafficking, and money laundering. Countering these threats will require constant vigilance, cooperation and dialogue.

The NZDF is not only responsible for the defence of New Zealand; it also represents a force for good in the world. The deployment of New Zealand servicemen and women in support of multilateral peacekeeping missions reinforces our wider commitment to collective security and our credentials as a good international citizen. Peacekeeping complements and strengthens New Zealand's profile in areas of considerable international tension, and strengthens our voice in calling for widespread participation in missions of importance to us in the Asia-Pacific region. Our contribution in Afghanistan is just the latest example of our preparedness to uphold the principles of international law and collective responsibility.

CLOSER DEFENCE RELATIONS WITH AUSTRALIA

Australia is New Zealand's most important and valued defence partner. A strong strategic relationship with Australia in support of common interests for a secure and peaceful region is a key outcome in *The Government's Defence Policy Framework*. We share a common commitment to the security and stability of the Asia Pacific region as reflected in our combined efforts in Bougainville, East Timor, and Solomon Islands. The East Timor mission, in particular, underlines our ability to work together effectively in an operational environment.

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 last year's meeting in Melbourne, Ministers directed their officials to give further emphasis to achieving the highest possible levels of interoperability between the two defence forces within national defence priorities, so that the full potential of Closer Defence Relations can be realised. In our assessment, practical levels of interoperability are very good. Recent

positive developments include the establishment of Headquarters Joint Forces New Zealand, which has greatly enhanced ADF-NZDF relations at the operational level, and the release of the LTDP. These will address many of the capability-based interoperability gaps that currently exist between Australia and New Zealand.

SOUTH PACIFIC

New Zealand shares security concerns with much of the Pacific through geographic proximity, common points of history, people to people links, commercial opportunities, social and humanitarian concerns, and diplomatic goals. Our mutual interests interact through complementary objectives, shared responsibilities and similar, emerging security challenges. As regional security issues become increasingly complex, conventional means of promoting security need to be adapted to meet them. Isolation no longer provides an adequate or partial solution for the region.

We are seeking better-targeted and more effective delivery of defence assistance to the South Pacific. This includes developing with the New Zealand Police a coordinated programme of assistance for law enforcement.

Papua New Guinea (PNG)

Our defence assistance to the PNG Defence Force has slowed as it grapples with the need to downsize and restructure to remain within budget. The apparent willingness of elements within the PNG Defence Force to become involved in the political process is of major concern.

Bougainville

The Bougainville Peace Agreement sets the scene for peace on the island. It provides for the establishment of an Autonomous Bougainville Government; an opportunity for the province to hold a referendum in the longer term to determine its political future; and a weapons disposal process. The Peace Monitoring Group, of which New Zealand is a member, continues to have an important role in building confidence in the political settlement and in supporting the weapons disposal process. A premature exit might simply create a situation where we are forced to re-deploy at some later date.

Solomon Islands

Solomon Islands is entering a critical period. Problems with governance, a faltering peace process, growing lawlessness and an economy in crisis are placing serious pressure on the Solomons as a unitary state. An improvement in the law and order situation is a prerequisite for economic recovery and the restoration of donor confidence.

The International Peace Monitoring Team (IPMT) completed its phased withdrawal from Solomon Islands in June. The IPMT had fulfilled its mandate to the extent that it was able. Open ethnic conflict has not reignited since the IPMT's deployment in November 2001. Addressing the deteriorating law and order situation through the Solomon Islands Police Project represents a better use of New Zealand's resources.

One member of the DPPU was part of the Election Monitoring Team while another was deputy leader of the IPMT and then Deputy High Commissioner.

Fiji

Reform of the Republic of Fiji Military Forces (RFMF) is fundamental to the organisation's present and future stability. Although the sanctions imposed by New Zealand against Fiji following the events of May 2000 have been lifted, there has been no resumption in bilateral defence cooperation. The one exception is the provision of refresher training for RFMF personnel in dealing with unexploded ordnance prior to deployment to East Timor. Consideration is being given to a renewed Mutual Assistance Programme with Fiji, although it would not necessarily resemble past programmes.

SOUTHEAST ASIA

Southeast Asian countries condemned the 11 September 2001 attacks, but there have been differences of emphasis in responding to the United States-led campaign against terrorism. The region's two significant Muslim nations, Indonesia and Malaysia, for example, have called for caution while the Philippines has invited direct United States military support. Southeast Asian economies are slowly recovering from the economic crisis of 1997, but the region must still deal with heightened ethnic tensions, and a growth in the incidence of trans-national crime, especially piracy and illegal migration.

New Zealand maintains important bilateral and multilateral defence and security relationships in Southeast Asia.

Five Power Defence Arrangements (FPDA)

The FPDA continues to make an important contribution to regional security by enhancing cooperation among its members: Australia, New Zealand, Malaysia, Singapore and the United Kingdom. The Minister of Defence's attendance at the Informal Ministers' Meeting and 50th Anniversary Celebrations in Malaysia last year reinforced the importance we place on the FPDA. New Zealand participates actively in FPDA exercises through the commitment of P-5 Orions as well as our Navy and Army assets. We have also supported the organisational changes adopted by FPDA such as the establishment of the joint headquarters, mechanisms for policy development, and arrangements for more effective integration of activities.

Thirty years on, the FPDA still provides participant countries with a useful mechanism for consultation and cooperation on defence matters. It is also a significant regional confidence building measure. The utility of the FPDA resides as much in the political commitment it represents as in the practical operational benefits it offers.

ASEAN Regional Forum (ARF)

New Zealand is committed to the ARF process as the only pan-regional forum devoted to discussing security issues. Against the expectations of many, the ARF has developed into a valuable forum and with the adoption of the first management tools for addressing regional security situations, attention is now focusing on proposals to enhance its role. The ARF is engaged in the regional response to terrorism and we are contributing to regional co-operation on terrorism issues. New Zealand Defence officials have participated in the two Inter-Sessional Group (ISG) meetings in New Delhi and Hanoi, and the Senior Officials' Meeting in Brunei. New Zealand has led the development of a register for ARF Confidence Building Measures to aid in the rationalisation of this process and supported efforts to enhance Defence participation in the ARF process, which are now gathering momentum. Most importantly, the ARF has accepted New Zealand's offer to co-host the next two ISG meetings. The first of these will be held in Wellington in November 2002.

Singapore

Singapore is our second most active defence partner after Australia. In the last year, the Minister of Defence has met with his Singaporean counterpart, Dr. Tan, at the FPDA Defence Ministers' Meeting and at the IISS Asia Security Conference in Singapore. The Singaporean Secretary of Defence visited New Zealand in July 2001. Senior meetings reinforce the considerable scope for defence cooperation both bilaterally, through regular exercises, training, and exchanges, and multilaterally, through groupings such as the FPDA and ARF. The defence relationship is an important strand of the wider bilateral contact between our two countries and has a part to play in underpinning new endeavours and foreign policy collaboration. Our cooperation in East Timor and the Closer Economic Partnership are cases in point.

Malaysia

New Zealand values its close bilateral defence relationship with Malaysia. As with Singapore, we welcome opportunities to co-operate bilaterally through meetings, exercises, and exchanges, and in multilateral co-operation through the FPDA and ARF. The Minister of Defence met with Malaysia's Minister of Defence, Datò Seri Najib, at the FPDA Defence Ministers' Meeting and again at the IISS Conference. The two Secretaries of Defence met in Kuala Lumpur for the Senior Executives' Meeting in May this year.

Thailand

We have close relations with Thailand in respect of our mutual participation in East Timor. We will be working closely with Thailand as they move to take over our area of operations once we withdraw our battalion. In addition to peacekeeping, we have an active programme of training through the Mutual Assistance Programme, as well as bilateral exercises and visits.

East Timor

New Zealand continues to make a major contribution to the newly independent nation of East Timor. By the time we withdraw our battalion group and RNZAF Iroquois helicopters in November 2002, we will have sustained this level of commitment, our largest to an operational mission for several decades, for over three years. This is a major achievement for a defence force with only two regular force battalions.

The withdrawal of our battalion and helicopters will be an important part of the phased downsizing of the UN presence in East Timor (the UN is planning on a full departure by mid-2004). This will signal the end of a NZDF ground presence in East Timor. Options for a much-reduced military contribution, likely to be a mix of staff officers, military observers and trainers for the East Timor Defence Force, are currently under consideration.

Other Southeast Asian Nations

New Zealand maintains small, but important, defence relationships based on Mutual Assistance Programme cooperation with Brunei and the Philippines. New Zealand remains committed to the demining process in Cambodia and Laos, where NZDF Technical Advisors are deployed. Our newest relationship in the region is with Vietnam. Our defence attaché in Thailand was cross-accredited to Hanoi last year and has established good contacts.

NORTH ASIA

One of the principal determinants of the shape of the political, economic and strategic landscape in the Asia-Pacific region is the triangular relationship between the United States, China, and Japan. In the wake of 11 September 2001, the United States is now viewing international security through an anti-terrorism prism that has resulted in increased levels of dialogue and cooperation across the Asia-Pacific region. China's cooperation with the United States in forming a global coalition in response to the terrorist attacks provided a timely circuit breaker in Sino-United States relations following their deterioration earlier last year (by next October, Presidents Bush and Jiang will have held three summits inside 12 months). Cross-straits relations between China and Taiwan appear to have entered a new positive phase but tensions on the Korean peninsula continue to cast a shadow over the region. Doubts about Pyongyang's commitment

to inter-Korean rapprochement have again been heightened in the wake of the recent naval clash in the Yellow Sea.

Reflecting the rapid growth and importance of New Zealand's wider relationships in Northeast Asia, appropriate reciprocal contact in the defence and security arena has continued. Northeast Asia is a region where strategic realities, uncertainties and market opportunities combine to compel a strategy of greater engagement. Moreover, there is an expectation on the part of countries in the region that a well-rounded relationship will have a defence component.

China

Defence contacts constitute one element of a wide-ranging and increasingly important relationship with China. 2002 is the 30th year of diplomatic relations and good progress continues to be made in developing closer defence links. Highlights included the visit to New Zealand in March by General Qian Shugen, Deputy Chief of the General Staff. His visit was preceded by a series of senior Peoples Liberation Army (PLA) delegations. The Minister of Defence, the Secretary of Defence and the former Chief of Air Staff made reciprocal visits to China. A third PLA officer is attending the RNZAF Command and Staff College senior officers' course and, in August 2002, this course will itself visit China. For the past three years NZDF officers have gained benefit from international security seminars hosted by the National Defence University in Beijing. Later this year the frigate HMNZS *Te Kaha* will visit Shanghai as part of a wider programme of regional port calls.

Republic of Korea

There has been increasing contact between New Zealand and the Republic of Korea (ROK) on security and defence issues. The Ministry hosted a third round of military-military talks in July 2001, followed by a delegation from the Korea National Defence University in October. The former Chief of General Staff visited Korea in September 2001. There is the potential for further cooperation especially in counter-terrorist training and maritime patrol exercises. HMNZS *Te Kaha* is scheduled to visit Korea later this year. In another positive development the ROK military hopes to accept a place on the RNZAF Command and Staff College senior officers' course in 2005.

Japan

Defence links with Japan have developed quickly, as reflected by the exchange of visits by Defence Ministers and senior military officers. The first bilateral defence meeting at full ministerial level took place in Tokyo last November. The Chairman of the Joint Staff Council, General Takegouchi, followed this with a visit to New Zealand in January 2002, the first visit by such a senior Japanese officer in nearly 20 years. Senior Vice Minister for Defence Mr

Kyogon Hagiwara's earlier visit to New Zealand in September 2001 was another significant milestone in the relationship.

The Chief of Naval Staff will attend the 8th Western Pacific Naval Symposium in Tokyo just prior to the Japan Maritime Self Defence Force's 50th Anniversary International Fleet Review in October 2002 in which HMNZS *Te Kaha* will also participate. There is a growing defence association through the ARF process and defence cooperation in East Timor. In addition to the annual NZDF involvement in security seminars hosted by the Japan Defence Agency, a second round of security consultations will probably be held in Tokyo later this year.

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 have further advanced the defence relationship.

United States

Having established common cause with the United States on counter-terrorism, a key component of the bilateral defence dialogue is on dealing with terrorism. New Zealand is one of a handful of countries committed to the military campaign in Afghanistan, a fact that is recognised and appreciated by the United States. The intensified cooperation on terrorism does not depend on the resolution of differences over our nuclear-free policy.

Canada

New Zealand has a close defence relationship with Canada. It centres on cooperation in peacekeeping, participation in exercises, and an annual three-month reciprocal exchange of around 20 personnel from each country. New Zealand is purchasing 105 Light Armoured Vehicles (LAV III) from General Motors Defence Canada to replace the Army's existing M113 Armoured Personnel Carriers. The LAV III has a high degree of commonality with the Canadian Army vehicle, and their purchase will lead to contacts and interoperability between our two armed forces.

PEACEKEEPING

New Zealand has a long-standing and active record of participating in international peace support operations. Including a battalion level commitment in East Timor, the NZDF is

committed to twelve United Nations or United Nations-sanctioned peace support and humanitarian demining missions around the world, including the Middle East, the Balkans, Africa, Afghanistan, and Indochina. At present, 804 NZDF personnel are serving on peace support missions. Overall, New Zealand has participated in more operational commitments in the last five years than in the previous twenty.

Acquisition

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

Major projects for the Acquisition Division currently include the LAV III, the Light Operational Vehicles, new naval vessels, maritime helicopters, and tactical communications equipment.

UPGRADING THE ARMY

Vehicles

Light Armoured Vehicles – Production of the pre-production unit has been completed and the vehicle is currently undergoing contractor testing. The first batch of vehicles is due for acceptance in September 2003 with the last batch due in November 2004.

Light Operational Vehicles – Tenders have been requested for the supply of both Military Vehicles (MV) and Limited Capacity Military Vehicles (LCMV). In the case of the MV, tenders were released to the five manufacturers whose vehicles had passed the NATO Reference Mobility Model tests and in the case of the LCMV, tenders have been advertised on a worldwide basis.

Tactical Communications

This project covers tactical communications for the Army and supporting RNZAF units. The Government approved the purchase of the equipment on 20 September 2000. The supplies are obtained through the United States Government Foreign Military Sales (FMS) organisation. Deliveries have already commenced and the project will be completed within budget and on time.

Weapons

The direct fire support weapon (area) and the medium range anti-armour projects have been on hold pending the development and approval of the LTDP. Government approval to proceed with the projects will be sought when the timing is determined by the NZDF.

NEW NAVAL VESSELS

Following the Government's endorsement of the Maritime Forces Review, Project PROTECTOR has been initiated to purchase new vessels for the Navy. The Ministry, in consultation with the NZDF and other appropriate agencies, is developing functional descriptions of the capabilities required for the multi-role vessel and patrol vessels for distribution to industry. This work includes the preparation of Registration-Of-Interest and Requests-For-Proposal documentation. Information flowing from the Registration-Of-Interest process may allow the Ministry to provide fleet composition options to the Government later in 2002.

AIR TRANSPORT CAPABILITIES

Fixed Wing Transport

Marshall Aerospace of the United Kingdom has been contracted to undertake a Life of Type Study on the C-130H Hercules aircraft fleet. The study will determine the configuration and condition of the aircraft and identify the feasibility and costs of extending their life. The final documentation for this study is scheduled for delivery in September 2002.

A Force Development Proposal is currently being prepared by the NZDF to detail the requirements for replacing the B727 aircraft. The NZDF requirements will be considered as part of a broader policy review by the Ministry of total fixed wing transport needs, with the results from the C-130 Life of Type Study being apposite. Subject to government approval to purchase new aircraft, proposals will be sought from industry worldwide to fulfil this requirement. Proposals are anticipated to include, as options, outright ownership, operating lease and shared ownership.

MARITIME SURVEILLANCE AIRCRAFT

P-3 Orion

Replacement of fatigue and corrosion critical structure on the six P-3 Orion aircraft to extend their life for another twenty years has been completed. A replacement autopilot system has been installed in all the aircraft.

Maritime Helicopters

The first four aircraft received final acceptance on 6 May 2002.

All aircrew and maintainer training by the manufacturer, required under the contract, has now been completed. Further training, associated with depot level maintenance on the Automatic Stabilisation System, will take place at the manufacturer's facility in September 2002.

The fifth aircraft is being accelerated through the production process and is due for delivery in December 2002.

A JOINT APPROACH

Joint Command and Control System

Following an Invitation-to-Register for a Project Definition Study, three tenderers were invited to respond to a Request-for-Proposal and their proposals have been received. The selection of a preferred tenderer is expected to be made in August 2002, and it is expected that the Project Definition Study will be completed by July 2003.

NEW ZEALAND INDUSTRIAL INVOLVEMENT

Defence Technologies New Zealand Joint Action Group

The Ministry has continued to support local companies seeking to obtain defence work from major acquisition projects and through exports. The main conduit for this assistance has been through the group of local companies, Defence Technologies New Zealand Joint Action Group (JAG), which have a focus on defence work. The Ministry provided regular briefings at JAG meetings and assisted that organisation to make contact with appropriate defence people in New Zealand, Australia and overseas. Assistance is also provided to JAG as sponsors of the annual Defence Industry Seminar. The 2001 event was held in Palmerston North and was well attended by defence and industry representatives.

Defence Industry Committee of New Zealand

The Ministry provided support for the Defence Industry Committee of New Zealand (DICNZ). This minister appointed committee provides industry feedback into Defence and briefs the Minister of Defence on issues relating to industry. The DICNZ established the Defence Industry Committee Awards of Excellence, which are awarded annually to companies that have provided Defence with excellence in service or products. The Minister presents the Awards at the Defence Industry Seminar dinner. The winner in 2001 was Australian Aerospace Pty Ltd (formally Celsius Hawker Pacific) which was the Ministry's contractor responsible for replacing the

fatigue and corrosion critical structure on the six P-3 Orion maritime patrol aircraft – Project KESTREL. Australian Aerospace demonstrated exceptional innovation, co-operation and flexibility in undertaking the aircraft refurbishment work.

Evaluation

The Evaluation Division carries out assessments and audits, under section 24(2)(e) of the Defence Act 1990, of any function, duty or project of the NZDF. The Division also conducts audits of the Ministry's activities relating to the procurement of major military capabilities.

These assessments and audits are undertaken when required by the Minister of Defence, or to a programme approved under the authority delegated by the Minister to the Secretary of Defence and the CDF. Reports and completed audits are submitted to the responsible chief executive and the Minister is provided with a copy.

The Secretary of Defence and the CDF, 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.

During the year the Division completed reports on:

- Overseas travel by NZDF Chiefs of Staff and Senior Officers;
- Physical security arrangements for NZDF establishments in the Wellington area;
- NZDF civil staff management delegations;
- Naval individual training;
- The Naval Health Service clinical services business unit;
- NZDF health and safety in employment policies and systems;
- Project KESTREL (the re-winging of the P-3 Orion aircraft);
- Disposal of used Army clothing; and
- NZDF leave policies.

The Evaluation Division also undertook internal audits of the Ministry for the Secretary.

In addition to undertaking audits to meet the Secretary's responsibilities under the Defence Act, the Division can undertake audits under section 5(6) of the Hazardous Substances and New Organisms Act 1996. During the year the Division monitored the NZDF's progress in introducing codes of practice and management systems for hazardous substances.

Corporate

The Corporate Division provides support services and policy advice in the areas of human resources, information management and technology, communications, and legal. It is responsible for all aspects of Ministerial services and support.

Over the last year, improvements and enhancements to the Ministry's management systems have continued. The revision of policies and procedures has been completed with the implementation of a comprehensive human resources manual.

Improvements and enhancements have been made to the electronic document management system and other electronic systems, and to the management of the Ministry's hard copy records.

The Division has started work on revising the Ministry's Strategic Business Plan in preparation for the first Statement of Intent to be published next year.

The Hunn Review

The Hunn review into the accountabilities and structural arrangements between the Ministry and the NZDF is nearing completion. The review is expected to make recommendations about the strategic level structure of Defence in order to optimise the delivery of high quality policy advice and to improve the effectiveness of the two organisations.

Conclusion

The release of the LTDP will have a major impact on the future work of the Ministry. The Plan sets out the path ahead for capability development and will determine the work of Policy and Planning, Acquisition, and Evaluation as projects are developed and new internal processes put into place.

Now that defence policy has been articulated in three over-arching government documents, released seriatim since 2000, a challenge for the Ministry is to communicate New Zealand's defence direction to our allies and friends, and to explain how the upgrade of existing equipment and the introduction of new equipment will be utilised to underscore our commitment to regional and international security.

As an organisation, the Ministry is performing a wider role as well as improving its own internal processes. There may be further organisational change ahead, but the Ministry will remain committed to providing high-quality outputs in its policy, acquisition, and evaluation roles.

A handwritten signature in blue ink that reads "Graham Fortune". The signature is written in a cursive, flowing style.

Graham Fortune

Secretary of Defence

23 September 2002

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 2002.



Graham Fortune
Secretary of Defence
26 September 2002

Countersigned by:



S J Patterson
Assistant Secretary of Defence (Finance)
26 September 2002



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 2002

We have audited the financial statements on pages 22 to 68. 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 2002. This information is stated in accordance with the accounting policies set out on pages 41 to 44

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 2002, 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 accounts 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). 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 22 to 68:

- comply with generally accepted accounting practice in New Zealand, and
- fairly reflect:
 - the Ministry of Defence’s financial position as at 30 June 2002;
 - 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 26 September 2002 and our unqualified opinion is expressed as at that date.



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



Statement of Objectives and Service Performance

For the year ended 30 June 2002

OBJECTIVES

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

QUALITY ASSURANCE

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

OUTPUT CLASS PERFORMANCE

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

CLASS OF OUTPUT D1 – POLICY ADVICE

DESCRIPTION

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

OUTCOME

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

SERVICE PERFORMANCE

TARGET

DELIVERED

- | TARGET | DELIVERED |
|---|--|
| <p>1. <i>Undertake analysis of significant issues that have an impact on the Government's defence and security policies</i></p> | <ul style="list-style-type: none"> ▪ The review on Information Operations was completed in August 2001. ▪ The review of New Zealand's Pacific defence and security policy was completed in April 2002. ▪ A paper on post-11 September implications for defence policy was completed in March 2002 and discussed with agencies. A supplement drawing out the key themes of the discussions has been substantially completed. |
| <p>2. <i>Undertake capability reviews to identify the options for achieving the Government's defence policy goals</i></p> | <ul style="list-style-type: none"> ▪ The Maritime Forces Review was completed in November 2001. ▪ The Hydrographic Survey Review was completed by the independent chair, Mr Ross Tanner, in April 2002. Final comments from agencies were conveyed to the Secretary of Defence in June 2002. |

- Input on policy concerning the mission systems upgrade for the P-3 Orion aircraft and the upgrade/replacement of the fixed wing transport aircraft (C-130 Hercules and Boeing 727s) is being provided in the development of options for the Government's consideration.
 - The Government's Long-Term Development Plan for the New Zealand Defence Force was completed by the Ministry of Defence and New Zealand Defence Force in June 2002. Work is underway on developing management and costing systems for the LTDP.
 - The review of the Naval Medical Service was completed by the Evaluation Division under Output Class 2.
-

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

- *Pacific*
Mutual Assistance Programme (MAP) talks were held with:
 - the Cook Islands;
 - Samoa;
 - Tonga; and
 - Vanuatu.
- *South East Asia*
Bilateral security and defence talks, including MAP talks, were held with:
 - Malaysia;
 - Singapore;
 - Philippines;
 - Thailand; and
 - Brunei.
- *North Asia*
The Ministry hosted bilateral military-military talks with Korea, followed by a delegation from the Korea National Defence University.
- *High Level Visits*
New Zealand hosted a number of high level visits including:
 - Lieutenant General Peter Cosgrove, Australian Chief of Army
 - Mr Dennis McNamara, Deputy Head of UNTAET (East Timor)
 - Lord Bach, the United Kingdom Under Secretary of State and Minister of Defence Procurement

- Admiral Sir Nigel Essenhigh, the United Kingdom First Sea Lord and Chief of Naval Staff
- Admiral Sir Michael Boyce, the United Kingdom Chief of Defence Staff
- Congressional Delegation from the United States led by Chairman Henry Hyde, House of Representatives, International Relations Committee
- General Edwin Smith, the United States Commanding General US Army Pacific
- General Qian Shugen, Deputy Chief of the General Staff, People's Liberation Army
- Mr Kyogon Hagiwara, Vice Minister for Defence, Japan
- General Takegouchi, Chairman of the Joint Staff Council, Japan Self Defence Force.

■ *Visits by New Zealand*

The Secretary of Defence:

- attended the ASEAN Regional Forum Ministerial Meeting in Hanoi;
- attended the Asian Aerospace Exhibition in Singapore;
- made an official visit to China; and
- visited Kuala Lumpur for the Senior Executives Meeting with his Malaysian counterpart.

There were high-level visits by the New Zealand Defence Force to:

- Australia;
- Afghanistan;
- China;
- South Korea;
- East Timor;
- France;
- Brussels;
- United States;
- United Kingdom;
- Middle East; and
- throughout the South Pacific.

- *Briefing Notes:*

Briefing notes were prepared for visits by the:

- Prime Minister, Minister of Foreign Affairs and Trade and Minister of Defence to Australia;
 - the Minister of Defence's visits to China and Japan;
 - the Prime Minister and Minister of Foreign Affairs and Trade visits to East Timor;
 - the Prime Minister's visit to Washington;
 - Minister of Foreign Affairs and Trade to Croatia and Bosnia-Herzegovina and
 - the military-to-military talks with France and the European Union.
-

4. *Participate in the regional multilateral security dialogue*

- *BRITANZ (Britain, Australia, New Zealand) Principals' meeting:*

- The Chief of Defence Force, Air Marshal Ferguson, hosted the British Chief of Defence Staff, Admiral Sir Michael Boyce, and the Australian Chief of Defence Force, Admiral Barrie, for the biennial BRITANZ Principals' meeting in Blenheim in April 2002.

- *ASEAN Regional Forum (ARF):*

- Participated and contributed to one Senior Officials' Meeting (SOM) and two Intersessional Group (ISG) meetings.
- Preparations have begun for New Zealand to co-host the next ISG meeting in Wellington, November 2002.
- The New Zealand Defence Force has been represented at all the meetings of the ASEAN Regional Forum Heads of Defence Colleges and Institutions. The Commandant of the RNZAF Command and Staff College attended the 5th meeting in Tokyo in August 2002.

- *Five Power Defence Arrangements (FPDA):*

- The Minister of Defence attended the Ministerial meeting and ASEAN 50th anniversary celebrations in July 2002.

- *International Institute of Strategic Studies (IISS):*

- The Minister of Defence attended the first meeting in Singapore in June 2002 of Asia Pacific Defence Ministers organised by the London based IISS.

- *Forum Regional Security Committee Meeting:*

- There was representation at the annual meeting held in Nadi, Fiji.

- *Japan:*
 - Ministry staff attended the Japanese Defence Agency (JDA) *Forum for Defence Authorities in the Asia Pacific Region*.
 - There was involvement in the annual National Institute for Defense Studies (NIDS) *Asia-Pacific Security Seminar*.

-
5. *Host the annual meeting of Australian and New Zealand Defence Ministers and senior officials*
- The annual meeting of New Zealand and Australian Ministers of Defence and the concurrent annual meeting of the Australia-New Zealand Consultative Committee (ANZCC) (comprising defence principals) took place in July 2001. Arrangements were made for the Ministerial Meeting and ANZCC scheduled to take place in Wellington in September 2002.
 - The Australia-New Zealand Defence Coordinating Group (comprising senior defence officials) met in Canberra in April 2002.

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

- *Ministerial Correspondence. Draft replies to ministerial correspondence will be provided within fourteen working days of receipt by the Ministry*
 - 259 Ministerial letters of reply were completed. Two were outside the timeframe: one was held over so that a standard reply to correspondents could be prepared on the disbandment of the air combat force, the other was late due to an administrative oversight.
- *Parliamentary questions. Parliamentary questions will be actioned within time frames set by Standing Orders of the House of Representatives*
 - 186 Parliamentary Questions were answered. All were within the timeframe.

- *Official Information Act requests. Official Information Act requests will be actioned within statutory requirements*
 - 18 Official Information Act requests were responded to. One response lay outside the timeframe due to a delay in material being provided by another department.

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

- The Ministry has maintained quality control procedures to support the expectations for policy advice delivered under this output class. The 2001 Departmental Forecast Report detailed the quality standards intended.
- ISO 9001 certification has been maintained.

FINANCIAL PERFORMANCE (GST EXCLUSIVE)

For the year ended 30 June 2002

30/6/2001 Actual \$000		30/6/2002 Actual \$000	30/6/2002 Main. Estimates \$000	30/6/2002 Supp. Estimates \$000
	Revenue			
3,120	Crown	3,116	3,116	3,116
2	Other	3	-	-
3,122	Total Revenue	3,119	3,116	3,116
2,946	Expenditure	2,905	3,116	3,116
176	Surplus	214	-	-

CLASS OF OUTPUT D2 – AUDIT AND ASSESSMENT OF PERFORMANCE

DESCRIPTION

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

OUTCOME

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

SERVICE PERFORMANCE

TARGET

DELIVERED

- | 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 No 267
Review of New Zealand Defence Force Chiefs of Staff Overseas Travel - Report No 268
Physical Security of New Zealand Defence Force Establishments in the Wellington Area - Report No 269
Review of New Zealand Defence Force Senior Officers Overseas Travel - Report No 270
New Zealand Defence Force Civil Staff Management Delegations - Report No 271
Naval Individual Training |

- Report No 272
Naval Health Service Clinical Services Business Unit
 - Report 1/2002
New Zealand Defence Force Health and Safety in Employment
 - Report 2/2002
Review of Project KESTREL
 - Report No 3/2002
Disposal of Used Army Clothing
 - Report 4/2002
New Zealand Defence Force Leave Policies.
 - The following internal audits of the Ministry were completed during the year:
 - Departmental Purchasing
 - Light Armoured Vehicle Project On-site Project Team
 - Health & Safety in Employment
 - Replacement Project Financial Information System.
-

2. *Conduct other assessments and audits of the New Zealand Defence Force as and when directed*

- The following studies were conducted at the request of the Minister:
 - a review of planned RNZAF personnel adjustments arising from disbandment of the Air Combat Force (suspended pending further work by the New Zealand Defence Force);
 - examination of the Army's policies and procedures for the disposal of DPM camouflage clothing (Report 3/2002).
-

- 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 2002

30/6/2001 Actual \$000		30/6/2002 Actual \$000	30/6/2002 Main. Estimates \$000	30/6/2002 Supp. Estimates \$000
	Revenue			
1,853	Crown	1,849	1,849	1,849
2	Other	2	-	-
1,855	Total Revenue	1,851	1,849	1,849
1,669	Expenditure	1,533	1,849	1,849
186	Surplus	318	-	-

CLASS OF OUTPUT D3 – MANAGEMENT OF EQUIPMENT PROCUREMENT

DESCRIPTION

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

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

OUTCOME

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

SERVICE PERFORMANCE

TARGET

DELIVERED

-
- | | |
|--|--|
| <p>1. <i>Progress continuation of the ANZAC ship project</i></p> | <ul style="list-style-type: none">■ Class issues continued to be monitored throughout the period across all ANZAC Class Ships. Resolution of the outstanding class issues was progressed but a small number still need to be resolved. Implementation of agreed solutions has been, and will continue to be, constrained by the availability of operational ships for non-programmed maintenance.■ The bilge keel defect, identified during the year, has been rectified on HMNZS <i>Te Kaha</i> and similar work will be undertaken on HMNZS <i>Te Mana</i> later in 2002. Costs have been met from the project contingency pending investigation and resolution of the cause and any attribution of responsibility. |
|--|--|

- **Cost Summary – ANZAC Ship**

A summary of expenditure charged to Crown appropriations, and forecast of future costs to complete, is:

	\$(000)
Expenditure to 30 June 2001	1,166,657
Expenditure 2001/02	32,944
Future commitments and forecasts	111,288
Forecast cost to complete	1,310,889
Project Approval	938,947
Cost escalations and foreign exchange variances to date	379,397
	1,318,344

2. *Subject to individual Government approval, progress light operational vehicles project for the Army*

- The number and type of vehicles were re-evaluated by the NZDF during the year, which resulted in a decision to reduce the numbers of high mobility vehicles and introduce a limited capability military vehicle into the total number.
- The limited capability military vehicle was introduced to meet lower mobility needs of the NZDF.
- For tender purposes, the project was split into high mobility vehicles and limited capability military vehicles.
- The tender for the high mobility vehicles was forwarded to short-listed suppliers and will close on 30 October 2002.
- The tender for the limited capability military vehicles was advertised world wide and will close on 9 August 2002.
- **Cost Summary – Light Operational Vehicles**

A summary of initial project expenditure charged to departmental output class D3, is:

	\$(000)
Expenditure to 30 June 2001	225
Expenditure 2001/02	24
Expenditure to 30 June 2002	249

3. *Progress special operations communications systems*

- The special operations communications systems for the NZ Army have been completed, except for some specialised items.
- The new communications systems have been issued. Performance is being monitored and minor improvements considered.
- The project remains within budget and final deliveries are on schedule.

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

- The majority of the communications systems have been delivered with major shipments occurring in December 2001 and June 2002.
- Tenders were also advertised, received and evaluated for system componentry during the period.
- Cost Summary – *Tactical Communications (including Special Operations Communications Systems)*.

A summary of expenditure charged to Crown appropriations, and forecast of future costs to complete, is:

	\$(000)
Expenditure to 30 June 2001	62,148
Expenditure 2001/02	40,469
Future commitments and forecasts	22,623
Forecast cost to complete	125,240
Project Approval	119,223
Foreign exchange variances to date	6,926
	126,149

5. *Progress light armoured vehicles for the Army*

- A decision to incorporate a new model turret, that is similar to the turret being installed in the Australian ASLAV, has caused a six month delay in the project. The turret is being manufactured in Adelaide, Australia.
- General Motors Defence (GMD) has built a pre-production unit (NZLAV001). This vehicle has been subjected to extensive testing by the manufacturer including a successful loading of the vehicle into an RNZAF Hercules aircraft.

- Contracts were also awarded for infrastructure requirements at Linton and Burnham Camps, and the NZ Army continues to work on logistic support arrangements, including the level of spare parts and introduction into service.
- The programme timing has been adjusted to reflect the decision to adopt the new model turret. The project is on time in accordance with the new programme.
- Cost Summary – *Light Armoured Vehicles*

A summary of expenditure charged to Crown appropriations, and forecast of future costs to complete, is:

	\$(000)
Expenditure to 30 June 2001	85,898
Expenditure 2001/02	4,318
Future commitments and forecasts	514,631
Forecast cost to complete	604,847
Project Approval	580,296
Foreign exchange variances to date	16,788
	597,084

6. Progress maritime

helicopters for the Navy

- The first four aircraft (NZ3601, NZ3602, NZ3603 and NZ3604) were accepted on 6 May 2002, in accordance with a revised contracted delivery schedule.
- The fifth helicopter (NZ3605) is due for delivery in December 2002, having been brought forward from the first quarter of 2003.
- All aircrew and maintainer training by the manufacturer, required under the contract, has now been completed.
- All publications and the majority of the data deliverables under the contact have now been received.
- The majority of spares have now been delivered.

■ Cost Summary – *Maritime Helicopters*

A summary of expenditure charged to Crown appropriations, and forecast of future costs to complete, is:

	\$(000)
Expenditure to 30 June 2001	315,209
Expenditure 2001/02	45,787
Future commitments and forecasts	35,771
Forecast cost to complete	396,767
Project Approval	338,020
Foreign exchange variances to date	58,225
	396,245

7. *Subject to individual Government approval, progress joint command and control system project definition study*

- Approval was granted during the period to progress the tendering for the project definition study. The tendering process involved a Registration-of-Interest, where responses were evaluated and companies short-listed for tender.
- The Request-for-Proposals was forwarded to selected organisations and closed on 28 June 2002. Three tenders were received.
- Evaluation and award of contract is due early in the 2002/2003 period.
- Cost Summary – *Joint Command and Control*

A summary of initial project expenditure charged to departmental output class D5, is:

	\$(000)
Expenditure to 30 June 2001	21
Expenditure 2001/02	55
Expenditure to 30 June 2002	76

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

- Approval was granted to seek tenders for the Life-of-Type Study for the C-130H transport aircraft. Tenders were evaluated and a contract for the study was awarded to Marshall of Cambridge Aerospace in November 2001.
- Work on the study has progressed to plan with two of five output reports having been delivered and reviewed. The final three reports are scheduled for delivery in August and September 2002.

■ **Cost Summary – Air Force C-130H Transport Aircraft**

A summary of initial project expenditure charged to departmental output class D3, is:

	\$(000)
Expenditure to 30 June 2001	14
Expenditure 2001/02	1,069
Expenditure to 30 June 2002	1,083

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

- The installation of the new autopilot in the six Orion aircraft was completed in May under a revised project schedule which took account of autopilot performance problems which needed to be resolved by the contractor. Work has commenced on closing the project.

■ **Cost Summary – Orion Autopilot**

A summary of expenditure charged to Crown appropriations, and forecast of future costs to complete, is:

	\$(000)
Expenditure to 30 June 2001	4,568
Expenditure 2001/02	2,531
Future commitments and forecasts	1,529
Forecast cost to complete	8,628
Project Approval	8,498
Foreign exchange variances to date	130
	8,628

10. *Complete replacement of the wings and horizontal stabiliser on P-3 Orion surveillance aircraft*

- The project was completed on 30 August 2001 ahead of schedule and within budget.

■ **Cost Summary – Orion Re-Wing**

A summary of expenditure charged to Crown appropriations, is:

	\$(000)
Expenditure to 30 June 2001	94,699
Expenditure 2001/02	2,050
Final Cost	96,749
Project Approval	109,650
Foreign exchange variances	(3,872)
	105,778

11. Maintain close links with New Zealand's industry and provide support for the Defence Industry Committee of New Zealand

- Supported meetings of the Defence Industry Committee of NZ (DICNZ) on 7 August 2001, 5 February 2002 and 23 May 2002;
- Arranged for the presentation of the Defence Industry Committee Awards at a dinner on 15 November 2001.

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

- Supported activities of the New Zealand companies forming the Defence Technologies NZ Joint Action Group (JAG) by assisting in the planning of the November Defence Industry Seminar.
- Provided assistance to the JAG planning the 2001 Defence Industry Seminar.
- Attended JAG meetings on 15 August 2001, 4 September 2002 and 30 April 2002 where updates on Defence projects were presented.
- The JAG has confirmed that the Ministry has provided adequate industry advice in support of Tradenz export activity.

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

- An update of company data was obtained for input into the database but was not forwarded to the publisher of the catalogue because of the limited timescale required for collection of the information.

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

- The only briefings to industry, where updates on Defence projects were presented, were to JAG meetings (see above).

Project Financial Performance For the year ended 30 June 2002

Project payments capitalised against Crown appropriations in 2001/02, and recoveries from New Zealand Defence Force, were:

	Expenditure			Recoveries From NZ Defence Force	
	2001/02 Main Estimates \$000	2001/02 Supp Estimates \$000	30/6/2002 Actual \$000	2001/02 Supp Estimates \$000	30/6/2002 Actual \$000
ANZAC Ships	38,883	47,638	32,944	37,336	37,336
Maritime Helicopter	28,705	63,704	45,787	81,170	81,170
Kestrel – P3 Orion rewing	7,954	2,050	2,050	3,332	3,332
P3 Orion autopilot	510	3,921	2,531	98	1,446
RNZN Bridge Simulator	-	76	-	10	10
Light Armoured Vehicles	28,140	5,944	4,318	86,497	86,497
Tactical Communications	60,334	54,028	40,469	70,144	70,144
Other projects	5,807	-	20	1,484	137
GST on imported goods and NZ payments	14,158	35,424	34,350	-	-
Total	184,491	212,785	162,469	280,071	280,072

- 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 achievements of agreed milestones.
- ISO 9001 certification has been maintained.

FINANCIAL PERFORMANCE (GST EXCLUSIVE)
For the year ended 30 June 2002

30/6/2001 Actual \$000		30/6/2002 Actual \$000	30/6/2002 Main Estimates \$000	30/6/2002 Supp. Estimates \$000
	Revenue			
3,332	Crown	3,138	3,356	3,138
7	Other	1,073	-	1,114
3,339	Total Revenue	4,211	3,356	4,252
3,217	Expenditure	4,002	3,356	4,252
122	Surplus/(deficit)	209	-	-

The appropriation (GST inclusive) for this output class was increased by \$1,008,000 for:

	\$(000)
■ C-130 aircraft Life of Type Study, funded by New Zealand Defence Force through Revenue Other	1,114
■ Expense transfer of tender phase costs for Light Operational Vehicles from 2001/02 to 2002/03	(218)
■ GST change on above adjustments	112
	<u>1,008</u>

Statements of Accounting Policies

For the year ended 30 June 2002

1. REPORTING ENTITY

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

These are the financial statements of the Ministry of Defence prepared pursuant to section 55 of the Public Finance Act 1989.

In addition the Ministry has reported the Crown activities that it administers.

2. MEASUREMENT SYSTEM

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

3. ACCOUNTING POLICIES

The following accounting policies have been applied:

DEPARTMENTAL

Budget Figures

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

Revenue

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

Depreciation

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

The estimated economic useful lives are:

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

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

For the year ended 30 June 2002, direct costs accounted for 67% of the Ministry’s costs (30 June 2001= 69%).

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

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

For the year ended 30 June 2002, indirect costs accounted for 33% of the Ministry’s costs (30 June 2001= 31%).

Receivables

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

Fixed Assets

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

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

Taxation

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

Goods and Services Tax (GST)

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

Provision for Employee Entitlements

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

Commitments

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

Contingent Liabilities

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

Financial Instruments

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

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

CROWN

Crown Activities

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

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

Budget Figures

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

Goods and Services Tax (GST)

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

Crown Work in Progress

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

Foreign Currency

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

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

4. CHANGES IN ACCOUNTING POLICIES

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

Statement of **Financial Performance**

For the year ended 30 June 2002

30/6/2001 Actual \$000	Note	30/6/2002 Actual \$000	30/6/2002 Main Estimates \$000	30/6/2002 Supp. Estimates \$000
Revenue				
8,305	2	8,103	8,321	8,103
11	3	1,081	-	1,114
61	5	14	30	15
8,377		9,198	8,351	9,232
Expenditure				
3,843	6	3,716	4,371	4,371
3,474	7	4,289	3,329	4,356
359	8	295	481	350
156	9	140	140	140
7,832		8,440	8,321	9,217
545		758	30	15

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

Statement of **Movements In Taxpayers' Funds**

For the year ended 30 June 2002

30/6/2001 Actual \$000		30/6/2002 Actual \$000	30/6/2002 Main. Estimates \$000	30/6/2002 Supp. Estimates \$000
1,555	Taxpayers' funds brought forward as at 1 July	1,555	1,555	1,555
545	Net operating surplus/(deficit)	758	30	15
545	Total recognised revenues and expenses for the year	758	30	15
(545)	Provision for repayment of surplus to the Crown	(758)	(30)	(15)
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 2002

30/6/2001 Actual \$000	Note	30/6/2002 Actual \$000	30/6/2002 Main Estimates \$000	30/6/2002 Supp. Estimates \$000
Taxpayers' Funds				
1,555		1,555	1,555	1,555
1,555		1,555	1,555	1,555
Represented by:				
Current Assets				
275		1,711	94	1,572
2,000	10	-	1,200	-
2,275		1,711	1,294	1,572
38		37	14	14
54	11	1,286	2	2
2,367		3,034	1,310	1,588
Non-Current Assets				
660	12	666	933	640
660		666	933	640
3,027		3,700	2,243	2,228
Current Liabilities				
582	13	1,034	335	335
545		758	30	15
209	14	187	200	200
1,336		1,979	565	550
Non-Current Liabilities				
136	14	166	123	123
1,472		2,145	688	673
1,555		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 2002

30/6/2001 Actual \$000		30/6/2002 Actual \$000	30/6/2002 Main. Estimates \$000	30/6/2002 Supp. Estimates \$000
	Cash Flows – Operating Activities			
	Cash provided from:			
	Supply of outputs to			
8,305	– Crown	8,103	8,321	8,103
1	– Customers	-	-	1,114
61	Interest	14	30	15
8,367		8,117	8,351	9,232
	Cash disbursed to:			
	Produce outputs			
(3,814)	– Personnel	(3,718)	(4,371)	(4,371)
(3,102)	– Operating	(4,138)	(3,329)	(4,549)
(75)	– Net GST paid	140	-	-
(156)	– Capital charge	(140)	(140)	(140)
(7,147)		(7,856)	(7,840)	(9,060)
1,220	Operating activities net cash flows	261	511	172
	Cash Flows – Investing Activities			
	Cash provided from:			
55	Sale of fixed assets	23	37	20
	Cash disbursed for:			
(327)	Purchase of fixed assets	(303)	(500)	(350)
(272)	Investing activities net cash flows	(280)	(463)	(330)
	Cash Flows – Financing Activities			
	Cash disbursed for:			
(505)	Repayment of surplus	(545)	(58)	(545)
(505)	Financing activities net cash flows	(545)	(58)	(545)
443	Net increase/(decrease) in cash held	(564)	(10)	(703)
1,832	Add opening cash and deposits	2,275	1,304	2,275
2,275	Closing cash and deposits	1,711	1,294	1,572

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 2002

30/6/2001 Actual \$000	Note	30/6/2002 Actual \$000	30/6/2002 Main. Estimates \$000	30/6/2002 Supp. Estimates \$000	
545		Net operating surplus/(deficit)	758	30	15
		Add/(Less) non-cash items			
359		Depreciation	295	481	350
		- Inc/(Dec) in non-current employee entitlements	30	-	-
121		Reclassification of fixed assets	-	-	-
480		Total non-cash items	325	481	350
		Working capital movements			
(20)		(Inc)/Dec in debtors and receivables	(1,232)	-	52
70		(Inc)/Dec in prepayments	-	-	24
169		Inc/(Dec) in creditors and payables	440	-	(247)
(16)		Inc/(Dec) in current employee entitlements	(22)	-	(22)
203		Working capital movements – net	(814)	-	(193)
		Add/(Less) investing activity items			
(8)	4	(Gain)/Loss on sale of fixed assets	(8)	-	-
(8)		Total investing activity items	(8)	-	-
1,220		Net cash flow from operating activities	261	511	172

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

Statement of **Commitments**

As at 30 June 2002

The Ministry charges initial project costs for the acquisition of defence equipment, up to the time of final approval to commit, as a departmental operating cost in Output Class D3 – Management of Equipment Procurement.

The amount disclosed below as a future commitment is based on the foreign exchange forward contract rate which covers the exposure.

30/6/2001 Actual \$000		30/6/2002 Actual \$000
-	C-130 aircraft Life of Type Study Less than one year	1,424

There were no commitments at 30 June 2001.

Statement of **Contingent Liabilities**

As at 30 June 2002

No guarantees and indemnities have been given outside the normal course of business. (30 June 2001 = nil)

There are no claims against the Ministry at balance date. (30 June 2001 = nil)

Statement of **Unappropriated Expenditure**

For the year ended 30 June 2002

No expenditure has been made or costs incurred in excess of or without appropriation by Parliament. (There was no unappropriated expenditure at 30 June 2001)

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

Statement of **Departmental Expenditure and Appropriations**

For the year ended 30 June 2002

(Figures are GST inclusive where applicable)

	30/6/2002 Expenditure Actual \$000	30/6/2002 Appropriation Voted \$000
<hr/>		
VOTE: DEFENCE		
Appropriations for classes of outputs		
D1 - Policy advice	3,294	3,505
D2 - Audit and assessment of performance	1,764	2,080
D3 - Management of equipment procurement	4,534	4,784
<hr/>		
Total	9,592	10,369
<hr/>		

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

Notes to the Financial Statements

For the year ended 30 June 2002

NOTE 1: BUDGET COMPOSITION

	Note	30/6/2002 Budget Forecasts \$000	30/6/2002 Supp. Estimates Changes \$000	30/6/2002 Budget Total \$000
Revenue				
Crown	2	8,321	(218)	8,103
Other	3	-	1,114	1,114
Interest	5	30	(15)	15
Total revenue		8,351	881	9,232
Expenditure				
Personnel costs	6	4,371	-	4,371
Operating costs	7	3,329	1,027	4,356
Depreciation	8	481	(131)	350
Capital charge	9	140	-	140
Total expenses		8,321	896	9,217
Net operating surplus		30	(15)	15

NOTE 2: REVENUE – CROWN

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

NOTE 3: OTHER REVENUE

	30/6/2001 Actual \$000	30/6/2002 Actual \$000	30/6/2002 Main Estimates \$000	30/6/2002 Supp. Estimates \$000
1 <i>Defence Quarterly</i> magazine		-	-	-
8 Net gain on sale of assets (Note 4)		8	-	-
- New Zealand Defence Force for initial project costs		1,073	-	1,114
2 Other		-	-	-
11 Total other revenue		1,081	-	1,114

Notes to the Financial Statements

For the year ended 30 June 2002

NOTE 4: GAIN ON SALE OF FIXED ASSETS

30/6/2001 Actual \$000		30/6/2002 Actual \$000
(7)	Motor Vehicles	-
15	Computer equipment	5
-	Office Furniture	3
8	Net gain on sale of assets	8

NOTE 5: INTEREST REVENUE

The Ministry invested surplus cash with New Zealand Debt Management Office (NZDMO) and earned interest at variable rates. The term deposit facility was terminated from 1 November 2001.

NOTE 6: PERSONNEL COSTS

30/6/2001 Actual \$000		30/6/2002 Actual \$000	30/6/2002 Main Estimates \$000	30/6/2002 Supp. Estimates \$000
3,842	Salaries and wages	3,686	4,368	4,368
1	Retirement and resigning leave	30	3	3
3,843	Total personnel costs	3,716	4,371	4,371

Notes to the Financial Statements

For the year ended 30 June 2002

NOTE 7: OPERATING COSTS

30/6/2001 Actual \$000		30/6/2002 Actual \$000	30/6/2002 Main Estimates \$000	30/6/2002 Supp. Estimates \$000
12	Consultancy	177	173	173
190	Professional services	217	-	217
70	Audit fees to auditors for audit of the financial statements	75	70	75
515	Share of NZDF costs for maintaining services	534	521	521
208	Grants and contributions	77	98	92
335	Inventory items	185	-	265
230	General maintenance and servicing	110	141	140
267	Travel and related costs	314	389	390
115	Courses, conferences and exhibitions	136	152	152
675	Rental of premises	722	765	765
362	Initial project costs			
	– C130 aircraft Life of Type Study	1,068	-	1,114
	– Joint command and control system	55	-	-
	– Light operational vehicles	24	268	50
	– New naval ships	19	-	-
	– Other	14	-	-
495	Other operating costs	562	752	402
3,474	Total operating costs	4,289	3,329	4,356

Notes to the Financial Statements

For the year ended 30 June 2002

NOTE 8: DEPRECIATION

30/6/2001 Actual \$000		30/6/2002 Actual \$000	30/6/2002 Main Estimates \$000	30/6/2002 Supp. Estimates \$000
109	Leasehold Improvements	56	164	98
104	Office and computer equipment	80	164	99
9	Motor Vehicles	1	16	16
137	Other Assets	158	137	137
359	Total depreciation charge	295	481	350

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 2002 was 9 percent (30 June 2001 = 10 percent).

NOTE 10: SHORT-TERM DEPOSITS

The term deposit facility with New Zealand Debt Management Office (NZDMO) was terminated from 1 November 2001.

30/6/2001 Actual \$000	Counterparty	Interest Rate	Term	30/6/2002 Actual \$000
2,000	NZDMO	4.938%	7 Days	-
2,000	Total short-term deposits			-

NOTE 11: DEBTORS AND RECEIVABLES

30/6/2001 Actual \$000		30/6/2002 Actual \$000
12	Sundry debtors – Department	1,276
42	– Non Department	10
54	Total debtors and receivables	1,286

Notes to the Financial Statements

For the year ended 30 June 2002

NOTE 12: FIXED ASSETS

30/6/2001 Actual \$000		30/6/2002 Actual \$000
	Leasehold Improvements	
396	At cost	491
(177)	Accumulated depreciation	(234)
	219 Leasehold improvements – net book value	257
	Office and computer equipment	
753	At cost	793
(621)	Accumulated depreciation	(682)
	132 Office and computer equipment – net book value	111
	Office Furniture	
262	At cost	262
(262)	Accumulated depreciation	(262)
	- Office furniture – net book value	-
	Motor Vehicles	
28	At cost	-
(12)	Accumulated depreciation	-
	16 Motor vehicles – net book value	-
	Other Assets	
732	At cost	895
(439)	Accumulated Depreciation	(597)
	293 Other Assets – Net Book Value	298
	Total Fixed Assets	
2,171	At cost	2,441
(1,511)	Accumulated depreciation	(1,775)
	660 Total Carrying Amount of Fixed Assets	666

Notes to the Financial Statements

For the year ended 30 June 2002

NOTE 13: CREDITORS AND PAYABLES

30/6/2001 Actual \$000		30/6/2002 Actual \$000
341	Sundry creditors	75
166	Accrued expenses	744
75	GST payable	215
582	Total creditors and payables	1,034

NOTE 14: PROVISION FOR EMPLOYEE ENTITLEMENTS

30/6/2001 Actual \$000		30/6/2002 Actual \$000
	Current Liabilities	
209	Annual leave	187
209	Total current portion	187
	Non Current Liabilities	
136	Long service, retirement and resigning leave	166
136	Total non-current portion	166
345	Total provision for employee entitlements	353

NOTE 15: CONTINGENT ASSETS

The Ministry does not have any contingent assets as at 30 June 2002 (30 June 2001 = nil).

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

Notes to the Financial Statements

For the year ended 30 June 2002

NOTE 16: FINANCIAL INSTRUMENTS

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

- *Credit Risk*

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

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

- *Fair Value*

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

- *Currency Risk and Interest Rate Risk*

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

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

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

- *Foreign Exchange Contracts (Departmental)*

The Ministry had departmental foreign exchange contracts with a face value of \$1.862 million at 30 June 2002. (30 June 2001 = nil)

Notes to the Financial Statements

For the year ended 30 June 2002

NOTE 17: RELATED PARTY INFORMATION

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

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

NOTE 18: MAJOR BUDGET VARIATIONS

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

- *Statement of Financial Performance*
 - Revenue Other was increased by \$1,114,000 to fund a C130 aircraft Life of Type Study to be paid for by New Zealand Defence Force.
 - Estimated Operating costs were increased by the same amount to make the Life of Type Study fiscally neutral to Vote Defence.
 - Personnel costs were below budget by \$655,000 because of lower staff levels throughout the financial year.
- *Statement of Financial Position (and Cash Flows)*
 - Debtors and receivables were considerably higher than forecast because the C130 aircraft Life of Type Study was unpaid by New Zealand Defence Force at balance date.
 - Creditors and payables were greater than forecast because of a higher level of accrued expenses, and a larger liability for GST at balance date.

Crown Statement of **Financial Performance**

For the year ended 30 June 2002

30/6/2001 Actual \$000		Note	30/6/2002 Actual \$000	30/6/2002 Main Estimates \$000	30/6/2002 Supp. Estimates \$000
	Crown Revenue				
1,220	Interest	C1	665	650	900
4,089	Other operational revenue	C2	115	-	-
5,309	Total Crown revenue		780	650	900
	Crown Expenditure				
25,234	GST input tax expensed		34,350	14,158	35,424
14	Other operating expenses		5	-	-
4,204	Unrealised exchange losses/(gains)		4,980	-	-
29,452	Total Crown expenses		39,335	14,158	35,424
	Net operating surplus/(deficit)				
(24,143)	- Crown Operations		(38,555)	(13,508)	(34,524)

The accompanying accounting policies and notes form part of these financial statements. For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated audited Crown Financial Statements for the year ended 30 June 2002.

Crown Statement of **Financial Position**

As at 30 June 2002

30/6/2001 Actual \$000		30/6/2002 Actual \$000	30/6/2002 Main Estimates \$000	30/6/2002 Supp. Estimates \$000
	Crown Funds			
170,651	Opening balance at 1 July	268,283	281,529	268,283
(24,143)	Net operating surplus/(deficit) – Crown operations	(38,555)	(13,508)	(34,524)
274,000	Funds received from New Zealand Debt Management Office	170,000	157,000	200,000
(152,225)	Funds paid to New Zealand Debt Management Office	(280,872)	(319,618)	(280,971)
268,283	Total Crown funds	118,856	105,403	152,788
	Represented by:			
	Current Assets			
62,257	Cash	46,638	21,022	55,470
25,910	Short-term deposits	17,419	9,010	-
271	Debtors and receivables	140	-	-
209,614	Work in progress	57,738	84,957	106,904
298,052	Total current assets	121,935	114,989	162,374
298,052	Total assets	121,935	114,989	162,374
	Current Liabilities			
29,769	Creditors and payables	3,079	9,586	9,586
29,769	Total current liabilities	3,079	9,586	9,586
268,283	Net Assets – Crown	118,856	105,403	152,788

The accompanying accounting policies and notes form part of these financial statements. For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated audited Crown Financial Statements for the year ended 30 June 2002.

Crown Statement of Cash Flows

For the year ended 30 June 2002

30/6/2001 Actual \$000	Note	30/6/2002 Actual \$000	30/6/2002 Main Estimates \$000	30/6/2002 Supp. Estimates \$000
Cash Flows – Operating Activities				
Cash provided from:				
1,220		665	650	900
4,089	C2	115	-	-
Cash disbursed to:				
(14)		(2)	-	-
(8,482)		(50,378)	(14,158)	(35,424)
(3,187)		(49,600)	(13,508)	(34,524)
Cash Flows – Investing Activities				
Cash provided from:				
153,047		280,072	318,968	280,075
23,635		35,009	39,871	35,009
Cash Disbursed For:				
(288,079)		(138,729)	(170,333)	(197,277)
(23,635)		(35,009)	(39,871)	(35,009)
(135,032)		141,343	148,635	82,798
Cash Flows – Financing Activities				
Cash provided from:				
274,000		170,000	157,000	200,000
Cash Disbursed For:				
(152,225)		(280,873)	(319,618)	(280,971)
121,775		(110,873)	(162,618)	(80,971)
(16,444)		(19,130)	(27,491)	(32,697)
108,815		88,167	57,523	88,167
(4,204)		(4,980)	-	-
88,167		64,057	30,032	55,470

The accompanying accounting policies and notes form part of these financial statements. For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated audited Crown Financial Statements for the year ended 30 June 2002.

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

For the year ended 30 June 2002

30/6/2001 Actual \$000		30/6/2002 Actual \$000
(24,143)	Net operating surplus/(deficit)	(38,555)
4,204	Unrealised exchange losses/(gains)	4,980
16,752	Increase/(decrease) in GST payable	(16,028)
-	Other items	3
(3,187)	Net cash flow from operating activities	(49,600)

Crown Statement of **Commitments**

As at 30 June 2002

30/6/2001 Actual \$000		30/6/2002 Actual \$000
	Capital commitments	
219,309	Less than one year	164,332
368,221	One to two years	310,574
204,149	Two to five years	9,976
-	More than five years	-
791,679	Total capital commitments	484,882

The accompanying accounting policies and notes form part of these financial statements. For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated audited Crown Financial Statements for the year ended 30 June 2002.

Crown Statement of **Expenditure And Appropriations**

For the year ended 30 June 2002

(Figures are GST inclusive where applicable)

	30/6/2002 Expenditure Actual \$000	30/6/2002 Appropriation Voted \$000
VOTE: DEFENCE		
Appropriations for purchase or development of capital assets by the Crown.		
Defence equipment	128,119	177,361
GST on defence equipment	34,350	35,424
Total	162,469	212,785

The accompanying accounting policies and notes form part of these financial statements. For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated audited Crown Financial Statements for the year ended 30 June 2002.

Notes to the Crown Financial Statements

For the year ended 30 June 2002

NOTE C1: INTEREST REVENUE

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

NOTE C2: OTHER OPERATIONAL REVENUE

30/6/2001 Actual \$000		30/6/2002 Actual \$000
4,089	Refunds from foreign military sales cases following the decision to exit the arrangement to lease F-16 aircraft.	115
4,089	Total operational revenue	115

NOTE C3: BUDGET COMPOSITION

	30/6/2002 Budget Forecasts \$000	30/6/2002 Supp. Estimates Changes \$000	30/6/2002 Budget Total \$000
Current Non Tax Revenue			
Crown interest	650	250	900
Capital Receipts			
Defence equipment	318,968	(38,897)	280,071
Expenditure			
Defence equipment	170,333	7,028	177,361
GST on defence equipment	14,158	21,266	35,424

Notes to the Crown Financial Statements

For the year ended 30 June 2002

NOTE C4: MAJOR BUDGET VARIATIONS

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

The appropriation was increased by \$7.028 million to recognise timing changes in existing contract payments not provided for in approved baselines. The projects involved were:

	\$(000)
▪ ANZAC Ships	8,755
▪ Light Armoured Vehicles	(22,196)
▪ P-3 Orion Aircraft Rewing	(5,904)
▪ Naval Helicopters	34,999
▪ Very Low Level Air Defence	(5,389)
▪ Orion Autopilot	3,411
▪ Tactical Communications	(6,306)
▪ Other	(342)
	7,028

- *GST on Defence Equipment*

The appropriation was increased by \$21.266 million to meet timing changes in import GST charges not provided for in approved baselines. The projects involved were:

	\$(000)
▪ ANZAC Ships	274
▪ Light Armoured Vehicles	716
▪ P-3 Orion Aircraft Rewing	2,535
▪ Naval Helicopters	14,065
▪ Orion Autopilot	842
▪ Tactical Communications	2,829
▪ Other	5
	21,266

Notes to the Crown Financial Statements

For the year ended 30 June 2002

NOTE C5: FINANCIAL INSTRUMENTS

- *Credit Risk*

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

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

- *Maximum Credit Risk Exposure*

Maximum exposures to credit risk at balance date are:

	30 June 2002 \$000	30 June 2001 \$000
Cash	46,638	62,257
Short-term deposits	17,419	25,910
Debtors and receivables	140	271
Forward exchange contracts	428,866	497,406
	493,063	585,844

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

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

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

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

- *Significant Concentrations of Credit Risk*

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

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

Notes to the Crown Financial Statements

For the year ended 30 June 2002

▪ *Fair Values*

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

	30 Jun 2002 Carrying Amount \$000	30 Jun 2002 Fair Value \$000	30 Jun 2001 Carrying Amount \$000	30 Jun 2001 Fair Value \$000
Cash	46,638	46,638	62,257	62,257
Short-term deposits	17,419	17,419	25,910	25,910
Debtors and receivables	140	140	271	271
Payables and provisions	3,079	3,079	29,769	29,769

▪ *Currency Risk*

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

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

▪ *Interest Risk*

The Ministry has no exposure to interest rate risk.

▪ *Foreign Exchange Contracts (Crown)*

The Ministry had Crown foreign exchange contracts with a face value of \$428.866 million at 30 June 2002. (30 June 2001 = \$497.406 million)

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 has been established 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 has completely revised its human resources policies over the last year including implementation of a comprehensive policy on overseas assignments. An Employee Assistance Programme is in place and a Health and Safety Committee has been established. The Ministry has almost completed a programme of re-equipping staff with modern ergonomic furniture.

The Ministry's new training and development programme is now well established. This has included skills training (e.g. presentation skills, writing skills and negotiation skills) training seminars (e.g. Official Information Act, Privacy Act and Protected Disclosures Act) one-on-one training to address skill gaps (e.g. project management, strategic planning) and a customised in-house management development programme for all employees who manage staff. Incorporating 360° feedback, the programme concentrates on equipping the Ministry's managers with the full range of management skills required.

- ***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.

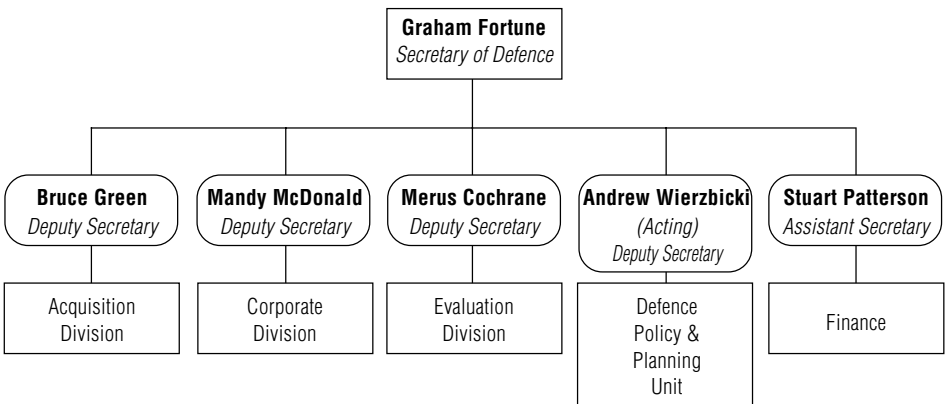
▪ **Disability**

The Ministry completed production of its first New Zealand Disability Strategy Implementation Work Plan. This covers the 2002/2003 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. The Ministry continues to be involved in the e-procurement project.

ORGANISATION CHART



Staff numbers at 30 June 2002 were 50 (excluding the Chief Executive).

FINANCIAL PERFORMANCE

	2001/02		Actual \$000
	Budgeted \$000	Estimated Actual \$000	
Departmental Activities			
Revenue: Crown	8,103	8,103	8,103
Revenue: Other	1,114	1,114	1,081
Output expenses	9,217	8,917	8,440
Net operating surplus/(deficit)	15	315	758
Receipts from the sale of fixed assets	20	20	23
Expenditure on fixed assets	350	350	175
Taxpayers' funds	1,555	1,555	1,555
Net cash flows from operating, investing and financing activities	(703)	(403)	(564)
Crown Activities			
Purchase or development of capital assets on behalf of the Crown	212,785	212,785	162,469
Total Crown revenue and receipts	280,971	280,971	280,740

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	3,505	2,080	3,776	170,333	14,158
Supplementary Estimates change	-	-	1,008	7,028	21,266
Change by Order in Council under section 5 of the Public Finance Act 1989	-	-	-	-	-
Total amount appropriated for 2001/2002	3,505	2,080	4,784	177,361	35,424
Estimated actual outturn for 2001/2002 as reported in 2002/2003 estimates	3,382	1,968	4,719	177,361	35,424
Audited actual outturn for 2001/2002	3,295	1,764	4,528	128,119	34,350
Unappropriated expenditure, expenses or liabilities approved under section 12 of the Public Finance Act 1989	-	-	-	-	-
Unappropriated expenditure, expenses or liabilities requiring validating legislation	-	-	-	-	-

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

(a) Defence Equipment

	2001-02 \$(000)	2000-01 \$(000)	1999-00 \$(000)	1998-99 \$(000)	1997-98 \$(000)	1996-97 \$(000)
Voted in Estimates	177,361	342,488	248,534	222,128	261,236	293,001
Actual Expenditure	128,119	316,435	214,820	197,388	165,366	180,840
Variance	49,242	26,053	33,714	24,740	95,870	112,161

(b) GST on Defence Equipment

	2001-02 \$(000)	2000-01 \$(000)	1999-00 \$(000)	1998-99 \$(000)	1997-98 \$(000)	1996-97 \$(000)
Voted in Estimates	35,424	41,202	85,673	8,850	80,280	8,100
Actual Expenditure	34,350	25,234	83,487	7,794	76,365	8,089
Variance	1,074	15,968	2,186	1,056	3,915	11

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

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

	2001-02 \$(000)	2000-01 \$(000)	1999-00 \$(000)	1998-99 \$(000)	1997-98 \$(000)	1996-97 \$(000)
Planned	280,071	189,075	230,741	196,028	226,359	181,664
Actual	280,072	189,076	194,886	196,007	157,130	181,669
Variance	(1)	(1)	35,855	21	69,229	(5)

