



Annual Report

for the year ended 30 June 2006

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

ISSN 1176-8355

Acts Administered

The Ministry of Defence administers the Defence Act 1990.

The latest Ministry of Defence publications are available from our website: www.defence.govt.nz

If you prefer to obtain your publication from the website and no longer need a paper copy, please let us know so that we can remove your name from our mailing list. Please advise by email to information@defence.govt.nz

This information is protected by Crown copyright or the copyright of third parties. For permission to reproduce this information please contact the Deputy Secretary of Defence (Corporate).

ISSN: 1176-8355

Published in October 2006 by
The Ministry of Defence
Defence House
15–21 Stout St
Wellington
New Zealand

www.defence.govt.nz

Contents

Part 1: Overview	1
Secretary of Defence's overview	2
Introduction	2
Policy and Planning	3
International Defence Relations.....	6
Acquisition of Defence Equipment	11
Evaluation.....	14
Corporate.....	14
Conclusion	14
 Part 2: Statement of responsibility and audit report	15
Statement of responsibility.....	16
Audit Report.....	17
 Part 3: Departmental financial statements	19
Statement of objectives and service performance.....	20
Output Class - Policy advice.....	21
Output Class - Audit and assessment of performance.....	33
Output Class - Management of equipment procurement	36
Statement of accounting policies.....	61
Statement of financial performance.....	65
Statement of movements in taxpayers' funds	65
Statement of financial position	66
Statement of cash flows	67
Reconciliation of net operating surplus to net cash flow from operating activities	68
Statement of commitments	69
Statement of contingent assets and liabilities.....	69
Statement of unappropriated expenditure.....	69
Statement of departmental expenditure and appropriations.....	70
Notes to the financial statements.....	71

Part 4: Non-departmental schedules	77
Statement of non-departmental accounting policies	78
Schedule of non-departmental revenues and receipts.....	79
Schedule of non-departmental expenses.....	80
Schedule of non-departmental assets.....	81
Schedule of non-departmental liabilities	81
Schedule of non-departmental commitments	82
Schedule of non-departmental expenditure and appropriation	82
Schedule of non-departmental contingencies	82
Notes to the non-departmental schedules	83
Part 5: Other information	85
Equal employment opportunities.....	86
Management performance	86
E-government.....	86
Progress toward adopting International Financial Reporting Standards (IFRS).....	87
Organisation chart	88
Financial performance highlights.....	89
Summary of appropriations (GST exclusive).....	90
Historical financial performance of significant items:	
Payments on behalf of the Crown.....	91
Historical financial performance of significant items:	
Receipts on behalf of the Crown.....	91

Part 1: Overview



Secretary of Defence's overview

Introduction

The roles of the Ministry of Defence are set out in section 24 of the Defence Act 1990. They are:

- to assist the Government make well-informed decisions about the defence of New Zealand and its interests through the provision of timely, high quality advice;
- to conduct audits and assessments of the New Zealand Defence Force and the acquisition activities of the Ministry; and
- to procure, upgrade, or repair significant items of military equipment.



These roles are reflected in the Ministry's Statement of Intent and contribute to the high-level outcome of **supporting New Zealand's security objectives and contributing to the security of other countries.**

This high-level outcome is based on a simple, but fundamental principle that a secure New Zealand is critical to our economic and social well-being. Achieving this has both domestic and international dimensions. At home, a strong economy and a prosperous workforce are predicated on securing our borders and our Exclusive Economic Zone, as well as assisting our South Pacific neighbours do the same. Further afield, New Zealand's present and future prosperity is closely linked to a stable and peaceful international security environment, in which all nations are encouraged to play by the rules. Our active participation in international security operations ensures our own security.

How well the Ministry does in meeting the high-level outcome is measured against an intermediate-level outcome of ensuring that our **advice and actions are credible and respected, and the Government's defence policy objectives are achieved.**

The Government's defence policy objectives are set out in *The Government's Defence Policy Framework* (June 2000). They are: to defend New Zealand and to protect its people and territorial waters; to meet our alliance commitments to Australia; to assist in the maintenance of security in the South Pacific; to play an appropriate role in the security of the Asia Pacific region; and contribute to global security. A second document, *the Government Defence Statement: A Sustainable Defence Force Matched to New Zealand's Needs* (May 2001), identifies the military capabilities the Government needs to meet these five objectives.

In the last year, the Ministry has continued to implement the Government's *Defence Long-term Development Plan* (LTDP) to update and replace a range of obsolete equipment. Committing \$3 billion over ten years, the plan links the Government's defence policy objectives, as set out in the *Defence Policy Framework*, with the capability requirements announced in the May 2001 Statement. Since the plan's release in 2002, Defence has progressed twenty-seven re-equipment projects. A highlight of the work undertaken during this reporting period was the Government's decision to purchase eight NH90 medium utility helicopters to replace the Royal New Zealand Air Force's aging Iroquois fleet. Ensuring that LTDP projects remain on track is a key focus for the Ministry.

Investment in new capabilities is being matched by investment in people and infrastructure. Many of the priorities for this reporting period flowed from the Government's Defence Sustainability Initiative and the defence funding programme of \$4.6 billion over ten years attached to it. The aim of the initiative is

to achieve long-term sustainability for Defence by building personnel levels, bringing new and upgraded equipment into service, and strengthening defence planning and management systems. Key priorities included addressing the gaps in the Ministry's policy capability, particularly where it lacked specialist technical and financial analysis skills, and working with the New Zealand Defence Force to strengthen organisational and corporate planning, policy, and governance capabilities.

The Government has indicated the importance of prioritising policies that will contribute to a strong sense of national identity. Ministers recognise that as New Zealanders we take great pride in who we are, what we do, and how we are seen, expressed in part through our stance on international issues and our willingness to assist in maintaining peace in various trouble spots around the world and in responding to humanitarian crises. An important focus for the Ministry is to provide the Government with sound policy advice on security risk management, military deployments, and purchasing equipment, the aim of which is to ensure that our Defence Force personnel are appropriately trained and equipped to undertake the wide-ranging tasks New Zealanders expect them to perform, often under very difficult conditions.

The deployment of New Zealand Defence Force personnel to restore order in the Solomon Islands and Timor-Leste are the most recent examples of this willingness to become involved in order to resolve conflict and prevent bloodshed. In both cases, New Zealand, working alongside our alliance partner Australia, responded quickly and appropriately to the requests for assistance from Solomon Islands and the Timor-Leste Governments, providing a meaningful military presence and allowing space for a political solution to evolve in both countries.

In Afghanistan, the work of New Zealand's Provincial Reconstruction Team, now in its fourth year, is a further example of how our Defence Force personnel can put their military skills to practical use, both in securing a troubled country and in helping to build the infrastructure and institutions of a viable Afghan state. This work, in helping to ensure that Afghanistan does not again become a haven for terrorists, underlines the seriousness in which New Zealand takes its international responsibilities, including in countries far from home.

Policy and Planning

The Secretary of Defence is the principal civilian adviser on defence matters to the Minister of Defence and to the Government. The Chief of Defence Force, who commands the New Zealand Defence Force, is the principal military adviser.

A strong and mutually reinforcing relationship between the Ministry and the New Zealand Defence Force is critical to Defence's strategic-level interaction with the Government and with other central government agencies. This cooperation is facilitated through the Office of Chief Executives, which brings the Secretary of Defence and the Chief of Defence Force together to discuss policy issues of mutual interest; the Executive Capability Board, through which senior military and civilian officials oversee major capital acquisition projects; and a range of joint engagements, formal and informal, between the Vice Chief of Defence Force and the Deputy Secretary (Policy and Planning), and their staff, that are designed to exchange information and improve collaboration within the Defence establishment.

The Defence Policy and Planning Unit is made up of staff from both the Ministry and the New Zealand Defence Force. It consists of the Strategic Policy Branch, the International Defence Relations Branch, and the new Strategy and Capability Analysis Branch. The principal role of the Unit is to provide consistent information and policy advice to both the Secretary of Defence and the Chief of Defence Force, and through them to the Minister of Defence and the Government.

Policy development

Defence Sustainability Initiative

In the past year, the Ministry has worked closely with the New Zealand Defence Force in continuing to implement the Defence Sustainability Initiative (DSI). The DSI is a ten-year defence funding package to enable the New Zealand Defence Force and the Ministry to rebuild capacity, and to fulfil the Government's goal of achieving a modern sustainable defence force matched to New Zealand's needs. A total of \$4.6 billion over a ten-year period was allocated by the Government in 2005/06, to be directed towards:

- personnel issues, including additional recruitment, improving retention, conditions of service, allowances and developing special training (including trades training) in all three services;
- implementing Government capability plans in the *Defence Long-term Development Plan* (LTDP);
- reviewing the Army's configuration;
- developing a real estate strategy, accommodation policy, and a policy on maintenance of the New Zealand Defence Force's property portfolio;
- addressing the backlog in minor capital projects, for example, in infrastructure, equipment and information technology; and
- expanding the Ministry's policy and purchase advice functions.

To manage this additional funding and the associated remedial work programme, the Government has directed the New Zealand Defence Force and the Ministry to enhance their management and organisational processes. To this end, a considerable work programme of eighteen separate projects was undertaken during this reporting period by the New Zealand Defence Force and the Ministry, with input from Treasury and the State Services Commission. As at 30 June 2006, these projects had either been completed or were well-advanced towards completion.

The projects in this programme addressed a wide range of governance and management issues, largely within the New Zealand Defence Force. The Ministry, however, also received additional funding to strengthen its policy advice capability, with specific emphasis on technical analysis. This has been achieved through the establishment of the Strategy and Capability Analysis Branch.

Defence Capital Asset Management Practice Review

On 15 May 2006, Cabinet approved the Terms of Reference of the Defence Capital Asset Management Practice Review (DCAMP). This important review is part of an over-arching review of public sector capital asset management, which in turn is one of a number of public sector expenditure reviews that address a range of departments and functional activities. The objective of these reviews is to achieve better value for money from public expenditure. A project team of senior personnel drawn from both the Ministry and the New Zealand Defence Force is undertaking the review. Meeting the report back date of September 2006 will be a priority for the Defence establishment over the next reporting period.

Strategic policy advice

Defence policy needs to have a solid empirical basis. As defence-policy makers we seek to comprehend the risks and challenges in our strategic environment and how they affect New Zealand's defence and security interests. A key function of the Ministry is to prepare periodic assessments for the Minister of Defence on the strategic environment, including the implications any changes may have for defence policy. In the last year, the Strategic Policy Branch prepared a geopolitical scan assessing the influences which are likely to shape our security interests over the next five years. Work on the scan informed a

series of briefings prepared for the Minister of Defence on a number of defence-related issues, including:

- defence policies of Australia and Japan;
- defence transformation in the United States;
- the implications for New Zealand's defence policy of natural disasters; and
- Defence's role in contributing to the Government's disarmament and arms control policies.

Capability development

Defence Long-term Development Plan (LTDP) update

First released on 11 June 2002, the LTDP is the key capital project-planning document covering the ten-year period out to 2012. Regularly updated, the plan enables decisions on major defence acquisitions (projects over \$7 million) to be prioritised and taken in the context of the Government's defence policy objectives and the project's fiscal affordability.

During the reporting period, work commenced on a third LTDP update. Due to be released shortly, the 2006 update will provide a current list of projects, as well as their associated preliminary costings, timings and priorities.

The Strategic Policy Branch has provided policy advice on a number of capability development issues over the past twelve months, including:

- **Helicopter replacement:** The Government selected the NATO Helicopter Industries' NH90 medium utility helicopter as the replacement for the Air Force's Iroquois fleet. Aside from a considerably greater carrying capacity, the new helicopters will be more appropriately configured to support the Army's enhanced mobility and firepower, as well as provide greater assistance to civil agencies during both national and international emergencies. The NH90 will also be able to operate from the helicopter decks of the Navy's ANZAC class frigates, the new multi-role vessel, and the new offshore patrol vessels.

Advice has also been provided on the next stage of the training/light utility helicopter project.

- **Improvised explosive device disposal:** Approval was given for the establishment of a radiological improvised explosive device disposal (IEDD) capability alongside the newly enhanced chemical, biological and conventional IEDD capability.
- **Boeing 757 modification:** Final proposals were approved for the programme to modify the Air Force's two Boeing 757 aircraft to a combined passenger/freight configuration. A decision was also taken not to modify the aircraft for use in supporting operations to Antarctica. This project is now in the equipment procurement phase.
- **Joint Command and Control System:** The project will provide Defence Force commanders with the means to command and control their forces individually, in groups, within a combined force, and in coalition environments. The Strategic Policy Branch has been involved in determining the options for operating and supporting the system throughout its life.
- **Land intelligence, surveillance, and reconnaissance:** The project addresses the gaps in the New Zealand Army's intelligence, surveillance, and reconnaissance capabilities. It aims to provide Army commanders with the ability to detect threats at greater distances and with greater certainty. The Strategic Policy Branch has been involved in determining the project's requirements.

Other projects

The Strategic Policy Branch has also been involved in reviewing the Capability Management Framework and has provided advice on navy projects and inter-agency preparedness for the introduction of the Project Protector fleet into service.

International Defence Relations

Closer Defence Relations with Australia

The trans-Tasman defence relationship is a uniquely close one. We share a common interest in a stable region and we work closely together to promote this. Our combined response to the civil unrest in the Solomon Islands in April and Timor-Leste in May 2006 underlined the close cooperation which exists between our two defence forces. Regular high-level discussions between officials ensure a deep, practical understanding of each other's policies and enhance our ability to cooperate effectively.

In the past year, New Zealand and Australia have continued to collaborate and share information over a range of areas, including logistics, communications, personnel and capability development. Both countries are undertaking major capability renewal and acquisition programmes, which offer prospects for project cooperation and greater interoperability. A range of bilateral and multilateral exercises assist in maintaining the complementary skills and capabilities necessary to operate together.

The Minister of Defence met Dr Brendan Nelson, his Australian counterpart in May 2006 for the annual defence Ministerial talks. The Ministers reaffirmed the importance of New Zealand and Australia staying closely engaged on regional security issues. They noted that recent developments emphasised the importance of the two countries working together with their Pacific neighbours to achieve security and stability in the region.

The Ministers also agreed that Australia and New Zealand would continue to look to develop further areas of collaboration and information sharing. This includes the logistics and communications fields, as well as key areas of capability development including the acquisition of medium utility helicopters, ANZAC ship upgrades, and the replacement of Army vehicle transport fleets and artillery and small arms replacement projects.

South Pacific

In the past year, developments in the South Pacific have continued to shape defence policy, outputs, and decisions on defence capabilities. This is indicative of New Zealand's enduring strategic interests in the region and the strong bonds of geography, history, and culture which link us closely to it. We have special obligations to assist our South Pacific neighbours in maintaining peace, promoting good governance and helping achieve economic well-being. The need for this assistance is increasing, including in the defence and security arena.

The region faces cumulative stresses arising from ethnic tensions, governance failures, and fragile economies which make it susceptible to debilitating trans-national security challenges.

A wide range of defence activities in the Pacific support New Zealand's interests. Principal areas of engagement include assistance with maritime surveillance, disaster relief, maritime search and rescue, strengthening peacekeeping capabilities and developing the professionalism of defence and police forces through the Mutual Assistance Programme (MAP). Major developments over the last twelve months in New Zealand's defence engagement in the South Pacific particularly covered Solomon Islands, Fiji, Tonga, Papua New Guinea, Vanuatu, Cook Islands, and Samoa.

Solomon Islands

The Regional Assistance Mission to Solomon Islands (RAMSI) has been in place for three years. It has achieved progress in restoring law and order, governance reforms, and economic development. The mission remains popular with Solomon Islanders.

RAMSI experienced a serious set back in April when rioting broke out in Honiara following the election of a new Prime Minister. Order was quickly restored with the assistance of additional military and police forces from New Zealand, Australia, and South Pacific nations. As the security situation stabilised, some of the additional forces were withdrawn. Despite the restoration of order, RAMSI is likely to require continuous New Zealand military support for some time to come.

Fiji

Fiji is an important South Pacific neighbour and a key partner in RAMSI. Our objectives for Fiji are to rebuild professionalism in, and strengthen the peacekeeping capacity of, the Republic of Fiji Military Forces.

In the last year, bilateral defence activities have included New Zealand military exercises in Fiji, training courses for Fijian military personnel, and visits to Fiji by the Minister of Defence and the New Zealand Chief of Defence Force.

Tonga

The deployment of Tongan Defence Services (TDS) personnel to Solomon Islands as part of RAMSI is a recent and significant development. The TDS is likely to contribute more actively to regional peace support operations such as RAMSI, where they performed very credibly. The New Zealand Defence Force's engagement with the TDS will therefore be broadened beyond the traditional focus on trade training, band and officer training to assist them to continue to participate meaningfully in regional operations.

Papua New Guinea

We continue to enjoy good defence relations with the Papua New Guinea Defence Force (PNGDF) which, like the military forces of Fiji and Tonga, has made a valued contribution to RAMSI. A key feature of New Zealand's defence engagement with Papua New Guinea is the ongoing support provided to the Commercial Support Programme (CSP), which has made significant progress over the last two years. The way the New Zealand Defence Force has provided support to the CSP is regarded as a model for New Zealand assistance to other Mutual Assistance Programme partners. After initially providing a New Zealand officer to the PNGDF to implement and oversee the CSP project, responsibility for managing the project has been shifted to the PNGDF. The New Zealand Defence Force role is now confined to providing ongoing advice and support from New Zealand.

Vanuatu

Our focus is to help the Vanuatu Police develop skill sets relevant to their policing work, and to strengthen the Vanuatu Mobile Force's national engineering capacity, while emphasising the latter's role as an integral component of the Police Force.

In cooperation with the Vanuatu Mobile Force, and with NZAID funding, a team of New Zealand Army engineers assisted in the conversion of the Police Barracks in Luganville into a temporary prison over April and May 2006. The project was part of a wider NZAID supported Corrections programme in Vanuatu.

Cook Islands and Samoa

Appropriate training support is provided to both the Cook Islands and Samoan Police forces, with an emphasis on developing the skills required for the effective operation of their Police patrol boats, and strengthening the information technology capacity of the Samoan Police.

Southeast Asia

Southeast Asia remains a key area for New Zealand's security interests. Terrorism continues to be the major security concern in the region. New Zealand engages in high-level relationships with defence partners in the region and defence officials contribute to the regional security dialogue. This includes the annual Shangri-La Dialogue in Singapore, which now occupies an important place in the regional security architecture. The Minister of Defence was one of seventeen Defence Ministers from, or with close security interests in, the Asia-Pacific region who attended this year's meeting.

Five Power Defence Arrangements

The Five Power Defence Arrangements (FPDA) continues to make an important contribution to regional security. The Arrangements bring the defence forces of Australia, Malaysia, New Zealand, Singapore, and the United Kingdom together to exercise, and provide a valuable forum for Defence Ministers and officials to exchange views on defence issues of relevance to all members. The FPDA continues to evolve to meet today's security challenges.

New Zealand participates in the full range of FPDA activities. These have recently been expanded to include scenarios based around combating non-conventional threats, such as maritime terrorism, piracy and people smuggling. In June 2006, the Minister of Defence met with his FPDA counterparts in Singapore and Malaysia to discuss these developments. A commitment was also made to explore options for enhanced cooperation in humanitarian assistance and disaster relief.

ASEAN Regional Forum

The ASEAN Regional Forum (ARF), which brings together twenty-four countries and the European Union, is the only Asia-Pacific pan-regional forum devoted to discussing security issues. New Zealand values the ARF and actively supports greater defence participation under its auspices.

New Zealand defence officials attended the Ministerial Meeting in Laos in July 2005; the Intersessional Group Meetings in Honolulu in October 2005 and the Philippines in March 2006; and the Senior Officials' Meeting and Security Policy Conference in Malaysia in May 2006. New Zealand also participated in a range of ARF confidence-building measures.

Singapore

New Zealand's extensive and long-standing defence links with Singapore are an integral part of the wider relationship between the two countries. The defence relationship is sustained through exercises, training and exchanges, and an annual schedule of meetings, including at senior levels. The Minister of Defence held talks with his Singaporean counterpart, Rear Admiral Teo Chee Hean, at the Shangri-La Dialogue in Singapore in June 2006. The introduction of formal army-to-army talks in September 2005 and the deepening of defence industry links underline the value in continuing to grow the relationship with Singapore.

Malaysia

New Zealand has a long history of defence association with Malaysia based on an annual programme of exercises, bilateral meetings, multilateral cooperation within the FPDA, and training provided to the

Malaysian Armed Forces through the Mutual Assistance Programme. Malaysia also offers training to the New Zealand Defence Force at its United Nations Peacekeeping School. The Minister of Defence met the Malaysian Deputy Prime Minister and Minister of Defence, Dato' Tan Sri Mohammed Najib, during the FPDA Ministers' Meeting in June 2006.

Timor-Leste

New Zealand responded swiftly to the recent crisis in Timor-Leste through the deployment of 200 Defence Force personnel as part of the Australian-led regional task force to restore civil order. Prior to the unrest, New Zealand had been providing modest assistance to the Timor-Leste defence force in an advisory capacity with logistic and human resource support, and small arms training. Over the reporting period, New Zealand also provided one military liaison officer to the United Nations Special Political Mission to Timor-Leste (UNOTIL).

Other Southeast Asian Nations

New Zealand's defence relationships with Brunei, the Philippines and Thailand centre primarily on the Mutual Assistance Programme. Joint military exercises were held with the Royal Bruneian Armed Forces in Brunei in July/August 2005 and in Central Otago in January/February 2006. The Minister of Defence held bilateral meetings with both the Deputy Minister of Defence of Brunei and the Secretary of National Defence of the Philippines at the Shangri-La Dialogue in Singapore. Defence links with Vietnam are developing and there has been considerable interaction with other Southeast Asian countries through the ARF defence dialogue process.

North Asia

North Asia is strategically important for New Zealand. Our strong economic links with the region make its ongoing stability critical to this country's prosperity. Relations between the countries of North Asia have a significant impact on the security of the wider Asia-Pacific region. New Zealand's defence engagement with China, the Republic of Korea and Japan has developed in line with growth in the overall bilateral relationships.

China

New Zealand's defence relationship with China continues to centre on visits and exchanges. Prominent events in the past year included the visit to New Zealand by Vice Admiral Wu Shengli, People's Liberation Army Deputy Chief of General Staff, in September 2005. A People's Liberation Army officer continues to attend the New Zealand Defence Force Command and Staff Course. New Zealand reciprocates by sending an officer to Beijing for six-weeks to attend the International Symposium on Regional Security Issues at China's National Defence University.

Republic of Korea

New Zealand's defence links with the Republic of Korea (ROK) extend back to New Zealand's participation in the Korean War. Bilateral defence engagement over the past year has included high-level visits, annual talks and academic exchanges.

In November 2005, the Minister of Defence visited the ROK and met with his counterpart, Mr Yoon Kwang Woong. New Zealand defence officials held defence talks with their ROK counterparts in Seoul in October 2005. In May 2006, a Defence Force officer began a twelve-week attachment at the Korea National Defence University as a visiting professor. The ROK Joint Staff College visited New Zealand in June 2006 and a Korean student is attending the New Zealand Defence Force Command and Staff Course.

New Zealand's contribution to the multinational United Nations Command underpins New Zealand's commitment to security on the Korean Peninsula and inter-Korean reconciliation. The Minister of Defence met with the then Commander United Nations Command, General Leon J. LaPorte, during his visit to the ROK in November 2005. Three Defence Force officers serve with the United Nations Command Military Armistice Commission.

Japan

New Zealand's defence relationship with Japan took a significant step forward with the formalisation in 2005 of annual bilateral defence talks. Previously this dialogue had taken place as security consultations on an ad-hoc basis. New Zealand defence officials visited Tokyo in December 2005 for the first talks in the new format. We reciprocated in May 2006 by hosting a visit by Japanese officials in Wellington. There will be opportunities for further bilateral engagement in the future as Japan continues its efforts to increase its participation in international peace support operations.

United Kingdom

Our defence relationship with the United Kingdom is long-standing, close and very important. Cooperation across all three Services continues to play a key role in maintaining our professional standards and interoperability with key defence partners. New Zealand continues to contribute to British peace support operations in Bosnia through our commitment to the European Union-led stabilisation force.

The Minister of Defence met with then United Kingdom Secretary of State for Defence, John Reid in February this year; and met with the current Secretary of State for Defence, Des Browne, in London, in early June 2006. He also met with the Secretary of State for the Armed Forces, Adam Ingram, in June in Singapore and Malaysia.

North America

United States

The relationship with the United States remains an important one for New Zealand. We continue to work alongside United States Forces in a number of international operations in pursuit of shared interests. A key component of New Zealand's bilateral defence relationship with the United States is the international campaign against terrorism. New Zealand is one of a growing number of countries contributing military forces to the stabilisation effort in Afghanistan; and we also actively contribute to, and participate in, the United States-led Proliferation Security Initiative. Such commitments are recognised and appreciated by Washington, including at very senior levels.

The Minister of Defence met his United States counterpart, Donald Rumsfeld, in Washington D.C. in April this year. The commanders of the United States' Pacific (Admiral William Fallon) and Central (General John Abizaid) Commands also visited New Zealand in January and February 2006, respectively.

Canada

New Zealand and Canada enjoy a close and cordial defence relationship. An important development in the relationship this year was the inaugural New Zealand-Canada political-military talks in Ottawa in May 2006. The talks reflect a strengthening of the bilateral relationship in recent years through shared experience in peace support operations, expanded training activities, and defence procurement.

Peace Support Operations

New Zealand has been a consistent contributor to peacekeeping missions for half a century. The Asia-Pacific region remains New Zealand's first priority for peacekeeping contributions, but our commitment to collective security and the rule of law requires ongoing contributions well beyond our region. Our current commitments are global in reach, with personnel carrying out peacekeeping activities in the Pacific, Middle East, Asia, Europe and Africa. As at 30 June 2006, approximately 411 New Zealand Defence Force personnel were deployed on overseas missions, the bulk of them in Timor-Leste, Solomon Islands, Afghanistan and the Middle East.

Afghanistan

New Zealand supports international efforts to stabilise Afghanistan and build indigenous capabilities. The focal point of this activity is the provision of a Provincial Reconstruction Team of over 120 personnel, a commitment that has been extended to September 2007. Working in Bamyan Province, this team aims to assist the Afghan authorities extend their influence beyond Kabul. Its emphasis is on improving the security environment, as well as facilitating the provision of humanitarian support and development assistance to the Afghan people. New Zealand Defence Force personnel are also training the Afghan National Army and a Military Liaison Officer is working with the United Nations Assistance Mission in Afghanistan.

Proliferation Security Initiative

The Proliferation Security Initiative (PSI) is a multilateral United States-initiated effort to counter the growing challenge to international security posed by the global proliferation of weapons of mass destruction (WMD), their delivery systems, and related materials – in a manner that is consistent with relevant domestic legal requirements and international law. The PSI objectives, which were launched in 2003, are encompassed in its Statement of Interdiction Principles. New Zealand expressed its support for the PSI Interdiction Principles in April 2004, and has been a member of the governing Operational Expert Group since November of that year. Since joining the PSI, New Zealand defence officials have attended several plenary and Operational Expert Group meetings; and the New Zealand Defence Force have contributed to the ongoing series of workshops and training exercises.

The contribution of a Royal New Zealand Air Force Boeing 757 aircraft, aircrew, and support personnel to the Australian-led PSI exercise, Exercise Pacific Protector, in April 2006 was significant. This enhanced our credentials as an active PSI contributor, particularly in our region.

Acquisition of Defence Equipment

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

Major projects over the last year have covered all three services, with the majority in the delivery phase. The light armoured vehicles and tactical communications projects are generally complete, following the delivery and introduction into service of the equipment, but some accessories remain to be delivered. Both projects are expected to be delivered within the Government approved budget.

Upgrading the Army

Light armoured vehicles

105 light armoured vehicles were purchased from General Dynamics Land Systems, Canada. All but one of these vehicles is now in service with the New Zealand Army. One vehicle will remain with the manufacturer to provide a systems validation and a test platform for Army operational purposes. Spare parts, special tools, and test equipment have been delivered and the project is in the final stages of completion.

Light operational vehicles

This project involves the acquisition of 321 light operational vehicles, in six variants, to meet the Army's motorisation requirements. Deliveries commenced in October 2004, and 131 non-armoured vehicles were in service with the Army by 30 June 2005. During the past 12 months all but one of the remaining non-armoured vehicles have been delivered to New Zealand, leaving five armoured variants outstanding at 30 June 2006.

At the request of the New Zealand Defence Force, five light operational vehicles were purchased for the Royal New Zealand Air Force. While the additional vehicles were funded separately from the Defence Force's capital programme minors, the Ministry assisted in their acquisition through the existing contract with the manufacturer.

Tactical Communications

This project covers tactical communications for the Army and supporting Royal New Zealand Air Force units. Final deliveries were received in the fourth quarter of 2005, and the project is now in the closure phase.

Very Low Level Air Defence

This project will provide alerting, cueing and identification of friend or foe systems for the Mistral very low-level air defence system, which is already in service. The systems will be delivered in the fourth quarter of 2006.

Medium Range Anti-Armour Weapon

This project will provide a medium-range anti-armour weapon, the Javelin missile, manufactured by Raytheon/Lockheed Martin Joint Venture. Proceeding under the United States' foreign military sales programme, the training equipment was delivered in June 2006. The missiles will be delivered in the fourth quarter of 2006.

Upgrading the Navy

Following the Government's endorsement of the Maritime Forces Review, Project Protector was initiated to purchase new vessels for the Royal New Zealand Navy. In July 2004, a contract was signed with Tenix Defence Systems for one Multi-Role Vessel, two Offshore Patrol Vessels and four Inshore Patrol Vessels. The Multi-Role Vessel was launched in Rotterdam in February 2006, undertaking contractor sea trials in late June 2006. The Offshore and Inshore Patrol Vessels are being built in Melbourne and Whangarei respectively. All seven ships will be delivered during 2007.

Upgrading the Air Force

C-130 Life Extension

A contract was signed with L-3 Spar Aerospace in December 2004 to upgrade and extend the life of the Royal New Zealand Air Force's C-130 Hercules fleet. In October 2005, the first aircraft was inducted into the life-extension programme at L-3 Spar Aerospace in Edmonton, Canada.

P-3 Orion Communications and Navigation Systems Upgrade

A contract was signed with L-3 Communications Integrated Systems in October 2004 to upgrade the communications and navigation systems of the Air Force's P-3 Orion fleet. The early Electro Optics installation was completed in New Zealand. Work commenced on the fit out of the new systems in the first aircraft following its arrival at the L-3 communications facility in Greenville, Texas, in September 2005.

Boeing 757 Purchase and Modifications

A contract to re-configure the Air Force's two Boeing 757 aircraft for cargo, as well as passengers, was signed with Mobile Aerospace Engineering in October 2005. Modification of the first aircraft will begin in the second quarter of 2007.

Helicopter Replacement

Work is proceeding on replacing the Air Force's Iroquois helicopters. The Government approved NATO Helicopters Industries (NHI), supplier of the NH90 medium utility helicopter, as preferred tender in March 2005. The Ministry has been engaged with NHI to obtain full costings for the NH90. Government approval was granted on 10 July 2006 to commence contract negotiations for the acquisition of eight NH90 helicopters.

Work is also proceeding on identifying a suitable Training/Light Utility Helicopter to replace the Air Force's Sioux helicopters. The evaluation of the Registration of Interest has been completed and Requests for Tenders will be sought in the fourth quarter of 2006.

A joint approach

Joint command and control system

The acquisition of a joint command and control system (JCCS) will provide Defence Force commanders, at strategic, operational, and tactical levels, with the means to execute, command and control their forces individually, jointly, within a combined force, and within a coalition environment. It will also provide a sustainable framework that is interoperable with our partners, including relevant non-defence partners.

In June 2006 the Ministry accepted responsibility for the acquisition of the JCCS.

New Zealand industry involvement

New Zealand Defence Industry Association

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 the New Zealand Defence Industry Association. During the year, the Ministry provided regular briefings at New Zealand Defence Industry Association meetings. Assistance was also provided to the Association for the annual two-day Defence Industry Seminar held at Te Papa Museum in Wellington in late October 2005.

Defence Industry Committee of New Zealand

The Ministry provided support for the Defence Industry Committee of New Zealand. This Ministerial appointed committee provides industry feedback to Defence and briefs the Minister on industry issues.

The Defence Industry Committee of New Zealand sponsors the Defence Industry Committee Awards of Excellence. These are awarded annually to companies that have provided Defence with excellence in products or services. The awards were part of the Defence Industry Seminar 2005.

Evaluation

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

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

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

In addition to undertaking audits to meet the Secretary's responsibilities under the Defence Act, the Evaluation Division undertakes audits under section 3(6) of the Hazardous Substances and New Organisms Act 1996.

Corporate

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

A major emphasis over the last year has been on progressing the new Defence building that will accommodate the two Defence organisations. This is scheduled for completion in February 2007.

Conclusion

The last year proved to be another challenging and rewarding one for the Ministry. As well as the continued focus on re-equipping the New Zealand Defence Force and operational deployments, substantial efforts were devoted to implementing the changes initiated under the DSI. While significant advances have been made, the next phase in the development of the Ministry and the New Zealand Defence Force will bring new challenges. Ensuring that sound policy continues to drive advice on defence capabilities and operations will remain the core function of the Ministry.

The Ministry is very conscious of the high international standing in which our Defence Force personnel are held and that New Zealanders take pride in the good work they do. The greater certainty provided by the DSI for defence planning and the investment in new capabilities mentioned above will ensure that these high standards are maintained well into the future.



Chris Seed
Acting Secretary of Defence
22 September 2006

Part 2: Statement of responsibility and audit report



Statement of responsibility

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

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

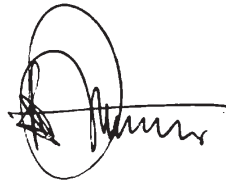
In my opinion, these financial statements fairly reflect the financial position and operations of the Ministry for the year ended 30 June 2006.

Signed by:



Chris Seed
Acting Secretary of Defence
22 September 2006

Countersigned by:



S J Patterson
Assistant Secretary of Defence (Finance)
22 September 2006

AUDIT REPORT

TO THE READERS OF MINISTRY OF DEFENCE'S FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2006

The Auditor-General is the auditor of Ministry of Defence (The Ministry). The Auditor-General has appointed me, J R Smait, using the staff and resources of Audit New Zealand, to carry out the audit of the financial statements of the Ministry, on his behalf, for the year ended 30 June 2006.

Unqualified opinion

In our opinion the financial statements of the Ministry on pages 20 to 84

- Comply with generally accepted accounting practice in New Zealand; and
- Fairly reflect:
 - the Ministry's financial position as at 30 June 2006;
 - the results of its operations and cash flows for the year ended on that date;
 - its standards of delivery performance achieved, as compared with the forecast standards outlined in the statement of forecast service performance adopted at the start of the financial year and its actual revenue earned and output expenses incurred, as compared with the forecast revenues and output exercises outlined in the statement of forecast service performance adopted at the start of the financial year and
 - the schedules of non-departmental activities on pages 78 to 84 fairly reflect the assets, liabilities, revenues, expenses, contingencies and commitments managed by the Ministry on behalf of the Crown for the year ended 30 June 2006.

The audit was completed on 22 September 2006, and is the date at which our opinion is expressed.

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

Basis of Opinion

We carried out the audit in accordance with the Auditor-General's Auditing Standards, which incorporate the New Zealand Auditing Standards.

We planned and performed the audit to obtain all the information and explanations we considered necessary in order to obtain reasonable assurance that the financial statements did not have material misstatements, whether caused by fraud or error.

Material misstatements are differences or omissions of amounts and disclosures that would affect a reader's overall understanding of the financial statements. If we had found material misstatements that were not corrected, we would have referred to them in our opinion.

The audit involved performing procedures to test the information presented in the financial statements. We assessed the results of those procedures in forming our opinion.

Audit procedures generally include:

- determining whether significant financial and management controls are working and can be relied on to produce complete and accurate data;
- verifying samples of transactions and account balances;
- performing analyses to identify anomalies in the reported data;
- reviewing significant estimates and judgements made by the Secretary of Defence;
- confirming year-end balances;
- determining whether accounting policies are appropriate and consistently applied; and determining whether all financial statement disclosures are adequate.

We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements or statement of service performance.

We evaluated the overall adequacy of the presentation of information in the financial statements. We obtained all the information and explanations we required to support our opinion above.

Responsibilities of the Secretary of Defence and the Auditor

The Secretary of Defence is responsible for preparing financial statements in accordance with generally accepted accounting practice in New Zealand. The financial statements must fairly reflect the financial position of the Ministry as at 30 June 2006 and the results of its operations and cash flows for the year ended on that date. The statement of service performance must fairly reflect, for each class of outputs, the Ministry's standards of delivery performance achieved and revenue earned and expenses incurred, as compared with the forecast standards, revenue and expenses adopted at the start of the financial year. In addition, the schedules of non-departmental activities must fairly reflect the assets, liabilities, revenues, expenses, contingencies and commitments managed by the Ministry on behalf of the Crown for the year ended 30 June 2006. The Secretary of Defence's responsibilities arise from sections 45A, 45B and 45(1)(f) of the Public Finance Act 1989.

We are responsible for expressing an independent opinion on the financial statements and reporting that opinion to you. This responsibility arises from section 15 of the Public Audit Act 2001 and section 45D(2) of the Public Finance Act 1989.

Independence

When carrying out the audit we followed the independence requirements of the Auditor-General, which incorporate the independence requirements of the Institute of Chartered Accountants of New Zealand.

In addition to the audit we have carried out an assignment in the area of tender process assurance, which is compatible with those independence requirements. Other than the audit and this assignment, we have no relationship or interests with the Ministry



J R Smaill
 Audit New Zealand
 On behalf of the Auditor-General
 Wellington, New Zealand

Matters relating to the electronic presentation of the audited financial statements

This audit report relates to the financial statements of the Ministry of Defence for the year ended 30 June 2006 included on the Ministry of Defence's web site. The Ministry of Defence's Secretary of Defence is responsible for the maintenance and integrity of the Ministry of Defence's web site. We have not been engaged to report on the integrity of the Ministry of Defence's web site. We accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.

The audit report refers only to the financial statements named above. It does not provide an opinion on any other information which may have been hyperlinked to/from these financial statements. If readers of this report are concerned with the inherent risks arising from electronic data communication they should refer to the published hard copy of the audited financial statements and related audit report dated 22 September 2006 to confirm the information included in the audited financial statements presented on this web site.

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

Part 3: Departmental financial statements



Statement of objectives and service performance

For the year ended 30 June 2006

Objectives

The Estimates of Appropriations, Statement of Intent and Output Plan 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. ISO 9001 accreditation has been maintained in the Acquisition Division. The Ministry maintains the financial management systems necessary to ensure that classes of outputs are delivered within approved appropriation and in compliance with the provisions of the Public Finance Act. Regular monitoring and reporting of expenditure against output forecasts was undertaken. Systems are in place to ensure working capital is managed at an optimum level and foreign currency exposure is minimised.

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.

Measuring our performance

Measuring our performance is an important part of the managing for outcomes environment. In our Statement of Intent, published in May, the Ministry stated that it intended to develop a broad set of indicators that reflect the various aspects of its activities and report on progress towards measurement in its Annual Report.

Progress

In the period to 30 June 2006, the Ministry resolved to:

- review its strategic risks to produce an integrated risk management framework
- commence reviewing existing outcomes framework in collaboration with key stakeholders with view to investigating possible shared outcomes
- continue to develop and implement measures, with the assistance of central agencies, to assess the overall impact of interventions
- develop and maintain close working relationships on the above issues with key stakeholders.

Output Class - Policy advice

Description

Under this output class the Minister of Defence will purchase:

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

Outcome

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

Service performance

Quantity and timeliness

Target	Delivered
1. Undertake analysis of significant issues that have an impact on the Government's defence policy and international defence relations including: <ul style="list-style-type: none"> • developments in the international security environment, especially in the Asia-Pacific region 	<ul style="list-style-type: none"> – The Ministry prepared a geopolitical environmental scan to inform other defence policy work. – The Ministry provided input to New Zealand's Association of South East Asian Nations (ASEAN) Regional Forum annual security outlook. – The Ministry provided analysis and advice on the response to riots in Solomon Islands. – The Ministry provided analysis and advice on the breakdown of law and order in Timor-Leste. – The Ministry provided analysis and advice on

Target	Delivered
<ul style="list-style-type: none"> • changes in the defence and security policies of key countries such as Australia and the United States 	<p>the conflict in southern Lebanon and the safety of New Zealand's United Nations Truce Supervision Organisation observers (UNTSO).</p> <ul style="list-style-type: none"> – The Ministry participated in the Australia /France/ New Zealand/United States quadrilateral meeting in Sydney. – The Ministry closely monitored the United States Global Strategic Review and the comments of partners in the region. – The Ministry provided policy briefs on 'United States/Japan: Transformation and Repositioning in Asia' and the 'United States Armed Forces Transformation and the Quadrennial Defence Review'.
<ul style="list-style-type: none"> • developments in regional security relations 	<ul style="list-style-type: none"> – The Ministry contributed to the inter-agency group which administers the Pacific Security Fund. – The Ministry provided advice on defence re-engagement with Fiji. – The Ministry provided input to the Proliferation Security Initiative Response Manual. – The Ministry prepared a Japan Defence Engagement Paper. – The Defence Attaché - Middle East appointment was established. – The Ministry provided advice on Five Power Defence Arrangements policy development through participation in the June meeting of member Defence Ministers. – The Ministry provided advice on defence re-engagement with Indonesia. – The Ministry monitored developments in the ASEAN Regional Forum; in particular the defence dialogue process.
<ul style="list-style-type: none"> • deployments of New Zealand Defence Force assets and personnel on United Nations or other operations 	<p>The Ministry was involved in the preparation of Cabinet papers and submissions relating to:</p> <ul style="list-style-type: none"> – The deployment of New Zealand Defence Force personnel to the Regional Assistance Mission to the Solomon Islands. – The possibility of New Zealand Defence Force

Target	Delivered
<ul style="list-style-type: none"> • the operation of the New Zealand Defence Force Mutual Assistance Programme • undertake capability reviews in cooperation with the New Zealand Defence Force to identify the options for achieving the Government's defence policy goals and the Ministry of Defence's outcomes, in particular capability reviews for projects from the <i>Defence Long-term Development Plan</i> (LTDP) 	<p>Engineer Support to a New Zealand AID Corrections Project in Santo.</p> <ul style="list-style-type: none"> – Operation Enduring Freedom. – The Multinational Force in the Sinai. – The Strategic Review of Peacekeeping. – The possible deployment of New Zealand Defence Force personnel to Sudan. – The deployment of additional New Zealand Defence Force personnel to the Regional Assistance Mission in Solomon Islands. – The deployment of additional New Zealand Defence Force personnel to Timor-Leste. – The rollover deployment of New Zealand's contribution to the United Nations Mission in Kosovo (UNMIK). – The possible deployment of additional New Zealand Defence Force personnel to Sudan. – The continued deployment of New Zealand Defence Force personnel to the United Nations Mission in Korea (UNCMAC). – The continued deployment of New Zealand Defence Force personnel to the United Nations Truce Supervision Organisation (UNTSO). – The Ministry was involved in providing policy advice on the Mutual Assistance Programme. – The Ministry discussed defence assistance with the Republic of Fiji Military Forces. – The Ministry participated in Mutual Assistance Programme talks with Timor Leste. – Policy advice, guidance and resources were provided to the Defence Sustainability Initiative and the Defence Funding Package Implementation project. – The Ministry provided advice on the Army Configuration Review, which is in preparation. – The Ministry was involved in a review of the <i>Defence Long-term Development Plan</i> (LTDP) and re-prioritisation exercise which will be reported to Cabinet.

Target	Delivered
<ul style="list-style-type: none"> • provide on-going advice during the acquisition phase of projects from the <i>Defence Long-term Development Plan</i> 	<ul style="list-style-type: none"> – The Ministry was involved in preparing the 2006 public update of the <i>Defence Long-term Development Plan</i> (LTDP). – The Ministry coordinated work to revise the New Zealand Defence Force's Employment Contexts, which are used to measure preparedness to undertake military tasks. – The Ministry was involved in the development and writing of Cabinet papers on: the Joint Command and Control capability; the Boeing 757 Modification Programme; and a follow-up Improvised Explosive Device Disposal capability paper. – The Ministry was involved in providing policy advice on the Land Intelligence, Surveillance and Reconnaissance project. – A combined Ministry and New Zealand Defence Force team commenced work on the Defence Force Health Capability project that includes the Ministry mobile medical review. – The Ministry was involved in the provision of policy advice, and the development of Cabinet papers, relating to the consolidation of the Air Force at the Ohakea airbase. – The Ministry was involved in updating Cabinet on the Medium Utility Helicopter and Training/ Light Utility Helicopter projects. – The Ministry provided policy advice on aircraft self-protection capabilities, especially for the P3 Orion and C130 Hercules aircraft. – The Ministry provided advice on the Direct Fire Support Weapon (Area) project. – The Ministry provided advice on navy projects. – The Ministry was involved in the provision of policy advice, and the development of a Cabinet paper, on the feasibility of modifying the Boeing 757s for use in supporting Antarctic operations. – The Ministry provided reports on: <ul style="list-style-type: none"> • Project Protector vessels, including interagency preparedness for the

Target	Delivered
<p>(LTDP) that have been approved by the Government, such as Project Protector vessels, the upgrade of the C-130H Hercules fleet, the acquisition and modification of the second-hand Boeing 757 aircraft, the upgrade of the mission systems for the P-3 Orion fleet, the acquisition of new helicopters and the acquisition of weapons and engineering equipment for the Army</p> <ul style="list-style-type: none"> • interface with the New Zealand Defence Force and civilian agencies for co-ordinated responses to defence policy and security issues. These will include: Antarctica, arms control and disarmament, maritime patrol and surveillance, and oceans policy and trans-national criminal activity 	<p>introduction of the vessels</p> <ul style="list-style-type: none"> • Improvised Explosive Device Disposal capability. <ul style="list-style-type: none"> – The Ministry provided advice on the P3 Orion Systems Upgrade project and the Joint Command and Control system. – The Ministry provided advice, including to Officials Domestic and External Security Committee (ODESC), on the helicopter capability project. – The Ministry provided advice to the Ministry of Foreign Affairs and Trade on arms control and disarmament issues, and particularly on Certain Weapons Convention related issues. – The Ministry provided an annualised update on arms control and disarmament issues. – The Ministry, in conjunction with the New Zealand Defence Force, provided policy input to the Ministry of Environment's Ocean Policy Review. – The Ministry provided input for an assessment being undertaken of Antarctic support provided by the New Zealand Defence Force. – The Ministry was involved in the development of options for meeting New Zealand's Short-Medium Range Aerial Patrol requirements, which is being led by the Ministry of Fisheries. – The Ministry provided a policy brief on the implications for New Zealand's defence policy of natural disasters. – The Ministry, in conjunction with the New Zealand Defence Force, is reviewing the Capability Management Framework. – The Ministry completed a science and technology review of its role in Defence. – The Ministry provided advice to the Ministry of Foreign Affairs and Trade on New Zealand's Pacific Fisheries Strategy.

Target	Delivered
	<ul style="list-style-type: none"> <li data-bbox="815 255 1362 398">– The Ministry provided input to a Ministry of Foreign Affairs and Trade-led Ministerial submission regarding World War Two Chemical Weapons disposal. <li data-bbox="815 421 1374 712">– The Ministry contributed significantly to the Defence Sustainability Initiative Programme, which is being led by the New Zealand Defence Force. This programme consists of around 17 separate projects, each of which is intended to address significant issues identified by the Defence Capability and Resourcing Review. <li data-bbox="815 734 1394 1384">– Other Defence Sustainability Initiative projects to which the Ministry made a significant contribution include: <ul style="list-style-type: none"> <li data-bbox="868 860 1278 891">• Organisational Structure Review <li data-bbox="868 913 1321 945">• Capability Management Framework <li data-bbox="868 967 1273 999">• Corporate Planning Framework <li data-bbox="868 1021 1342 1088">• Corporate Performance Management Systems <li data-bbox="868 1111 1230 1142">• Human Resources Strategy <li data-bbox="868 1164 1337 1196">• Knowledge Management Framework <li data-bbox="868 1218 1337 1249">• Information Management Framework <li data-bbox="868 1272 1257 1339">• Housing and Accommodation Assistance Policy <li data-bbox="868 1361 1222 1393">• Army Configuration Review <li data-bbox="815 1415 1390 1809">– The Ministry has led the work on the Defence Sustainability Initiative -Ministry of Defence Policy Capability project, which is now completed. This project defined the composition of a new “Strategy and Capability Analysis” team within the Ministry’s Policy and Planning Unit that will restore identified weaknesses in the Ministry’s overall policy capability. The team will consist of a Director and up to six advisers. The Director and four advisers are already in place. <li data-bbox="815 1832 1401 1930">– The Ministry is leading the Defence Capital Asset Management Practice Review (DCAMP), which is being undertaken in conjunction with

Target	Delivered
<ul style="list-style-type: none"> • manage defence relationships with Australia and other regional countries (including key bilateral meetings between Australia and New Zealand Defence Ministers, and Senior Officials' meetings), and participate in the regional multilateral security dialogues (including the Association of South-East Asian Nations Regional Forum and Five Power Defence Arrangements Defence Ministers' Meeting.) 	<p>the New Zealand Defence Force, with input from Treasury and the State Services Commission. This exercise is scheduled for completion by the end of September 2006.</p> <ul style="list-style-type: none"> – The Ministry is leading the work on the Defence Sustainability Initiative -Definition of the Ministry of Defence Purchase Advice Function project. This project was delayed by the Defence Capital Asset Management Practice Review and is now scheduled for completion by the end of August 2006. – The Ministry was involved in the Australia-New Zealand Ministerial Meetings held in May and the Australia-New Zealand Defence Coordinating Group meeting. – The Ministry finalised and signed the Mutual Logistic Support Arrangements agreement with Malaysia. – The Ministry provided advice for the Pacific Security Strategy Review led by Ministry of Foreign Affairs and Trade. – The Ministry drafted a discussion paper on renewing defence engagement with Indonesia. – The Ministry provided briefing and conducted the bilateral Defence Coordinating Group and Senior Official Meetings with Malaysia. – The Ministry provided briefing for the Five Power Defence Arrangements Consultative Committee. – The Ministry provided advice on defence engagement with Japan. – The Ministry hosted a visit by the Singapore Permanent Secretary for Defence. – The Ministry provided briefing for the Forum Regional Security Meeting in Fiji. – The Ministry provided briefing and conducted the bilateral defence talks with Canada. – The Ministry provided briefing and conducted the bilateral defence talks with Japan.

Target	Delivered
	<ul style="list-style-type: none"> <li data-bbox="815 248 1390 353">– The Ministry provided briefing and conducted the Britain, Australia and New Zealand (BRITANZ) talks. <li data-bbox="815 376 1390 443">– The Ministry provided briefing and participated in the Shangri-La Dialogue. <li data-bbox="815 465 1390 571">– The Ministry provided briefing and participated in the Five Power Defence Arrangements Ministerial Meeting. <li data-bbox="815 593 1390 734">– The Ministry provided briefing and attended the Proliferation Security Initiative exercise, Pacific Protector, and the Operational Experts Group meeting in Miami. <li data-bbox="815 757 1390 936">– The Ministry was involved in providing briefing and attending the ASEAN Regional Forum Defence Officials' Dialogue, Security Policy Conference and Senior Officials' Meeting. <li data-bbox="815 958 1390 1025">– The Ministry provided briefing for the inaugural Singapore-New Zealand Strategic Dialogue. <li data-bbox="815 1048 1390 1930">– The Ministry provided the following briefings: <ul style="list-style-type: none"> <li data-bbox="868 1099 1353 1167">• The visit by the Director-General of the Multinational Force in the Sinai. <li data-bbox="868 1189 1353 1256">• The visit by the Minister to the Middle East. <li data-bbox="868 1279 1353 1346">• The visit by the Minister to the United Kingdom and Europe. <li data-bbox="868 1368 1353 1435">• The visit by the Chilean Chief of Army designate. <li data-bbox="868 1458 1353 1525">• The visit by the Commander of United States Central Command. <li data-bbox="868 1547 1390 1615">• The visit by the Commander of the United States Pacific Command. <li data-bbox="868 1637 1310 1704">• The visit by the South African Navy Inspector-General. <li data-bbox="868 1727 1390 1794">• Visit by the Air Component Commander to the Middle East. <li data-bbox="868 1816 1390 1883">• The visit by HMNZS <i>Te Mana</i> to India, Singapore, Thailand, Vietnam and Brunei. <li data-bbox="868 1906 1390 1930">• The visit by the Australian Foreign Minister.

Target	Delivered
	<ul style="list-style-type: none"> • The visit by the Foreign Minister to Fiji. • The visit by the Prime Minister to the Philippines. • The visit by the Prime Minister to Australia. • The visit by the Prime Minister to South Africa. • The visit by the Governor-General of Papua New Guinea. • The visit by the Chief of Army of Singapore. • The Five Power Defence Arrangements Defence Chiefs meeting attended by the Chief of Defence Force and Chief of Defence Force designate. • The visit by the Minister of Defence to Solomon Islands. • The visit by the Minister of Defence and the Secretary of Defence to the United States. • The visit by the Minister of Defence to France and the United Kingdom. • The visit by the Minister of Defence to the Five Power Defence Arrangements Headquarters (Malaysia). • The visit by the Minister of Defence to Fiji. • The visit by the Minister of Defence and the Commander Joint Forces to Timor-Leste. • The visit by the Prime Minister of Singapore. • The visit by the Foreign Minister of Thailand. • The visit by the French Overseas Minister. • The visit by Lieutenant-General Esperon, Commanding General of the Philippine Army (now Chief of Staff of the Armed Forces of the Philippines –Chief of Defence Force-equivalent). • The visit by the Chief of Staff of Qatar.

Target	Delivered
	<ul style="list-style-type: none"> • The visit by Lieutenant General Kim, Commander Special Warfare Command, Republic of Korea. • The visit by the Republic of Korea Staff College. • The visit by the Peoples Liberation Army Overseas Educational Exchange Working Group delegation. • The visit by the Commander of the Timor-Leste Armed Forces. • The visit by a Deputy Commander of the Greek Army. • The visit by HMNZS <i>Te Mana</i> to Singapore, India. • The visit by the Chief of Defence Force to NATO and the European Union. • The visit by the Commander Joint Forces to Afghanistan. • The visit by the Chief of Navy to India. • The visit by the Chief of Army to Afghanistan and Australia. • The visit by the Deputy Chief of Navy to Malaysia, Singapore. • The visit by the Deputy Chief of Army to Malaysia.

2. Provide the following Ministerial services:

- responses to Ministerial correspondence
 - replies to Ministerial correspondence will be actioned within 14 working days of receipt by the Ministry
 - A total of 33 items were actioned within 14 working days of receipt in the year ended 30 June 2006, including three that were delayed owing to late external advice.
- responses to Parliamentary questions
 - Parliamentary questions will be actioned within time frames set by Standing Orders of the House of Representatives
 - A total of 49 Parliamentary Questions were actioned within the time frames set by Standing Orders of the House of Representatives in the year ended 30 June 2006.

Target	Delivered
<ul style="list-style-type: none"> • responses to Official Information Act requests <ul style="list-style-type: none"> – Official Information Act enquiries will be actioned within statutory requirements 	<ul style="list-style-type: none"> – A total of 10 Official Information Act requests were actioned in the year ended 30 June 2006. All responses were within the statutory timeframe.

Output Quality Measures and Standards

The 2005 Statement of Intent detailed the quality standards intended.

In addition:

	Comment
<ul style="list-style-type: none"> • the Ministry will maintain quality control procedures to support the policy advice delivered under this output class 	<ul style="list-style-type: none"> – The Ministry has maintained quality control procedures to support the expectations for policy advice delivered under this output class. – The quality and review processes of the Policy and Planning Division incorporate the quality requirements, and it is considered that these standards have been achieved in the years work.
<ul style="list-style-type: none"> • the quality of policy advice will be assessed in terms of whether it is credible, respected, and contributes to the achievement of the Government's defence policy objectives by: <ul style="list-style-type: none"> – seeking the Minister's view – seeking the views of key stakeholders in policy advice. 	<ul style="list-style-type: none"> – The quality of policy advice is discussed regularly with the Minister. The Minister has expressed satisfaction with the policy advice received from the Ministry.
<ul style="list-style-type: none"> • the Policy and Planning Division will implement recommendations agreed by the Ministry from audits or reviews. 	<ul style="list-style-type: none"> – Recommendations from three audits are being implemented.

Cost of Output Class - Policy advice (GST exclusive)

For the year ended 30 June 2006

30/6/2005 Actual \$000		30/6/2006 Actual \$000	30/6/2006 Main estimates \$000	30/6/2006 Supp. estimates \$000
Revenue				
3,025	Crown	3,526	3,780	3,780
235	Other	47	27	43
3,260	Total revenue	3,573	3,807	3,823
Expenditure				
1,462	Personnel	1,698	1,746	2,052
585	Operating	453	627	560
1,136	Other	1,173	1,434	1,211
3,183	Total expenditure	3,324	3,807	3,823
77	Surplus	249	-	-

Output Class - Audit and assessment of performance

Description

Under this output class the Minister of Defence will purchase:

- audits and assessments of any function, duty or project of the New Zealand Defence Force
- audits and assessments of the Ministry's procurement, replacement or repair of major military equipment
- audits of the controls on hazardous substances under the control of the Minister of Defence, as required by the Hazardous Substances and New Organisms Act 1996.

Outcome

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

Service performance

Quantity and timeliness

Target	Delivered
1. Complete satisfactorily an approved programme of audits and assessments that will lead to improvements in performance and accountability in the Defence organisations	<ul style="list-style-type: none"> • The following programmed evaluations were completed during the year: <ul style="list-style-type: none"> – 13/2005 Management of Official Information Act activities – 14/2005 Strategic Personnel Policy and Management Structures – 15/2005 Management of Specialist Military Equipment – 16/2005 Review of Headquarters Joint Forces New Zealand – 17/2005 Review of a Proposal to Establish a Joint Logistics and Support Organisation – 18/2005 New Zealand Defence Force Communications and Information Systems Organisation – 19/2005 New Zealand Defence Force Health and Safety Management7/2004

Officer Career Management in the New Zealand Defence Force

- 1/2006
Implementation of Improvements to New Zealand Defence Force / Ministry of Defence Collaborative Arrangements
- 2/2006
New Zealand Defence Force Output 15.1 – Mutual Assistance Programme
- 3/2006
Management of New Zealand Defence Force senior Officers
- 4/2006
Policy Direction for New Zealand Defence Force Individual Training
- 5/2006
New Zealand Defence Force Output 8.2 – Engineers
- 6/2006
Defence Crown Capital Forecasting
- 7/2006
New Defence Headquarters Building Project
- 8/2006
Introduction of Enhanced Maritime Surface Patrol Capability
- 9/2006
Welfare Support for Families of Deployed New Zealand Defence Force Personnel

2. Conduct other audits and assessments as and when directed.

- No unprogrammed audits were completed during the year.

Output Quality Measures and Standards

Quality Standard	Comment
The 2005 Statement of Intent detailed the quality standards intended.	<ul style="list-style-type: none"> – 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. – All reports were subjected to peer review.

- Managerial review was maintained throughout the evaluation process.

In addition:

- the quality of audit and assessment of performance will be assessed in terms of whether it is credible, effective, respected and contributes to the achievement of the Government's defence policy objectives by:
 - seeking the Minister's view
 - seeking the views of key stakeholders in audit and assessment of performance.
- the Evaluation Division will implement recommendations agreed by the Ministry from audits and reviews.
 - The views of the Minister were sought as to the quality of audits and assessments of performance.
 - The Defence Evaluation Board agreed at its meetings in December 2005 and June 2006 that audits and assessments of performance met its expectations as to quality and utility.
 - No recommendations from audits and reviews have had to be implemented during 2005/06.

Cost of Output Class - Audit and assessment of performance (GST exclusive)

For the year ended 30 June 2006

30/6/2005 Actual \$000		30/6/2006 Actual \$000	30/6/2006 Main estimates \$000	30/6/2006 Supp. estimates \$000
Revenue				
1,748	Crown	1,735	1,748	1,748
13	Other	27	26	43
1,761	Total revenue	1,762	1,774	1,791
Expenditure				
715	Personnel	757	766	819
28	Operating	53	34	38
876	Other	904	974	934
1,619	Total expenditure	1,714	1,774	1,791
142	Surplus	48	-	-

Output Class - Management of equipment procurement

Description

Under this output class the Minister of Defence will purchase the following:

- management of procurement, or refurbishment, on behalf of the Crown, of significant equipment contributing to a capability of the New Zealand Defence Force. This will involve:
 - management of procurement functions from the initial identification of a requirement through ministerial approval-in-principle and commitments
 - the subsequent acquisition process, including 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
 - advice on introduction into service and the management of any warranty provisions
 - investigation of associated financing arrangements and on-sale to the New Zealand Defence Force
- maintenance of an information base on industrial capability, and the provision of advice to industry on defence requirements.

Outcome

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

Service performance

Quantity, quality and timeliness

It will progress some or all of the following projects, subject to appropriate Government approval for each:

1. Army Engineering Equipment

This project will improve the Army's engineering equipment and its ability to support the mobility of the motorised land force with the acquisition of combat engineering tractors, rapid gap-crossing system and water purification/storage equipment. This equipment is expected to enter service in 2006/07.

Target	Delivered
<ul style="list-style-type: none"> • In 2005/06 it is planned to: <ul style="list-style-type: none"> – take costed proposals back to the Government – negotiate a contract with a preferred supplier, or suppliers. • Further project milestones will be known once a contract is awarded. 	<ul style="list-style-type: none"> – This project is under review within the New Zealand Defence Force as part of an update of the <i>Defence Long-term Development Plan</i> (LTDP). The Ministry of Defence awaits the outcome of the review. – No contracts have been awarded.

Financial summary of pre-acquisition costs charged to departmental output class

- Management of equipment procurement in 2005/06 (GST exclusive)

	\$
Budget for pre-acquisition costs	222,000
Expenditure to 30 June 2006	39,000

2. Replacement Helicopter Capability



Photographic representation of the proposed TNZA NH90 helicopter.

This project proposes the replacement of the Iroquois utility helicopter and the Sioux training helicopter with a capability that meets the New Zealand Defence Force's contemporary needs.

The training helicopter is expected in service in 2006 with the medium utility helicopter entering service 2008/09.

Target	Delivered
<ul style="list-style-type: none"> • In 2005/06 it is planned to: <ul style="list-style-type: none"> – take costed proposals back to the Government – negotiate a contract with a preferred supplier, or suppliers. • Further project milestones will be known once a contract is awarded. 	<ul style="list-style-type: none"> – A response to a Best and Final Offer (BAFO) with NH Industries was received in October 2005. – Cabinet directed in April 2006 that the Ministry of Defence enter into non-binding negotiations with NH Industries to determine the overall cost of acquiring NH90 helicopters, based on options for numbers and delivery dates. – In July 2006 Cabinet authorised Ministry of Defence to enter into contract negotiations with NH Industries. These negotiations were completed and a contract with NH Industries was signed by the Minister of Defence on 31 July 2006. – Project milestones will now be developed. The delivery of aircraft are scheduled between November 2009 and June 2011.

**Financial summary of pre-acquisition costs charged to departmental output class -
Management of equipment procurement in 2005/06 (GST exclusive)**

	\$
Budget for pre-acquisition costs	118,000
Expenditure to 30 June 2006	<u>322,625</u>

- Pre-acquisition costs are recovered from NZ Defence Force and are fiscally neutral in Vote Defence. The additional costs for this project were provided for in the total NZ Defence Force budget for new project activities.

3. Acquisition of direct fire support weapon (area) for the New Zealand Army

This weapon will provide land forces with the ability to engage targets at a range of up to two kilometres.

Target	Delivered
<ul style="list-style-type: none"> • In 2005/06 it is planned to: <ul style="list-style-type: none"> – enter into a contract for the acquisition of this equipment. 	<ul style="list-style-type: none"> – This project is on hold as a satisfactory combined weapon and sighting system was not available. The New Zealand Army has had to reconsider its requirements and a restructured project is included in the 2006 update of the <i>Defence Long-term Development Plan</i> (LTDP) due to be released shortly. – No costs were incurred during 2005/06.
<ul style="list-style-type: none"> • Further project milestones will be known once a contract is awarded. 	<ul style="list-style-type: none"> – No contract has been awarded.

It will continue management of the following projects:

1. Acquisition of new maritime forces vessels for the Royal New Zealand Navy



MRV undergoing seatrials in the North Sea.



This project is for the acquisition of a multi role vessel (MRV), two offshore patrol vessels (OPV) and four inshore patrol vessels (IPV) to meet inshore and offshore requirements for maritime surface surveillance in New Zealand's Exclusive Economic Zone in the South Pacific. The multi role vessel, in addition to carrying out patrol duties, will provide tactical sealift for the New Zealand Defence Force, support disaster relief and peace support operations, provide diplomatic and military presence, and provide training. The vessels are forecast to enter service by 2008.

Target	Delivered
<ul style="list-style-type: none"> • The project milestones in 2005/06 are to: <ul style="list-style-type: none"> – complete all design activity on all three vessel types – progress the MRV build from initial keel lay to launch in preparation for fit out 	<ul style="list-style-type: none"> – Detailed design reviews have been held in accordance with the programme. All reviews have been completed other than the final review of the MRV and Ship to Shore Transfer which will be conducted after the MRV arrives in Melbourne. – The MRV (to be named HMNZS <i>Canterbury</i>), was launched on 11 February 2006, and is scheduled to undertake sea trials in July 2006 and depart Rotterdam for Melbourne in August 2006. Fit out of the gun and military communications, along with crew training, will occur between October and December 2006. Delivery of the MRV is planned for January 2007. Both Landing Craft (LCMs) were launched in April, completed sea trials in May and will be embarked in the MRV for delivery in Melbourne in October 2006.

- commence the build of both OPVs
- The keel lay of OPV1 (to be named HMNZS *Otago*) occurred on 16 December 2005 with launch scheduled for 18 November 2006. At 30 June 2006, construction of OPV1 was approximately 50% complete and OPV2 (to be named HMNZS *Wellington*) about 10% complete. Six modules for OPV2 are being constructed in the Netherlands for transport to Melbourne on the MRV.
- commence the build of the first two IPVs.
- Keel lay for IPV1 (to be named HMNZS *Rotoiti*) occurred on 10 March 2006. At 30 June 2006, construction of IPV1 was 40% complete with launch scheduled for January 2007. IPV2 (to be named HMNZS *Hawea*) was 10% complete and steel had been cut for IPV3 (to be named HMNZS *Pukaki*). All IPVs are scheduled for delivery in 2007 with IPV4 (to be named HMNZS *Taupo*) expected in December 2007.



Image of the inshore patrol vessel.



Image of the offshore patrol vessel.

**Financial summary of project costs charged to non-departmental appropriations
as at 30 June 2006 (GST inclusive)**

	\$
Project approval	499,724,161
Foreign exchange variances to date and forecast to complete	(3,358,032)
GST	62,466,000
Total approved cost	<u>558,832,129</u>

GST exclusive

Expenditure to 30 June 2005	114,034,511
Expenditure 2005/06	152,024,097
Future commitments and forecasts	230,306,265
	<u>496,364,873</u>

GST

GST to 30 June 2005	1,976,000
Expenditure 2005/06	4,475,836
Future commitments and forecasts	56,014,162
	<u>62,465,998</u>
Total forecast cost to complete	<u>558,830,871</u>

- Foreign exchange variances at 30 June 2006 are favourable by \$3.358 million due to the purchase rates for foreign currencies being better than the exchange rates used in the Cabinet paper for financial approval.

	Approval Rate	Forecast Average Rate
AUD	0.8821	0.8979
CAD	0.8210	0.8471
EUR	0.5059	0.5085
GBP	0.3464	0.3455
JPY	65.5436	70.9001
NOK	4.2444	4.3357
SEK	4.6683	4.8496
USD	0.6215	0.6456

- Commitments and forecasts are valued using an average exchange rate of forward contracts still to be settled, plus the actual exchange rates for currencies in the bank. The exchange rate used to calculate commitments and forecasts at 30 June 2006 were:

AUD	0.8965	JPY	70.9000
CAD	0.8339	NOK	4.2192
EUR	0.4906	SEK	4.8496
GBP	0.3444	USD	0.6477

2. Acquisition of medium range anti-armour weapon for the New Zealand Army



US Soldier demonstrates the Javelin system NZ has acquired.

This weapon will provide land forces with a medium range capability against armoured vehicles and other targets.

Target	Delivered
<ul style="list-style-type: none"> Deliveries are scheduled to be completed in the second half of 2006. 	<ul style="list-style-type: none"> On-going technical support being negotiated. The Javelin system was delivered in June 2006, except for the missiles. The missile delivery date will be advised by the United States Government in September 2006.

Financial summary of project costs charged to non-departmental appropriations as at 30 June 2006 (GST inclusive)

	\$
Project approval	23,856,000
Foreign exchange variances to date and forecast to complete	(2,019,747)
GST	2,982,000
Total approved cost	<u>24,818,253</u>

GST exclusive

Expenditure to 30 June 2005	11,220,443
Expenditure 2005/06	5,248,473
Future commitments and forecasts	5,367,337
	<u>21,836,253</u>

GST

GST to 30 June 2005	125
Expenditure 2005/06	838,185
Future commitments and forecasts	2,143,690
	<u>2,982,000</u>
Total forecast cost to complete	<u>24,818,253</u>

- Foreign exchange variances at 30 June 2006 are favourable by \$2.020 million due to the purchase rates of the USD currency being better than the USD exchange rates used in the Cabinet paper for financial approval.

USD approval rate = 0.5841

USD forecast average rate = 0.6498

- Commitments and forecasts are valued using an average exchange rate of forward contracts still to be settled, plus the actual exchange rates for currencies in the bank. The exchange rate used to calculate commitments and forecasts at 30 June 2006 was USD = 0.6477.

3. Acquisition of very low level air defence system for the New Zealand Army

This project will purchase an alerting and cueing system to bring the Army's Mistral air defence system up to an improved operational standard.

Target	Delivered
<ul style="list-style-type: none"> Deliveries are scheduled to be completed in the second half of 2006. 	<ul style="list-style-type: none"> Transport aircraft availability and small schedule slippage will see delivery being achieved in October 2006.

Financial summary of project costs charged to non-departmental appropriations as at 30 June 2006 (GST inclusive)

	\$
Project approval	13,728,376
Foreign exchange variances to date and forecast to complete	490,511
GST	1,716,047
Total approved cost	<u>15,934,934</u>

GST exclusive

Expenditure to 30 June 2005	3,768,237
Expenditure 2005/06	3,402,285
Future commitments and forecasts	7,048,365
	<u>14,218,887</u>

GST

GST to 30 June 2005	8,729
Expenditure 2005/06	4,259
Future commitments and forecasts	1,703,058
	<u>1,716,046</u>
Total forecast cost to complete	<u>15,934,933</u>

- Foreign exchange variances at 30 June 2006 are unfavourable by \$0.491 million due to the purchase rates of the USD currency being worse than the USD exchange rates used in the Cabinet paper for financial approval.

EUR approval rate = 0.5187

EUR forecast average rate = 0.4999

- Commitments and forecasts are valued using an average exchange rate of forward contracts still to be settled, plus the actual exchange rates for currencies in the bank. The exchange rate used to calculate commitments and forecasts at 30 June 2006 was EUR = 0.4906.

4. Upgrade and refurbishment of C-130H aircraft for the Royal New Zealand Air Force



The C-130 Hercules on deployment in Afghanistan.

This project will extend the life of the Royal New Zealand Air Force C-130H Hercules aircraft by upgrading the aircraft systems and undertaking some structural refurbishment work.

The first aircraft will be completed in 2007 with the final aircraft completed in 2010.

Target	Delivered
<ul style="list-style-type: none"> • The project milestones in 2005/06 are to: <ul style="list-style-type: none"> – complete all design activity for aircraft upgrade – commence work on the modification of the prototype aircraft. 	<ul style="list-style-type: none"> – The majority of the design effort has been completed. – The induction of aircraft number one into the upgrade and refurbishment programme achieved in October 2005. – Work is progressing as planned on the removal of redundant systems and structural components requiring replacement. – The contractor is now receiving parts and equipment into store as planned.

**Financial summary of project costs charged to non-departmental appropriations
as at 30 June 2006 (GST inclusive)**

	\$
Project approval	233,739,000
Foreign exchange variances to date and forecast to complete	(1,582,072)
GST	29,217,000
Total approved cost	<u>261,373,928</u>

GST exclusive

Expenditure to 30 June 2005	43,962,237
Expenditure 2005/06	65,889,248
Future commitments and forecasts	121,631,500
	<u>231,482,985</u>

GST

GST to 30 June 2005	6,100
Expenditure 2005/06	104,075
Future commitments and forecasts	29,106,825
	<u>29,217,000</u>
Total forecast cost to complete	<u>260,699,985</u>

- Foreign exchange variances at 30 June 2006 are favourable by \$1.582 million due to the purchase rates of the CAD currency being better than the CAD exchange rates used in the Cabinet paper for financial approval. The USD rate is slightly unfavourable

CAD approval rate = 0.7857

CAD forecast average rate = 0.8390

USD approval rate = 0.6748

USD forecast average rate = 0.6677

- Commitments and forecasts are valued using an average exchange rate of forward contracts still to be settled, plus the actual exchange rates for currencies in the bank. The exchange rates used to calculate commitments and forecasts at 30 June 2006 was CAD = 0.8339 and USD = 0.6477

5. Upgrade of P-3K Orion mission systems for the Royal New Zealand Air Force



P-3K Orion flying on a routine monitoring patrol of the New Zealand coast.

This project will upgrade the sensors and mission management systems required for the Royal New Zealand Air Force's P-3K Orion maritime patrol aircraft to conduct surface surveillance tasks.

The first aircraft will be completed in 2008 with the final aircraft completed in 2010.

Target	Delivered
<ul style="list-style-type: none"> • The project milestones in 2005/06 are to: <ul style="list-style-type: none"> – complete an interim installation of the electro-optics system on three aircraft – commence work on the full modification for the first aircraft in Greenville, Texas – complete all detailed design work for the upgrade. 	<ul style="list-style-type: none"> – Installation of interim electro-optics on the three aircraft, which were being fitted with the system, has been completed. – Design reviews for the main upgrade equipment suite, structural design and software has been essentially completed. – Prototype aircraft positioned with contractor in the United States and removal of redundant systems underway. – Contractor now receiving parts and equipment into store.

**Financial summary of project costs charged to non-departmental appropriations
as at 30 June 2006 (GST inclusive)**

	\$
Project approval	373,069,314
Foreign exchange variances to date and forecast to complete	(25,739,590)
GST	46,633,667
Total approved cost	<u>393,963,391</u>

GST exclusive

Expenditure to 30 June 2005	65,617,789
Expenditure 2005/06	110,719,174
Future commitments and forecasts	170,908,326
	<u>347,245,289</u>

GST

GST to 30 June 2005	325,148
Expenditure 2005/06	892,358
Future commitments and forecasts	45,416,145
	<u>46,633,651</u>
Total forecast cost to complete	<u>393,878,940</u>

- Foreign exchange variances at 30 June 2006 are favourable by \$25.740 million due to the purchase rates of the USD currency being better than the USD exchange rates used in the Cabinet paper for financial approval.

USD approval rate = 0.6107

USD forecast average rate = 0.6624

- Commitments and forecasts are valued using an average exchange rate of forward contracts still to be settled, plus the actual exchange rates for currencies in the bank. The exchange rate used to calculate commitments and forecasts at 30 June 2006 was USD = 0.6477.

6. Boeing 757 Acquisition/Modification for the Royal New Zealand Air Force

This project replaces the Boeing 727 aircraft with Boeing 757 aircraft to provide greater range and payload capacity.

Two aircraft have been purchased and are being operated by the Royal New Zealand Air Force in a passenger configuration. The intention is to modify them to provide a dual passenger/freight capability. A contract for this conversion was signed in October 2005.

The first aircraft will be completed in 2007 with the final aircraft completed in 2010.

Target	Delivered
<ul style="list-style-type: none"> • The project milestones in 2005/06 are to: <ul style="list-style-type: none"> – have the modification programme engineering design phase completed and accepted – induct the first aircraft into the contractor's facility for modification. 	<ul style="list-style-type: none"> – Contract documents were signed on 10 October 2005. – Preliminary Design Reviews have been undertaken with the final review scheduled for September 2006. – Aircraft induction will be delayed until early 2007 owing to more extensive design effort required and longer lead times in some items of equipment.

Financial summary of project costs charged to non-departmental appropriations as at 30 June 2006 (GST inclusive)

	\$
Project approval	220,603,771
Foreign exchange variances to date and forecast to complete	316,721
GST	27,575,375
Total approved cost	248,495,867

GST exclusive

Expenditure to 30 June 2005	108,470,231
Expenditure 2005/06	35,127,622
Future commitments and forecasts	77,322,029
	220,919,882

GST

GST to 30 June 2005	13,055,092
Expenditure 2005/06	45,449
Future commitments and forecasts	14,474,834
	27,575,375
Total forecast cost to complete	248,495,257

- Foreign exchange variances at 30 June 2006 are unfavourable by \$0.317 million due to the purchase rates of the USD currency being worse than the USD exchange rates used in the Cabinet paper for financial approval.

USD approval rate = 0.6093

USD forecast average rate = 0.6084

- Commitments and forecasts are valued using an average exchange rate of forward contracts still to be settled, plus the actual exchange rates for currencies in the bank. The exchange rate used to calculate commitments and forecasts at 30 June 2006 was USD = 0.6477.

It will complete the following projects:

1. Acquisition of light operational vehicles (LOV) for the New Zealand Army



Pinzgauer General Service Variant.

This project provides the Army with a modern, light operational, military vehicle. They are the primary means of transport in peacekeeping operations, peace enforcement operations (including in support of the light armoured vehicle) and may provide support for evacuation operations in the South Pacific.

Target	Delivered
<ul style="list-style-type: none"> The project milestones in 2005/06 are to: <ul style="list-style-type: none"> complete the delivery of the second and final tranche of 133 vehicles by 30 June 2006 	<ul style="list-style-type: none"> As at 30 June 2006 all but six vehicles had been delivered. Of these six vehicles: <ul style="list-style-type: none"> four armoured vehicles were held up due to export licence issues one armoured vehicle is to remain in the United Kingdom for testing purposes

- complete the delivery of spares and training.
- one non-armoured vehicle was due for delivery in July 2006.
- A minor quantity of spares are outstanding. Training is complete.

Financial summary of project costs charged to non-departmental appropriations as at 30 June 2006 (GST inclusive)

	\$
Project approval	93,333,000
Foreign exchange variances to date and forecast to complete	1,362,420
GST	11,666,000
Total approved cost	<u>106,361,420</u>

GST exclusive

Expenditure to 30 June 2005	57,700,145
Expenditure 2005/06	32,726,302
Future commitments and forecasts	3,655,914
	<u>94,082,361</u>

GST

GST to 30 June 2005	4,802,834
Expenditure 2005/06	5,212,133
Future commitments and forecasts	1,651,033
	<u>11,666,000</u>
Total forecast cost to complete	<u>105,748,361</u>

- Foreign exchange variances at 30 June 2006 are unfavourable by \$1.362 million due to the purchase rates of the GBP currency being worse than the GBP exchange rates used in the Cabinet paper for financial approval.
Average GBP approval rate = 0.3556
GBP forecast average rate = 0.3504
- Commitments and forecasts are valued using an average exchange rate of forward contracts still to be settled, plus the actual exchange rates for currencies in the bank. The exchange rate used to calculate commitments and forecasts at 30 June 2006 was GBP = 0.3444.

3. ANZAC Ships



HMNZS Te Kaha.

This project was to procure two ANZAC class frigates from the 10-ship build programme, to replace two existing surface combatants complete with spares and training facilities.

New Zealand ships, HMNZS *Te Kaha* and HMNZS *Te Mana* have been delivered and are in service.

Target	Delivered
<ul style="list-style-type: none"> • The project milestones in 2005/06 is to: <ul style="list-style-type: none"> – discontinue New Zealand's involvement in this project and settle any outstanding obligations. 	<ul style="list-style-type: none"> – The Ministry requested the Australian Department of Defence to identify final Treaty obligations with a view to settlement by 3 June 2006. The Australian Department of Defence is awaiting costing information to achieve our closure objective. – There are no other matters to report.

**Financial summary of project costs charged to non-departmental appropriations
as at 30 June 2006 (GST inclusive)**

	\$
Approved contract at base rates	938,949,321
Approved escalations at base rates	252,391,118
Foreign exchange variances to date and forecast to complete	125,151,984
GST	153,808,491
Total approved cost	<u>1,470,300,914</u>

GST exclusive

Expenditure to 30 June 2005	1,242,635,679
Expenditure 2005/06	179,614
Future commitments and forecasts	500,000
	<u>1,243,315,293</u>

GST

GST to 30 June 2005	157,477,745
Expenditure 2005/06	753
Future commitments and forecasts	-
	<u>157,478,498</u>
Total forecast cost to complete	<u>1,400,793,791</u>

- The ANZAC Ship approval was stated in 1989 base exchange rates against a basket of currencies. A Treaty with Australia recognised contract escalation and currency variances, and agreed the methodologies for calculation.

3. Light Armoured Vehicles



Light Armoured Vehicle.

These Army vehicles are intended to provide protected mobility for light infantry manoeuvre groups in combat or when undertaking peace support operations.

Target	Delivered
--------	-----------

- The project milestones in 2005/06 are to:
 - purchase 36 sets of add-on armour.
 - All add-on armour has been delivered.

Financial summary of project costs charged to non-departmental appropriations as at 30 June 2006 (GST inclusive)

	\$
Project approval	580,296,353
Foreign exchange variances to date and forecast to complete	13,793,878
GST	72,537,044
Total approved cost	<u>666,627,275</u>

GST exclusive

Expenditure to 30 June 2005	585,024,280
Expenditure 2005/06	7,817,704
Future commitments and forecasts	1,248,247
	<u>594,090,231</u>

GST

GST to 30 June 2005	52,238,269
Expenditure 2005/06	1,006,934
Future commitments and forecasts	483,958
	<u>53,729,161</u>
Total forecast cost to complete	<u>647,819,392</u>

- Foreign exchange variances at 30 June 2006 are unfavourable by \$13.794 million due to the purchase rates of the CAD and USD currency being worse than the CAD and USD exchange rates used in the Cabinet paper for financial approval.

CAD approval rate = 0.6600

CAD forecast average rate = 0.6546

USD approval rate = 0.4400

USD forecast average rate = 0.4230

- Commitments and forecasts are valued using an average exchange rate of forward contracts still to be settled, plus the actual exchange rates for currencies in the bank. The exchange rate used to calculate commitments and forecasts at 30 June 2006 were CAD = 0.8339 and USD = 0.6477

4. Replacement or Upgrade of Tactical Mobile Communications for the Army

The project replaces and/or upgrades existing Army short range communications systems to provide high band width (higher capacity) digital theatre communication systems to support command and control requirements of the New Zealand Defence Force Battalion Group operations.

Target	Delivered
<ul style="list-style-type: none"> • The project milestones in 2005/06 are to: <ul style="list-style-type: none"> – purchase specialist vehicular intercom systems for the Special Operations Vehicle. 	<ul style="list-style-type: none"> – Delivery of intercom systems was completed in February 2006. – Some accessories remain to be delivered. This is scheduled by the end of October 2006.

Financial summary of project costs charged to non-departmental appropriations as at 30 June 2006 (GST inclusive)

	\$
Project approval	119,223,000
Foreign exchange variances to date and forecast to complete	4,383,983
GST	14,903,000
Total approved cost	<u>138,509,983</u>

GST exclusive

Expenditure to 30 June 2005	120,361,618
Expenditure 2005/06	1,504,606
Future commitments and forecasts	1,743,598
	<u>123,609,822</u>

GST

GST to 30 June 2005	11,509,462
Expenditure 2005/06	350,971
Future commitments and forecasts	3,039,728
	<u>14,900,161</u>
Total forecast cost to complete	<u>138,509,983</u>

- Foreign exchange variances at 30 June 2006 are unfavourable by \$4.384 million due to the purchase rates of the USD currency being better than the USD exchange rates used in the Cabinet paper for financial approval.

USD approval rate = 0.4300

USD forecast average rate = 0.4141

- Commitments and forecasts are valued using an average exchange rate of forward contracts still to be settled, plus the actual exchange rates for currencies in the bank. The exchange rate used to calculate commitments and forecasts at 30 June 2006 was USD = 0.6477.

Defence Industry

Target	Delivered
<ul style="list-style-type: none"> The Ministry of Defence will continue to facilitate effective communication between Defence and New Zealand industries to provide appropriate goods and services as required. 	<ul style="list-style-type: none"> The Ministry considers it has communicated effectively with New Zealand industry during 2005/06. The Ministry believes the place for New Zealand industry to register its capabilities is with Industrial Capability Network (ICN), which is part of New Zealand Trade and Enterprise, and maintains a working relationship with that group.
<ul style="list-style-type: none"> It will provide support for the Defence Industry Committee of New Zealand (DICNZ). 	<ul style="list-style-type: none"> The Ministry provided support to DICNZ meetings on 16 August 2005, 7 December 2005 and 5 April 2006. The New Zealand Defence Industry Awards of Excellence for 2005 were presented by the Minister of Defence on 19 October 2005.
<ul style="list-style-type: none"> It will ensure that local, including domestic, suppliers are afforded opportunities to compete for work consistent with the government procurement policy as set out in the Office of the Controller and Auditor-General's 2001 publication Procurement: A Statement of Good Practice and Policy Guide for Purchasers, issued by the Ministry of Economic Development in July 2002. 	<ul style="list-style-type: none"> The ICN has assisted prime contractors to engage New Zealand industry in current defence business. Industry involvement programmes for recent projects exceed \$166 million for New Zealand industry.
<ul style="list-style-type: none"> It will complete material for the Australia and New Zealand Industry Defence Equipment and Capability Catalogue database and update databases on industrial capability. 	<ul style="list-style-type: none"> Database templates are available on the Ministry of Defence website for ease of access to New Zealand business entities.
<ul style="list-style-type: none"> It will conduct industry briefing sessions on current Defence projects and activities. 	<ul style="list-style-type: none"> Future industry liaison ideas were discussed at the 2005 New Zealand Defence Industry Association (NZDIA) Forum at Te Papa in October 2005.
<ul style="list-style-type: none"> Using the Industry Capability Network as an agent will ensure that prospective overseas-based prime contractors are fully aware of the abilities of domestic industry to participate in the supply and support of capability being acquired through projects managed by the Ministry. 	<ul style="list-style-type: none"> Suppliers and prime contractors have been referred to the ICN database. There is on-going dialogue with ICN to ensure that local industry is offered the appropriate assistance.

Output Quality Measures and Standards

	Comment
<ul style="list-style-type: none"> • New capabilities and major refurbishment will be acquired within approved budgets, to the quality standards negotiated for each project, and within the agreed delivery schedule. 	<ul style="list-style-type: none"> – The financial summaries of project costs include a valuation of future commitments and forecasts using an average exchange rate of forward contracts still to be settled, plus actual exchange rates for currencies in the bank. As at 30 June 2006 the financial summary for each project indicates that each project will be acquired within its approved budget. – The quality standards for each project are reviewed during the due diligence process and supply contracts are with companies that operate quality management systems. Equipment produced under contract is deemed to be subject to those quality management systems with acceptance being linked to milestone payments. – Any significant changes in time frames are discussed in preceding information about individual acquisition projects.
<ul style="list-style-type: none"> • All acquisitions and contracts will meet the Government's policy requirements. • All contracts will be negotiated in a timely manner, and payments will be made on time if the provider is meeting the terms of the contract. • Contract awards will be subject to considerations of through-life cost, quality and delivery schedules. • Prices agreed for projects will be based on a competitive tender process where possible. When tendering is not possible, prices will be based either on independent benchmarks, or on full cost disclosure by the provider. • Payments will be made at the agreed sum, to the correct supplier, and no payments will be made in excess of the agreed sum. • Any significant variations or potential risks will be identified, together with corrective actions required or taken. • Assumptions behind advice will be explicit, and argumentation will be logical and supported by facts. 	<ul style="list-style-type: none"> – The Ministry has maintained quality control procedures to support the expectations for acquisition activities under this output class: <ul style="list-style-type: none"> • prices agreed for new projects approved by the Government during the financial year have been based on a competitive tender process, where applicable and contract awards have been subjected to consideration of through-life costs, quality, risk, delivery schedule and local industrial participation • potential risks for all projects have been identified together with corrective actions required or taken • all payments made have been at the contracted prices to the correct suppliers upon the achievement of agreed milestones • assumptions behind advice have been adequate consultation has taken place with interested parties and objections to proposals identified • problems with implementation, technical feasibility and time have been addressed

- Evidence will be given of adequate consultation with interested parties, and possible objections to proposals will be identified.
 - Problems of implementation, technical feasibility, timing, and consistency with other policies will be addressed.
 - Defence industry advice reports will clearly state their purpose and address any issues raised by the Minister.
 - The Defence Industry Committee of New Zealand will be asked to confirm annually that the Ministry and its agent, the Industry Capability Network, have appropriately promoted domestic suppliers' capabilities to prospective overseas-based prime contractors.
 - ISO 9001 certification has been maintained.
 - The quality of management of equipment procurement will be assessed in terms of whether it is credible, respected, and contributes to the achievement of the Government's defence policy objectives by:
 - seeking the Minister's views
 - seeking the views of key stakeholders in management of equipment procurement.
 - The Acquisition Division will implement recommendations agreed by the Ministry from audits or reviews.
 - Industrial Capability Network (ICN) has outlined the activities it conducted on projects during the financial year to ensure that competitive local industry was given full, fair and reasonable opportunity to compete for Ministry project work. This included ensuring local capability was a consideration in the bids of potential overseas prime contractors.
 - Process management issues are discussed regularly with the Minister.
 - The views of other stakeholders are obtained at Executive Capability Board and DICNZ meetings.
 - Recommendations from three audits are being implemented.
-

Cost of Output Class - Management of equipment procurement (GST exclusive)

For the year ended 30 June 2006

30/6/2005 Actual \$000		30/6/2006 Actual \$000	30/6/2006 Main estimates \$000	30/6/2006 Supp. estimates \$000
Revenue				
3,458	Crown	3,412	3,547	3,547
594	Other	294	27	383
4,052	Total revenue	3,706	3,574	3,930
Expenditure				
1,139	Personnel	1,091	1,391	1,428
715	Operating	388	134	506
1,873	Other	1,933	2,049	1,996
3,727	Total expenditure	3,412	3,574	3,930
325	Surplus/(deficit)	294	-	-

The appropriation (GST inclusive) for this output class was increased by \$389,000 for:

	\$(000) (GST incl)
Helicopter capability	
New provision for pre-acquisition costs in 2005/06. Funded by recovery from New Zealand Defence Force as Revenue Other.	118
Army Engineering	
New provision for pre-acquisition costs in 2005/06. Funded by recovery from New Zealand Defence Force as Revenue Other.	222
State Sector Retirement Savings Scheme	
New provision for implications arising from the take up of the State Sector Retirement Savings Scheme.	49
Total change for financial year	389

Non-departmental project financial performance

For the year ended 30 June 2006

Project payments made in 2005/06, and recoveries from the New Zealand Defence Force, were:

	Expenditure			Recoveries from NZ Defence Force	
	2005/06 Main estimates \$000	2005/06 Supp. estimates \$000	30/6/2006 Actual \$000	2005/06 Supp. estimates \$000	30/6/2006 Actual \$000
ANZAC ships	-	6	180	478	478
B-757 aircraft	10,666	45,151	35,128	16,430	16,430
Light armoured vehicles	-	8,062	7,818	16,333	16,333
Tactical communications	-	1,387	1,505	847	847
Light operational vehicles	11,707	36,430	32,726	32,128	32,128
Medium range anti-armour weapon	6,747	8,325	5,248	9,533	9,533
Air defence system	2,728	3,484	3,402	3,928	3,928
P-3K Orion systems upgrade	120,436	119,295	110,719	112,469	112,469
Project Protector vessels	177,040	171,315	152,024	148,550	148,550
C-130H Life extension	113,793	99,035	65,889	55,186	55,186
Sub total	443,117	492,490	414,639	395,882	395,882
GST on imported goods and NZ payments	18,200	27,395	12,945	-	-
Total	461,317	519,885	427,584	395,882	395,882

(Figures are GST exclusive)

Statement of accounting policies

For the year ended 30 June 2006

Reporting Entity

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

These are the financial statements of the Ministry of Defence prepared pursuant to section 45 of the Public Finance Act 1989 and generally accepted accounting practice.

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

Measurement system

The financial statements have been prepared on an historical cost basis modified by the revaluation of certain fixed assets

Accounting policies

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

Budget figures

The Budget Figures are those presented in the Budget Estimates (Main estimates) and those amended by the Supplementary Estimates (Supp. estimates) and any transfer made by Order in Council under section 26 of the Public Finance Act 1989.

Revenue recognition

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

Interest income

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

Receivables

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

Cost allocation

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

- Criteria for direct and indirect costs
 - "Direct costs" are those costs directly attributed to an output.
 - "Indirect costs" are those costs that cannot be identified in an economically feasible manner with a specific output.
- Direct costs assigned to outputs
 - Direct costs are assigned to outputs by charging payments to specific job numbers. Selection of a "general cost" job number within an output class will treat the expense as a direct cost to the output class even though a specific job within the output class has not been identified.

- For the year ended 30 June 2006, direct costs accounted for 70% of the Ministry's costs (30 June 2005= 71%).
- Basis for assigning indirect and corporate costs to outputs
 - Indirect costs are assigned to outputs by charging payments to a corporate job number. The accounting system is programmed to allocate corporate job costs to the three output classes on a predetermined percentage for each expense item. The percentage number is an assessment of services to be provided to each output class in the ensuing year. The percentage numbers remain constant for the financial year.
 - For the year ended 30 June 2006, indirect costs accounted for 30% of the Ministry's costs (30 June 2005= 29%).

Expenses

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

Property, plant and equipment

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

Depreciation

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

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

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

The cost of leasehold improvements is capitalised and depreciated over the estimated remaining useful life of the improvement or the unexpired period of the lease, whichever is the shorter.

Employee entitlements

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

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

Commitments

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

Contingent liabilities

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

Statement of cash flows

Cash means balances on hand and held in bank accounts.

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

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

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

Foreign currencies

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

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

Financial instruments

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

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

Goods and services tax (GST)

The statement of unappropriated expenditure and the statement of departmental expenditure and appropriations are exclusive of GST. The statement of financial position is also exclusive of GST, except for creditors and payables and debtors and receivables which are GST inclusive. All other statements are GST exclusive.

The amount of GST owing to or from the Inland Revenue Department at balance date, being the difference between output GST and input GST, is included in creditors and payables or debtors and receivables as appropriate.

Taxation

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

Taxpayers' funds

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

Changes in accounting policies

Change to employee entitlements

The Ministry has changed its accounting policy for employee entitlements to recognise accumulating sick leave as a liability. Under current New Zealand generally accepted accounting practice, sick leave is typically expensed as it is taken and unused sick leave is not usually recognised as a liability due to its non-vesting nature.

The introduction of International Financial Reporting Standards from 1 July 2007 requires entities to recognise accumulating sick leave as a liability. The Ministry has anticipated this new requirement and included a provision of \$10,000 for sick leave in its financial statements for 2005/06. (Note 11 to the financial statements.)

All policies, other than employee entitlements, have been applied on a basis consistent with other years.

Statement of financial performance

For the year ended 30 June 2006

30/6/2005 Actual		Note	30/6/2006 Actual	30/6/2006 Main estimates	30/6/2006 Supp. estimates
\$000			\$000	\$000	\$000
Revenue					
8,231	Crown	2	8,673	9,075	9,075
842	Other	3	368	80	469
9,073	Total revenue		9,041	9,155	9,544
Expenditure					
4,756	Personnel costs	4	5,005	5,272	5,316
3,325	Operating costs	5	2,975	3,405	3,792
324	Depreciation	6	346	354	312
124	Capital charge	7	124	124	124
8,529	Total expenses		8,450	9,155	9,544
544	Net operating surplus		591	-	-

Statement of movements in taxpayers' funds

For the year ended 30 June 2006

30/6/2005 Actual		30/6/2006 Actual	30/6/2006 Main estimates	30/6/2006 Supp. estimates
\$000		\$000	\$000	\$000
1,555	Taxpayers' funds brought forward as at 1 July	1,555	1,555	1,555
544	Net operating surplus/(deficit)	591	-	-
544	Total recognised revenues and expenses for the year	591	-	-
(544)	Provision for repayment of surplus to the Crown	(591)	-	-
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 2006

30/6/2005 Actual		Note	30/6/2006 Actual	30/6/2006 Main estimates	30/6/2006 Supp. estimates
\$000			\$000	\$000	\$000
Taxpayers' funds					
1,555	Taxpayers' funds		1,555	1,555	1,555
1,555	Total taxpayers' funds		1,555	1,555	1,555
Represented by:					
Current assets					
1,906	Cash		1,873	1,458	1,400
82	Prepayments		-	14	14
94	Debtors and receivables	8	164	2	2
2,082	<i>Total current assets</i>		2,037	1,474	1,416
Non-current assets					
746	Property, plant and equipment	9	1,239	739	1,019
746	<i>Total non-current assets</i>		1,239	739	1,019
2,828	Total assets		3,276	2,213	2,435
Current liabilities					
199	Creditors and payables	10	526	335	335
544	Provision for repayment of surplus to the Crown		591	-	-
287	Provision for employee entitlements	11	433	200	310
1,030	<i>Total current liabilities</i>		1,550	535	645
Non-current liabilities					
243	Provision for employee entitlements	11	171	123	235
1,273	Total liabilities		1,721	658	880
1,555	Net assets		1,555	1,555	1,555

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

Statement of cash flows

For the year ended 30 June 2006

30/6/2005 Actual \$000		30/6/2006 Actual \$000	30/6/2006 Main estimates \$000	30/6/2006 Supp. estimates \$000
Cash flows - operating activities				
Cash provided from:				
8,231	Crown	8,673	9,075	9,075
842	Customers	368	80	469
9,073		9,041	9,155	9,544
Cash disbursed to produce outputs:				
(4,631)	Personnel	(4,840)	(5,272)	(5,316)
(3,430)	Operating	(2,764)	(3,405)	(3,481)
(41)	Net GST paid	104	-	-
(124)	Capital charge	(124)	(124)	(124)
(8,226)		(7,624)	(8,801)	(8,921)
847	Operating activities net cash flows	1,417	354	623
Cash flows - investing activities				
Cash provided from:				
-	Sale of fixed assets	-	-	-
Cash disbursed for:				
(326)	Purchase of fixed assets	(906)	(250)	(585)
(326)	Investing activities net cash flows	(906)	(250)	(585)
Cash flows - financing activities				
Cash disbursed for:				
(184)	Repayment of surplus	(544)	-	(544)
(184)	Financing activities net cash flows	(544)	-	(544)
337	Net increase/(decrease) in cash held	(33)	104	(506)
1,569	Add opening cash and deposits	1,906	1,354	1,906
1,906	Closing cash and deposits	1,873	1,458	1,400

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 2006

30/6/2005 Actual		30/6/2006 Actual	30/6/2006 Main estimates	30/6/2006 Supp. estimates
\$000		\$000	\$000	\$000
544	Net operating surplus/(deficit)	591	-	-
	Add/(Less) non-cash items			
324	Depreciation	346	354	312
83	Inc/(Dec) in non-current employee entitlements	(72)	-	(5)
407	Total non-cash items	274	354	307
	Working capital movements			
115	(Inc)/Dec in debtors and receivables	(71)	-	92
(51)	(Inc)/Dec in prepayments	82	-	68
(194)	Inc/(Dec) in creditors and payables	331	-	141
26	Inc/(Dec) in current employee entitlements	210	-	15
(104)	Working capital movements - net	552	-	316
847	Net cash flow from operating activities	1,417	354	623

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

Statement of commitments

As at 30 June 2006

The Ministry is relocating to a new Defence building, currently under construction on the corner of Aitken and Mulgrave Streets, Wellington. The New Zealand Defence Force, as head tenant, is managing the project. The Ministry has been given financial approval for \$2.861 million of capital expenditure for this relocation.

At balance date no proposal had been received from New Zealand Defence Force on sub-tenant contractual obligations between New Zealand Defence Force and the Ministry of Defence in relation to the new Defence building. The Ministry has not entered into any operating commitments on the new Defence building at 30 June 2006.

The Ministry has no commitments for future payments and expenditure to be incurred on operating contracts that have been entered into at balance date. (30 June 2005 = Nil.)

Statement of contingent assets and liabilities

As at 30 June 2006

The Ministry does not have any contingent assets or liabilities as at 30 June 2006. (30 June 2005 = Nil.)

No guarantees and indemnities have been given outside the normal course of business. (30 June 2005 = Nil.)

There are no claims against the Ministry at balance date. (30 June 2005 = Nil.)

Statement of unappropriated expenditure

For the year ended 30 June 2006

No expenditure has been made or costs incurred in excess of or without appropriation by Parliament. (There was no unappropriated expenditure at 30 June 2005.)

Statement of departmental expenditure and appropriations

For the year ended 30 June 2006

	30/6/2006 Expenditure actual \$000	30/6/2006 Final Appropriation voted \$000
Vote: Defence		
Appropriations for classes of outputs		
Policy advice	3,324	3,823
Audit and assessment of performance	1,714	1,791
Management of equipment procurement	3,412	3,930
Total	8,450	9,544

(Figures are GST exclusive)

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

Notes to the financial statements

For the year ended 30 June 2006

Note 1: Budget composition

	Note	30/6/2006 Main estimates \$000	30/6/2006 Supp. estimates changes \$000	30/6/2006 Budget total \$000
Revenue				
Crown	2	9,075	-	9,075
Other	3	80	389	469
Total revenue		9,155	389	9,544
Expenditure				
Personnel costs	4	5,272	44	5,316
Operating costs	5	3,405	387	3,792
Depreciation	6	354	(42)	312
Capital charge	7	124	-	124
Total expenses		9,155	389	9,544
Net operating surplus		-	-	-

Note 2: Revenue – Crown

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

Note 3: Other revenue

30/6/2005 Actual \$000		30/6/2006 Actual \$000	30/6/2006 Main estimates \$000	30/6/2006 Supp. estimates \$000
212	Defence capability and resourcing review	-	-	-
63	Employer superannuation subsidy recovered	127	80	129
567	New Zealand Defence Force for initial project costs	241	-	340
842	Total other revenue	368	80	469

Note 4: Personnel costs

30/6/2005 Actual \$000		30/6/2006 Actual \$000	30/6/2006 Main estimates \$000	30/6/2006 Supp. estimates \$000
4,552	Salaries and wages	4,777	5,096	5,075
83	Retirement and resigning leave	46	50	50
121	Superannuation contributions	182	126	191
4,756	Total personnel costs	5,005	5,272	5,316

Notes to the financial statements – continued

For the year ended 30 June 2006

Note 5: Operating costs

30/6/2005 Actual		30/6/2006 Actual	30/6/2006 Main estimates	30/6/2006 Supp. estimates
\$000		\$000	\$000	\$000
306	Consultancy	101	93	93
80	Professional services	99	87	87
74	Audit fees for financial statements	78	75	75
10	Fees to auditors for other services	13	11	1
588	Share of New Zealand Defence Force costs for maintaining services	524	588	588
45	Grants and contributions	46	46	46
11	Inventory items	27	11	11
39	General maintenance and servicing	30	44	44
224	Travel and related costs	297	279	279
62	Courses, conferences and exhibitions	106	70	79
802	Rental of premises	722	768	768
58	Printing and stationery	66	61	66
187	Computer expenses	127	182	193
102	Electronic information, Acts and Regulations	100	95	100
283	Other operating costs	397	995	1,022
	Initial project costs			
119	Helicopter replacement study	203	-	118
47	Army engineering	39	-	222
163	P-3K Orion systems upgrade	-	-	-
125	C-130H life extension	-	-	-
3,325	Total operating costs	2,975	3,405	3,792

Note 6: Depreciation

30/6/2005 Actual		30/6/2006 Actual	30/6/2006 Main estimates	30/6/2006 Supp. estimates
\$000		\$000	\$000	\$000
59	Leasehold improvements	45	9	40
189	Office and computer equipment	205	245	190
76	Other assets	96	100	82
324	Total depreciation charge	346	354	312

Note 7: 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 2006 was 8 percent (30 June 2005 = 8 percent).

Notes to the financial statements – continued

For the year ended 30 June 2006

Note 8: Debtors and receivables

30/6/2005 Actual \$000		30/6/2006 Actual \$000
91	Sundry debtors - department	159
3	- non department	5
94	Total debtors and receivables	164

Note 9: Property, plant and equipment

30/6/2005 Actual \$000		30/6/2006 Actual \$000
	Leasehold improvements	
511	At cost	511
(466)	Accumulated depreciation	(511)
45	Leasehold improvements - net book value	-
	Office and computer equipment	
1,425	At cost	1,456
(1,058)	Accumulated depreciation	(1,255)
367	Office and computer equipment - net book value	201
	Office furniture	
262	At cost	262
(262)	Accumulated depreciation	(262)
-	Office furniture - net book value	-
	Other assets	
997	At cost	1,126
(825)	Accumulated depreciation	(912)
172	Other assets - net book value	214
	Work in progress	
95	(a) Ministry share of costs of new Defence building	824
67	(b) New financial management information system in process of installation	-
	Total property, plant and equipment	
3,357	At cost	4,179
(2,611)	Accumulated depreciation	(2,940)
746	Total carrying amount of property, plant and equipment	1,239

Notes to the financial statements – continued

For the year ended 30 June 2006

Note 10: Creditors and payables

30/6/2005 Actual \$000		30/6/2006 Actual \$000
66	Trade creditors	286
64	Accrued expenses	134
2	GST payable	106
132	Creditors and payables	526
67	Accrued expenses for property, plant and equipment	-
199	Total creditors and payables	526

Note 11: Provision for employee entitlements

30/6/2005 Actual \$000		30/6/2006 Actual \$000
	Current liabilities	
287	Annual leave	340
-	Sick leave	10
-	Long service-current	83
287	Total current portion	433
	Non current liabilities	
243	Long service, retirement and resigning leave	171
243	Total non-current portion	171
530	Total provision for employee entitlements	604

Note 12: Financial instruments

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

Notes to the financial statements – continued

For the year ended 30 June 2006

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.

Foreign exchange contracts (departmental)

The Ministry had no departmental foreign exchange contracts as at 30 June 2006.

(30 June 2005 = Nil.)

Note 13: Related party information

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

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

New Zealand Defence Force

During the year the Ministry paid the New Zealand Defence Force \$1.348 million being \$0.524 million for services received, including a contribution to the cost of Defence Attachés, and \$0.824 million for capital costs on the new Defence Building in Aitken Street, Wellington invoiced to 30 June 2006.

The Ministry received \$0.241 million from the New Zealand Defence Force for recovery of pre-acquisition costs incurred in the purchase of military equipment that do not meet the criteria for capitalisation.

The Ministry received \$395.882 million (2005 \$282.357 million) for non-departmental expenses incurred in the purchase of military equipment. At 30 June 2006 the amount due for recovery in July 2006 from the New Zealand Defence Force was \$185.484 million (2005 \$166.727 million).

Notes to the financial statements – continued

For the year ended 30 June 2006

Note 15: Major budget variations

The major variations from the prospective financial information previously published in the 2005 Statement of Intent are:

Total vote

Vote Defence (Revenue Other and Operating Costs) were increased by \$389,000 for:

	30/6/2006 Main estimates \$000	30/6/2006 Supp. estimates \$000	Total voted \$000
Pre-acquisition costs recovered from New Zealand Defence Force.			
The projects in 2005/2006 were:			
Army engineering	-	222,000	222,000
Replacement helicopter study	-	118,000	118,000
Recovery of State Sector Retirement Scheme employer subsidy	80,000	49,000	129,000
Total	80,000	389,000	469,000

Part 4: Non-departmental schedules



Statement of non-departmental accounting policies

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

These non-departmental balances are consolidated into the Financial Statements of Government therefore readers of these statements and schedules should also refer to the Financial Statements of Government for 2005/06.

The following accounting policies have been applied:

Budget figures

The budget figures are those presented in the budget estimates (main estimates) and those amended by the supplementary estimates (supplementary estimates) and any transfer made by Order in Council under section 26 of the Public Finance Act 1989.

Revenue recognition

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

Interest income

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

Goods and services tax (GST)

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

Work in progress

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

Foreign currency

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

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

Schedule of non-departmental revenues and receipts

For the year ended 30 June 2006

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

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

30/6/2005 Actual		30/6/2006 Actual	30/6/2006 Main estimates	30/6/2006 Supp. estimates
\$000	Note	\$000	\$000	\$000
Administered on behalf of the Minister of Defence				
Sales of military equipment, at cost, to New Zealand Defence Force				
The individual projects are:				
861	Maritime helicopters	-	-	-
1,006	ANZAC ships	478	-	478
4,958	Tactical communications equipment	847	432	847
123,230	Light armoured vehicles	16,333	16,468	16,333
30,765	P-3K Orion systems upgrade	112,469	119,335	112,469
61,005	Project Protector vessels	148,550	168,258	148,550
42,899	Light operational vehicles	32,128	47,531	32,128
2,088	Very low level air defence system	3,928	3,829	3,928
10,262	B-757 aircraft and modifications	16,430	14,318	16,430
5,283	Medium range anti-armour weapon	9,533	12,535	9,533
-	C-130H Life extension	55,186	117,685	55,186
282,357	Total sales to New Zealand Defence Force	395,882	500,391	395,882
237	Interest on foreign currency investments	570	170	200
282,594	Total revenues and receipts administered on behalf of the Minister of Defence	396,452	500,561	396,082

(Figures are GST exclusive)

Schedule of non-departmental expenses

For the year ended 30 June 2006

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

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

This schedule includes both capital and operating expenses.

30/6/2005 Actual \$000		30/6/2006 Actual \$000	30/6/2006 Main estimates \$000	30/6/2006 Supp. estimates \$000
Administered on behalf of the Minister of Defence				
	Purchase of military equipment			
	The individual projects are:			
9	Maritime helicopters	-	-	-
840	ANZAC ships	180	-	6
21,521	Light armoured vehicles	7,818	-	8,062
54,072	Light operational vehicles	32,726	11,707	36,430
9,084	Medium range anti-armour weapon	5,248	6,747	8,325
2,138	Very low level air defence system	3,402	2,728	3,484
65,618	P-3K Orion systems upgrade	110,719	120,436	119,295
43,962	C-130H Life extension	65,889	113,793	99,035
114,035	Project Protector vessels	152,024	177,040	171,315
236	B-757 aircraft and modification	35,128	10,666	45,151
1,560	Tactical communications equipment	1,505	-	1,387
313,075	Total purchases of military equipment	414,639	443,117	492,490
14,585	GST input tax expensed	12,945	18,200	27,395
4,129	Unrealised exchange losses/(gains)	(22,335)	-	-
331,789	Total expenses administered on behalf of the Minister of Defence	405,249	461,317	519,885

(Figures are GST exclusive)

Schedule of non-departmental assets

As at 30 June 2006

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

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

30/6/2005 Actual		30/6/2006 Actual	30/6/2006 Main estimates	30/6/2006 Supp. estimates
\$000		\$000	\$000	\$000
Administered on behalf of the Minister of Defence				
162,033	Crown bank accounts	201,278	78,221	161,220
42	Debtors and receivables	1,232	-	-
166,727	Work in progress	185,484	136,009	263,335
328,802	Total assets administered on behalf of the Minister of Defence	387,994	214,230	424,555

(Figures are GST exclusive)

Schedule of non-departmental liabilities

As at 30 June 2006

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

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

30/6/2005 Actual		30/6/2006 Actual	30/6/2006 Main estimates	30/6/2006 Supp. estimates
\$000		\$000	\$000	\$000
Administered on behalf of the Minister of Defence				
10,441	Creditors and payables	1,787	9,586	9,586
10,441	Total liabilities administered on behalf of the Minister of Defence	1,787	9,586	9,586

(Figures are GST inclusive)

Schedule of non-departmental commitments

As at 30 June 2006

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

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

30/6/2005 Actual \$000		30/6/2006 Actual \$000
	Capital commitments	
455,776	Less than one year	316,208
291,160	One to two years	112,314
63,718	Two to five years	70,509
-	More than five years	-
810,654	Total non-departmental capital commitments	499,031

(Figures are GST exclusive)

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

Schedule of non-departmental expenditure and appropriation

For the year ended 30 June 2006

The statement of expenditure and appropriation details expenditure incurred against appropriation. The Ministry administers this appropriation on behalf of the Crown.

30/6/2005 Actual \$000		30/6/2006 Actual \$000	30/6/2006 Main estimates \$000	30/6/2006 Supp. estimates \$000
	Vote Defence			
	<i>Capital expenditure</i>			
313,075	Defence equipment	414,639	443,117	492,490
313,075	Capital expenditure	414,639	443,117	492,490

(Figures are GST exclusive)

Schedule of non-departmental contingencies

As at 30 June 2006

There are no non-departmental contingent assets or contingent liabilities at 30 June 2006. (30 June 2005 = Nil.)

Notes to the non-departmental schedules

For the year ended 30 June 2006

Note C1: Interest revenue

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

Note C2: Budget composition

	30/6/2006 Initial budget \$000	30/6/2006 Budget changes at Supp. estimates time \$000	30/6/2006 Final Budget total \$000
Non tax revenue			
Interest on foreign currency investments	170	30	200
Capital receipts			
Sales of military equipment, at cost, to New Zealand Defence Force	500,391	(104,509)	395,882
Capital expenditure			
Purchase of military equipment	443,117	49,373	492,490
GST on defence equipment	18,200	9,195	27,395

Note C3 Major budget variations

Capital expenditure - defence equipment

The appropriation was increased by \$49.373 million to recognise timing changes in existing contract payments, and an additional funding approval for the Boeing 757 modification project approved by Government during the financial year that was not provided for in Main Estimates. The projects involved were:

	\$(000)
– ANZAC ships	6
– Light armoured vehicles	8,062
– Tactical communications	1,387
– B-757 aircraft and modifications	34,485
– Light operational vehicles	24,723
– Medium range anti-armour weapon	1,578
– Very low level air defence system	756
– C-130H Life extension	(14,758)
– P-3K Orion systems upgrade	(1,141)
– Project Protector vessels	(5,725)
	49,373

Notes to the non-departmental schedules – continued

For the year ended 30 June 2006

GST on defence equipment

The budget for GST was increased by \$9.195 million to meet timing changes in import GST charges. The projects involved were:

	\$(000)
– Light armoured vehicles	663
– Tactical communications	3,292
– B-757 aircraft and modifications	(64)
– Light operational vehicles	2,956
– Medium range anti-armour weapon	340
– Very low level air defence system	87
– C-130H Life extension	858
– P-3K Orion systems upgrade	350
– Project Protector vessels	713
	9,195

Note C4: Financial instruments

Currency risk

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

- the Ministry is not required to arrange cover for foreign exchange transactions more than two years in the future, unless Cabinet decides to the contrary
- a maximum of net aggregate NZ\$2 million equivalent exposure at one time is allowed
- cover will occur within five working days of any exposure being identified. These exposures are identified contracts both formal and informal.

Foreign exchange contracts (Crown)

The Ministry had Crown foreign exchange contracts with a face value of \$237.033 million at 30 June 2006. (30 June 2005 = \$521.508 million.)

Part 5: Other information



Equal employment opportunities

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

Management performance

Good employer practices and staff development

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

Public service integrity

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

Quality

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

Disability

The Ministry has a Disability Strategy Implementation Work Plan for each financial year.

Govt ³

The Ministry has signed up to this sustainable environment initiative.

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.

Progress toward adopting International Financial Reporting Standards (IFRS)

Full adoption of New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) does not occur until the 2007/08 financial year, although comparative information will be collected throughout 2006/07 in parallel with current reporting requirements.

As part of the transition to NZ IFRS, the Treasury requires a preliminary NZ IFRS opening balance sheet for 1 July 2006 (based on 30 June 2006 information) by October 2006 and an audited opening balance sheet by 20 December 2006.

In reporting expenditure during 2006/07, NZ IFRS interim reports for September, October and November 2006 will be provided to the Treasury by mid-December 2006. NZ IFRS interim reports for December 2006 to June 2007 will be provided to the Treasury with current Generally Accepted Accounting Practice (GAAP) information.

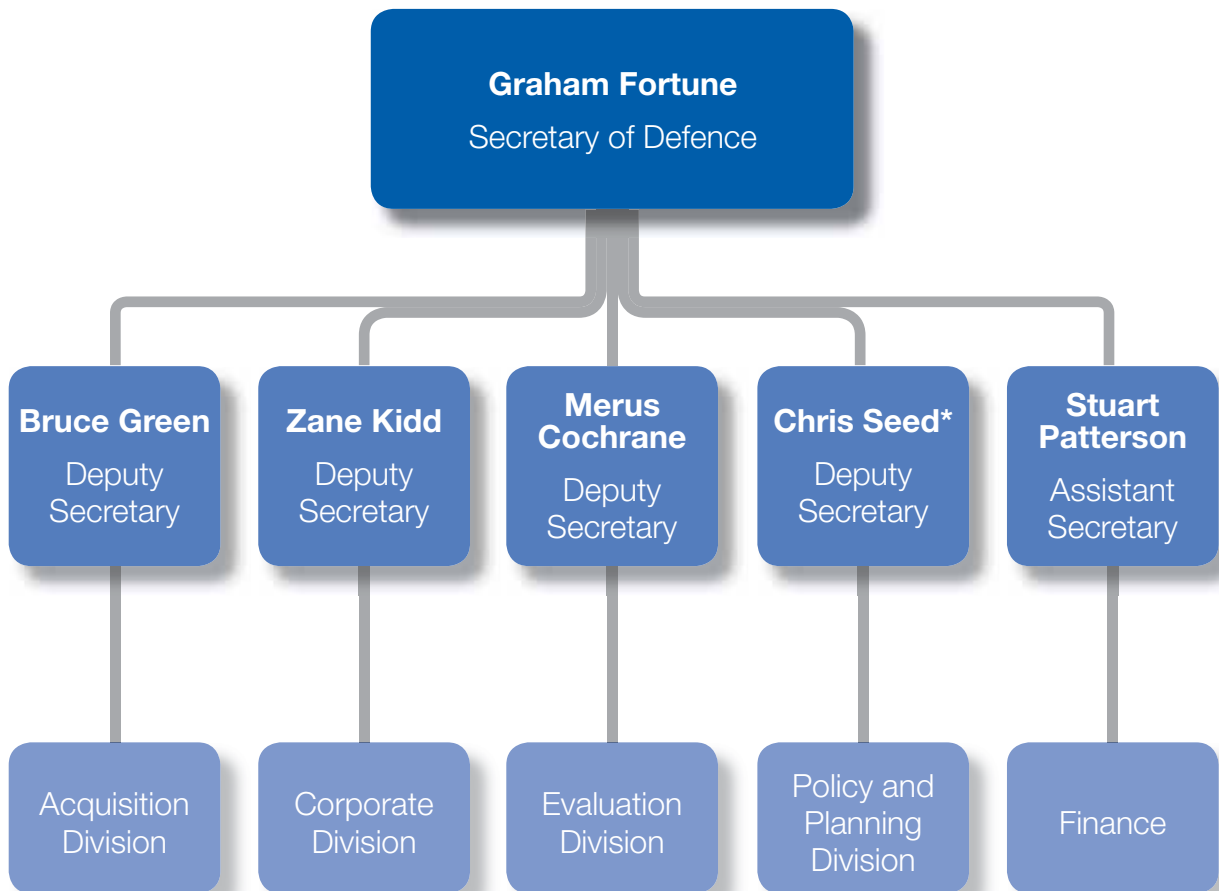
Under current standards, gains or losses on foreign-exchange forward contracts are not recognised, as any exposure to gains or losses on these contracts is generally offset by a related gain or loss on the item being hedged. Under NZ IFRS these foreign-exchange forward contracts will be valued at fair value, with any gains or losses being taken to the statement of financial performance. At present all foreign-exchange forward contracts entered into by the Ministry relate to non-departmental expenses not spent in the production of the Ministry's outputs, and any gains or losses recognised will not affect the Ministry's statement of financial performance, but be reflected in the Crown's statement of financial performance.

The Ministry will translate foreign currency transactions using the spot rate at the date of the transaction, and not the Ministry's cash rate that is derived from foreign-exchange forward contracts, as it presently does under GAAP. The effect of this change will be that non-departmental project expenditure will be influenced by spot rates and not foreign-exchange forward contract rates. Project costs recovered from New Zealand Defence Force will also be influenced by the use of spot rates, and the forecasting of annual expenditure and revenue cash flows is expected to be less accurate because of constant changes in spot rates. Hedge accounting will not apply.

Other changes in reporting financial information are expected to be minor, and no problems are envisaged in being able to extract added data. The Ministry has included in its 2005/06 financial statements the NZ IFRS requirement to recognise sick leave in the provision for employee entitlements. The Ministry's financial management and information system does not need to be modified in order to provide NZ IFRS financial information.

The 2005/06 financial statements prepared by the Ministry in this annual report are prepared under current New Zealand GAAP.

Organisation chart



Staff numbers at 30 June 2006 were 60 (excluding the Chief Executive).

* As from 1 September 2006 Chris Seed is Acting Secretary of Defence.

Financial performance highlights

	2005/06 Supp estimates \$000	2005/06 Estimated actual \$000	2005/06 Actual \$000
Departmental activities			
Revenue: crown	9,075	8,673	8,673
Revenue: other	469	469	368
Output expenses	9,544	9,142	8,450
Net operating surplus/(deficit)	-	-	591
Additions to physical assets	585	585	838
Disposals of physical assets	-	-	17
Taxpayers' funds	1,555	1,555	1,555
Net cash flows from operating, investing and financing activities	(506)	104	(33)
Non-departmental activities			
Capital expenditure-defence equipment	492,490	444,677	414,639
Total crown revenue and receipts	396,082	396,282	396,452

Summary of appropriations (GST exclusive)

	Policy advice	Audit and assessment of performance	Management of equipment procurement	Capital expenditure – defence equipment
	\$(000)	\$(000)	\$(000)	\$(000)
Main estimates appropriation	3,807	1,774	3,574	443,117
Supplementary estimates change	16	17	356	49,373
Change by order in council under section 26A of the Public Finance Act 1989	-	-	-	-
Total amount appropriated for 2005/2006	3,823	1,791	3,930	492,490
Estimated actual outturn for 2005/2006 as reported in 2006/2007 estimates	3,602	1,764	3,776	444,677
Audited actual outturn for 2005/2006	3,323	1,714	3,413	414,639
Unappropriated expenditure, expenses or liabilities approved under section 26B 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

	2005-06 \$(000)	2004-05 \$(000)	2003-04 \$(000)	2002-03 \$(000)	2001-02 \$(000)	2000-01 \$(000)
Voted in Estimates	492,490	377,184	335,870	405,812	177,361	342,488
Actual Expenditure	414,639	313,075	301,466	363,978	128,119	316,435
Variance	77,851	64,109	34,404	41,834	49,242	26,053

(b) GST on defence equipment

	2005-06 \$(000)	2004-05 \$(000)	2003-04 \$(000)	2002-03 \$(000)	2001-02 \$(000)	2000-01 \$(000)
Voted in Estimates	27,395	24,245	48,224	40,116	35,424	41,202
Actual Expenditure	12,945	14,585	47,272	19,881	34,350	25,234
Variance	14,450	9,660	952	20,235	1,074	15,968

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

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

	2005-06 \$(000)	2004-05 \$(000)	2003-04 \$(000)	2002-03 \$(000)	2001-02 \$(000)	2000-01 \$(000)
Planned	395,882	282,348	462,298	124,875	280,071	189,075
Actual	395,882	282,357	462,298	124,875	280,072	189,076
Variance	-	(9)	-	-	(1)	(1)