



MINISTRY OF
DEFENCE

Manatū Kaupapa Waonga

Annual Report

for the year ended 30 June 2009

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



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Part 1 : Overview



Secretary of Defence's overview

Introduction

The 2008/09 year saw the Ministry manage a wide range of acquisition projects, staff a large number of international linkages, whilst simultaneously embarking on the 2009 Defence Review. This review will be a comprehensive examination of all aspects of defence and will provide an opportunity for the public to express their views.

The achievements outlined below reflect the dedicated efforts of Ministry staff to meet the Ministry's core responsibilities of providing policy advice, managing equipment procurement, and undertaking audits and assessments of the New Zealand Defence Force (NZDF) and the acquisition activities of the Ministry.

The 2009 Defence Review

The 2009 Defence Review was initiated by the Government in line with pre-election commitments. Terms of Reference for the Review were promulgated on 21 April. A three person advisory panel was appointed at the same time and a public consultation document was released by the Minister of Defence and the Associate Minister of Defence on 26 June.

This will be the first full defence review undertaken since 1996/1997. The Ministry is tasked with producing a defence assessment as prescribed by Section 24 (2) (c) of the Defence Act. Work on this is well under way with the support of the NZDF and in close collaboration with other government departments and agencies in the wider security sector. Resources have been reallocated within the two defence organisations to support this major project.

Within defence ten work streams have been established. The leaders of three are external to defence. The first body of work has covered the strategic environment, policy objectives, capability options and funding levels. Progress to date makes me confident that the Ministry will be able to meet the reporting deadlines set down by the Government.

Acquisitions

One of the Ministry's principal functions is the procurement and delivery of military capability to the NZDF. For the Royal New Zealand Air Force (RNZAF), the highlight in the year under review was the completion of the upgrade and conversion of the two Boeing 757 aircraft. Delivery was taken of the first aircraft in August 2008 and of the second in November. Both have proved themselves in service throughout the remainder of the year, in transporting troops, VIPs and freight. Progress has been slower on the P3 and C130 upgrade projects. Challenges with software integration have proved to be the main obstacle to timely completion of the respective prototypes, but both are expected to be complete by the end of 2009. The helicopter projects in Europe are well underway, with the first flight of the first NH 90 Medium Utility helicopter taking place in May 2009.

For the Royal New Zealand Navy (RNZN), the Ministry engaged in intensive negotiations with British Aerospace Engineering (BAE) Systems Australia Defence Pty Ltd on remedying deficiencies in HMNZS *Canterbury* (BAE took ownership of Tenix Defence Pty Ltd, the original contractor for Project Protector, in June 2008). Significant progress had been made by the end of the year. *Canterbury* has been engaged in testing and exercising its capabilities in a wide range of tasks in New Zealand and Pacific waters. At the same time the four inshore patrol vessels were delivered to the RNZN, sailing at two week intervals in April and May to Devonport from the yard at which they were built in

Whangarei. It is expected that the remaining two ships of Project Protector (the two offshore patrol vessels) will be delivered to the RNZN by the end of 2009.

Activity for the New Zealand Army was less prominent but the Ministry received tenders for gap crossing equipment, currently under consideration, and continued work for an appropriate life cycle contractor support agreement for the medium range anti-armour weapon.

The Ministry has worked though the year with the office of the Auditor-General and the NZDF to improve reporting on the progress of major defence acquisition projects.

We have continued to facilitate effective communication between defence and New Zealand industries able and willing to provide appropriate goods and services to the Defence Force. We continued to provide support to the Defence Industry Committee of New Zealand (DICNZ).

Evaluation

The Ministry's responsibility to audit any function of the NZDF and the procurement function of the Ministry itself was discharged through the publication of 15 evaluation reports. Action in response to the recommendations in those reports is monitored through twice yearly meetings of the Defence Evaluation Board.

The wider world

When the NZDF deploys overseas it almost invariably does so with other allied or partner Defence Forces. The Ministry supports government decision making on these deployments and the wide range of international defence relationships within which they take place. In the course of the year several deployments of New Zealand forces were renewed.

Our closest defence relationship is with Australia, and reflecting this intimacy there were five ministerial level meetings with Australia in the course of the year. These provided an opportunity for New Zealand to be briefed on Australia's defence white paper, published in May 2009.

New Zealand's defence relationship with the United States was focussed on our deployment with the International Security Assistance Force (ISAF) in Afghanistan but extended into a range of other mutually beneficial areas. In the same context we strengthened dialogue with North Atlantic Treaty Organization (NATO), especially on Afghanistan and in particular the development of the NATO ISAF comprehensive plan.

In Asia the standing of our defence relationship with Singapore was enhanced with the signing of an Arrangement on Defence Cooperation. There was a wide range of defence interaction with the other Asian defence forces. The Ministry contributed to New Zealand's successful hosting of *Exercise Maru*, a Proliferation Security Initiative activity held in Auckland in September 2008.

Organisational capacity

The Ministry of Defence is led by the Secretary of Defence. In the course of the year new appointments were made to head three of the Ministry's five divisions: Acquisition, Finance and Policy. As at 30 June 2009 the Ministry had 61 staff in place. The Ministry has not been immune from the effects of the difficult economic climate, and has necessarily restrained some recruitment, especially in the policy advice area. Replacement of departing staff has taken place only where this has been necessary to maintain organisational capacity.

Looking ahead

The defence review and white paper, for which the Ministry is the lead agency, will be the principal focus for the Ministry in the coming year. But delivery of capability and advice on deployments will continue to feature as the Ministry fulfils its statutory responsibilities.



John McKinnon
Secretary of Defence
30 September 2009

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 Statement of Service Performance and the judgements made in the process of producing these.

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 and Statement of Service Performance fairly reflect the financial position and operations of the Ministry for the year ended 30 June 2009.

Signed by:



John McKinnon
Secretary of Defence
30 September 2009

Countersigned by:



Bryan Westbury
Deputy Secretary (Finance)/Chief Financial Officer
30 September 2009

AUDIT REPORT

TO THE READERS OF THE MINISTRY OF DEFENCE'S FINANCIAL STATEMENTS AND STATEMENT OF SERVICE PERFORMANCE FOR THE YEAR ENDED 30 JUNE 2009

The Auditor-General is the auditor of the Ministry of Defence (the Ministry). The Auditor-General has appointed me, Stephen Lucy, using the staff and resources of Audit New Zealand, to carry out the audit. The audit covers the financial statements and statement of service performance included in the annual report of the Ministry for the year ended 30 June 2009.

Unqualified Opinion

In our opinion:

- The financial statements of the Ministry on pages 44 to 64:
 - comply with generally accepted accounting practice in New Zealand; and
 - fairly reflect:
 - the Ministry's financial position as at 30 June 2009;
 - the results of its operations and cash flows for the year ended on that date;
 - its expenses and capital expenditure incurred against each appropriation administered by the Ministry and each class of outputs included in each output expense appropriation for the year ended 30 June 2009; and
 - its unappropriated expenses and capital expenditure for the year ended 30 June 2009.
- The schedules of non-Departmental activities on pages 66 to 75 fairly reflect the assets, liabilities, revenues, expenses, commitments and contingencies managed by the Ministry on behalf of the Crown for the year ended 30 June 2009.
- The statement of service performance of the Ministry on pages 12 to 41:
 - complies with generally accepted accounting practice in New Zealand; and
 - fairly reflects for each class of outputs:
 - its standards of delivery performance achieved, as compared with the forecast standards included 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 expenses included in the statement of forecast service performance adopted at the start of the financial year.

The audit was completed on 30 September 2009, 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 and statement of service performance 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 and statement of service performance. 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 and statement of service performance. 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 and statement of service performance disclosures are adequate.

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

We evaluated the overall adequacy of the presentation of information in the financial statements and statement of service performance. 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 the financial statements and statement of service performance 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 2009 and the results of its operations and cash flows for the year ended on that date.

The financial statements must also fairly reflect the expenses and capital expenditure incurred against each appropriation administered by the Ministry and each class of outputs included in each output expense appropriation for the year ended 30 June 2009. The financial statements must also fairly reflect the Ministry's unappropriated expenses and capital expenditure for the year ended on that date.

In addition, the Secretary of Defence is responsible for preparing schedules of non-Departmental activities, in accordance with the Treasury Instructions 2008, that 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 2009.

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.

The Secretary of Defence's responsibilities arise from sections 45A and 45B of the Public Finance Act 1989.

We are responsible for expressing an independent opinion on the financial statements and statement of service performance 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.

Other than the audit, we have no relationship with or interests in the Ministry.



S B Lucy
Audit New Zealand
On behalf of the Auditor-General
Wellington, New Zealand

Part 3 : Statement of service performance



Statement of objectives and service performance

For the year ended 30 June 2009

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 evaluate their performance against their objectives in order to compare results with priorities, resource allocations and targets set at the beginning of the year. Quarterly reports were made to the Minister of Defence on the delivery of these 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 skills programmes and career development opportunities; annual evaluations and reviews of staff performance; and managerial oversight. International Standards Organisation (ISO) 9001 accreditation has been maintained in the Acquisition Division. The Ministry maintains the financial management systems necessary to ensure that classes of outputs are delivered within 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.

Cost effectiveness of the Ministry's interventions

The Ministry's interventions impact primarily on the operations and capabilities of the NZDF. The cost effectiveness of the Ministry's interventions is therefore manifest through the contribution that they make to the efficiency and effectiveness of the NZDF.

In April 2009 Cabinet approved the Terms of Reference of a defence review, known as the Defence Review 09, commissioned pursuant to section 24(2)(c) of the Defence Act 1990. This review, led by the Secretary of Defence, is tasked with examining many aspects of the capability and operations of the NZDF. Through its value-for-money programme, the government is examining the efficiency and effectiveness of every government agency. The Defence Review 09 is the agreed mechanism by which the efficiency and effectiveness of Defence will be subject to critical scrutiny. The exercise will be complete with the intended publication of a defence white paper by 30 March 2010.

A necessary first step for demonstrating that expenditure is cost effective in achieving desired outcomes is to be able to specify those outcomes in measurable terms. In a defence context, this is a difficult task. The Ministry has been leading an exercise through which government agencies in the security sector are working together to specify relevant outcomes in measurable terms. When complete, this work will support evaluation of the cost effectiveness of the Ministry's interventions.

Output Class – Policy advice

Description

Under this output the Minister of Defence purchases:

- advice on defence policy matters. This includes advice on:
 - strategies for achieving goals and outcomes
 - changes in the strategic environment with implications for defence policy
 - the defence and security policies of other countries
 - deployment of NZDF assets and personnel
 - the military capabilities required to meet defence policy goals, broad resources 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 Ombudsmen correspondence.

Performance Measure	2008/09 Budget	2008/09 Actual
Submission of papers and other responses for the Minister, including Cabinet papers.	24 - 30	46
Prepare Ministerial correspondence for the Minister.	35 - 55	131
Prepare answers to Parliamentary questions for the Minister.	90 – 100	72
Prepare answers to Select Committee questions for the Minister.	20 - 30	73
The supply of individual policy papers will be of high quality, which will be assessed by the percentage of first drafts of all policy papers accepted by the Minister.	90%	Achieved
The supply of all other responses will be of high quality, which will be assessed by the percentage of responses accepted without substantive amendment.	95%	Achieved
All reports and oral advice will be delivered within the agreed or statutory time frame.		
Ministerials within 14 working days of receipt of the request.	Achieved	Mostly achieved
Replies to Parliamentary questions for written answer provided by the due date.	Achieved	Mostly achieved
Replies to Parliamentary Questions for oral answer provided by midday on the day that the reply is due in the House.	Achieved	Achieved

Overarching Policy Advice

The Ministry began Defence Review 09. Significant resources have been allocated to the workstreams, background papers have been drafted, public consultation has begun, and the Ministers' advisory panel has been established.

The Ministry is working with the NZDF, the Office of the Auditor-General, and the State Services Commission on the design of a Major Projects Report which will better enable external stakeholders to monitor the progress of large capability projects. The Ministry has been engaged with the Foreign Affairs, Defence and Trade Select Committee to ensure that the reporting template that is being developed will supply external stakeholders with the necessary information requirements.

International Security Environment

Objective

To undertake analysis of significant issues that have an impact on the Government's defence policy and international defence relations including developments in the international security environment, especially in the Asia-Pacific region, changes in the defence and security policies of key countries such as Australia and the United States, and developments in regional security relations.

Performance

The Ministry provided analysis and advice on the situation in Fiji and the Korean Peninsula; NZDF contributions to Timor-Leste, Solomon Islands and Afghanistan; and New Zealand's defence engagement with the South Pacific, China, Indonesia, and the United States.

The Ministry contributed to the planning for the New Zealand-run Proliferation Security Initiative exercise, Exercise Maru, and the Indonesia-Japan-New Zealand co-hosted Intersessional Meeting on Maritime Security under the auspices of the Association of South East Asian Nations (ASEAN) Regional Forum.

The Ministry is a member of the inter-agency Pacific Security Fund administration group and is jointly leading sub-sectoral implementation of the Pacific Disciplined Forces and Pacific Maritime Surveillance strategies. Advice was also provided on policy developments within the Five Power Defence Arrangements and within the ASEAN Regional Forum (ARF) defence dialogue process.

Deployments

Objective

To undertake analysis and provide advice on the deployment of NZDF assets and personnel on United Nations (UN) or other operations.

Performance

The Ministry was involved in the preparation of a number of Cabinet papers and submissions. These included extending the NZDF's deployments to UN peace support operations in Korea, Sudan, and Iraq; deploying NZDF personnel to peacekeeping operations in Afghanistan and Lebanon; seeking approval for additional support to the Provincial Reconstruction Team (PRT) in Afghanistan; considering options for drawdown in Solomon Islands and Timor-Leste; reviewing the NZDF deployment to Afghanistan; and reviewing the criteria for New Zealand engagement in peacekeeping operations.

Mutual Assistance Programme

Objective

To undertake analysis and provide policy advice in support of the operation of the NZDF Mutual Assistance Programme (MAP).

Performance

The Ministry provided policy advice on the development of various MAP country programmes and participated in bilateral talks with Australia, Samoa, Papua New Guinea, Vanuatu, the Cook Islands, Timor-Leste, Brunei and Viet Nam.

Capability

Objective

To provide advice during the capability development phase of projects and undertake capability reviews in co-operation with the NZDF to identify the options for achieving the Government's defence policy goals and the Ministry of Defence's outcomes.

Performance

The Ministry has contributed policy, technical, and business case advice on a wide range of land, air, maritime and joint capability projects.

Advice developed for Land and Special Forces projects have included the Land Command & Control, Communications, Computers, Intelligence, Surveillance, and Reconnaissance project; Army Combat Service Support Vehicles; Land Transport Capability project; Special Operations Training Facilities; Night Vision Equipment and the NZDF In-Service Weapons Replacement project.

Advice provided on air projects focused on the Ohakea Taxiways project and future infrastructure requirements for the Ohakea and Whenuapai Air Force bases. Advice provided on major maritime projects included the ANZAC Frigate Platform Systems and ANZAC Self Defence Upgrades. Advice provided on joint capability projects included Wideband Satellite Communications, Network Enabled Capability and the Joint Command and Control System.

In addition to project advice, the Ministry has made a major contribution to Defence's capability development and sustainment processes. Work has involved support for the Defence Review's analysis of the NZDF's future capabilities and force structure; the New Zealand Army Transformation Plan; the revision of the Capability Management Framework; and the Defence Sustainability Initiative Programme.

The Ministry continues to assist the NZDF in developing an integrated cost model of all NZDF expenditure (both operating and capital) as well as an output-forecasting model for NZDF force element availability.

Acquisition

Objective

To provide advice during the acquisition phase of projects that have been approved by the Government, such as the Project Protector vessels, the upgrade of the C-130 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 helicopters and the acquisition of weapons and engineering equipment for the New Zealand Army.

Performance

Policy advice and support was provided on the following projects under acquisition: Special Operations capability; Night Vision Equipment, Medium Utility Helicopter project; Training and Light Utility Helicopter project; Boeing 757 modification project; and Project Protector.

In conjunction with the NZDF, advice was prepared to assist in finalising agreements on the infrastructure development requirements for the Ohakea and Whenuapai Air Force bases.

Whole of Government Response

Objective

To work with the NZDF and civilian agencies for co-ordinated responses to defence policy and security issues. These included: integrated missions in Afghanistan, Timor-Leste and Solomon Islands, plus Antarctica, arms control and disarmament, maritime patrol and surveillance, environment and security and trans-national criminal activity.

Performance

The Ministry participated in the whole-of-government reviews on Afghanistan and contributions to peacekeeping, and regularly attended interagency meetings on the three largest deployments. These interactions ensure coordination of activities in theatre and in Wellington.

In conjunction with the NZDF, the Ministry provided advice to the Ministry of Foreign Affairs and Trade on export control applications. It also provided input into the process for ratification of the Convention on Cluster Munitions. The Ministry assisted in Defence's annual return for the UN Conventional Arms Register and provided an updated brief to Foreign Affairs, Defence and Trade Committee (FADTC) on the NZDF's depleted uranium monitoring programme.

International Defence Relationships

Objective

To manage defence relationships with Australia and other regional countries (including key bilateral meetings between Australian and New Zealand Defence Ministers, and Senior Officials' meetings), and participate in the regional multilateral security dialogues (including the Association of Southeast Asian Nations Regional Forum and Five Power Defence Arrangements Defence Ministers' Meeting).

Performance

The Ministry provided briefings and conducted bilateral defence talks with Australia, Singapore, Malaysia, Viet Nam, Republic of Korea, and China.

The Ministry provided a range of briefings and was represented at several bilateral and multilateral meetings. These included: the Asia Security Summit (Shangri-La Dialogue); the Five Power Defence Arrangements defence chiefs' meeting and Ministers' meeting; the annual NZDF-French Armed Forces in New Caledonia activities coordination meeting; the Quadrilateral Defence Co-ordination Group talks between Australia, New Zealand, and the United States; NATO/ISAF Defence Ministers' meetings; the Proliferation Security Initiative; and various ASEAN Regional Forum security meetings and dialogue.

The Ministry provided briefings to the Prime Minister, Minister of Defence, Chief of Defence Force, Service Chiefs, senior NZDF officers and officials for meetings in: Afghanistan, Australia, Canada, Indonesia, Japan, Malaysia, New Caledonia, Papua New Guinea, Republic of Korea, Singapore, Solomon Islands, Thailand, Timor-Leste, United Arab Emirates, United Kingdom, United States, Vanuatu, and Viet Nam.

The Ministry was involved in the organisation and preparation of briefings for visits to New Zealand by defence ministers, chiefs of defence force, service chiefs and senior officials from: Australia, Brunei,

Canada, Chile, China, Japan, Malaysia, NATO, Netherlands, Papua New Guinea, Saudi Arabia, Singapore, Thailand, Timor-Leste, United Kingdom, United States, and Viet Nam.

Official Correspondence

Objective

To provide the following ministerial services:

- responses to Parliamentary Questions to be actioned within the timeframes set by the Standing Orders of the House of Representatives
- responses to ministerial correspondence to be actioned within 14 working days of receipt by the Ministry
- responses to Official Information Act requests to be actioned within the timeframe set by statutory requirements
- responses to Ombudsmen Correspondence requests to be actioned within the timeframe set by statutory requirements.

Performance

During this year, the Ministry responded to 131 ministerials, of which 106 were actioned within fourteen working days, 72 Parliamentary Questions, of which 66 were completed within the time frames set by the Standing Orders of the House of Representatives, and 64 Official Information Act requests, of which 62 were actioned within the time frame set by statutory requirement. One Ombudsmen correspondence request was actioned by the Ministry within the time frame set by statutory requirement. Responses completed outside the time frames reflect the complexity of information at issue which required intensive consultation with stakeholders.

Quality Control

Objective

To maintain quality control procedures to support the policy advice delivered under this output. Advice will meet the following quality standards:

- reports will address the issues raised by the Minister in relation to the issues listed above
- assumptions will be explicit and arguments will be logical and supported by facts
- forecasts will be supported through analysis
- a range of options will be presented where appropriate and assessed for benefits, costs, and consequences
- consultation will be undertaken with the NZDF and other parties, and any objections identified
- issues of implementation, technical feasibility, timing, and consistency with other policies will be considered
- reports and oral advice will be delivered within agreed or statutory timeframes, and will be based on agreed or established formats (such as those set down by the Cabinet Office)
- budgetary implications will be identified.

Written and oral advice tendered to the Minister of Defence will accurately reflect:

- revenue and expense implications (quantified where possible)
- administrative implications and costs (quantified where possible).

The Ministry of Defence will maintain quality control procedures to support the policy advice delivered under this output.

The quality of policy advice will be assessed in terms of whether it is credible, effective, respected and contributes to the achievement of the Government's defence and security policy objectives by:

- seeking the Minister's views
- seeking the views of key stakeholders in policy advice
- monitoring the results of self review.

Performance

The Ministry ensures that reports produced under this output class directly address issues raised by the Minister, provide logical arguments supported by facts, thorough analysis and, where appropriate, present a range of options assessed for benefits, costs, and consequences. Consultation is undertaken with the NZDF and other parties, and any objections identified. Issues of implementation, technical feasibility, timing, and consistency with other policies are also considered.

The quality of policy advice was assessed by seeking the Minister's views and those of key stakeholders.

Cost of Output Class – Policy advice (GST exclusive)

For the year ended 30 June 2009

30/6/2008 Actual		30/6/2009 Actual	30/6/2009 Main estimates	30/6/2009 Supp. estimates
\$000		\$000	\$000	\$000
Revenue				
3,941	Crown	4,174	3,891	4,174
80	Other	57	68	68
4,021	Total revenue	4,231	3,959	4,242
Expenditure				
2,861	Personnel	2,910	2,878	2,957
1,142	Operating	1,165	1,081	1,285
4,003	Total expenditure	4,075	3,959	4,242
18	Surplus	156	–	–

Output Class – Audit and assessment of performance

Description

This output class involves conducting for the Minister of Defence:

- audits and assessments of any function, duty or project of the NZDF
- 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 Organism Act 1996.

Objective

To provide the Government with independent audit advice on the performance of the NZDF and the procurement activities of the Ministry of Defence. This is achieved through the satisfactory completion of an approved schedule of audits and assessments, and of other audits and assessments as required by the Minister of Defence.

Performance Measure	2008/09 Budget	2008/09 Actual
Delivery of a target number of audit reports to the Minister of Defence.	15 - 18	15
Reports will be of quality, timeliness and effectiveness that is acceptable to key stakeholders.	Achieved	Achieved
Audits will be performed in accordance with the Ministry's Auditing Standards.	Achieved	Achieved

Performance

Fifteen evaluation reports were completed during the year, covering a wide range of topics. These included the management of NZDF heritage properties, the implementation of Govt³ initiatives, the effectiveness of the Joint Logistics and Support Organisation, and the New Zealand Army's Logistic Executive. Audits were also conducted of the NZDF's corporate performance management systems, arrangements for business continuity management, management of orders and instructions, handling of Ministerial information requests, and management of the Defence Transformation Programme.

Audits were conducted of the RNZAF's aircrew personnel planning, and recruitment and retention policies for civil staff. The arrangements for supporting new equipment were examined, and a review was conducted of the RNZAF's operational test and evaluation of its modified Boeing 757 aircraft.

Assessments of the delivery of two NZDF outputs were completed.

The quality, effectiveness and timeliness of reports was achieved through the use of risk assessment to identify matters for the audit programme, the application of Evaluation Division policies, procedures and standards, and peer and managerial review. The views of the Secretary of Defence and Chief of Defence Force were sought to confirm that the quality and effectiveness of audits and assessments was acceptable.

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

For the year ended 30 June 2009

30/6/2008 Actual \$000		30/6/2009 Actual \$000	30/6/2009 Main estimates \$000	30/6/2009 Supp. estimates \$000
Revenue				
1,842	Crown	1,854	1,842	1,854
26	Other	56	67	67
1,868	Total revenue	1,910	1,909	1,921
Expenditure				
1,235	Personnel	1,269	1,362	1,349
562	Operating	553	547	572
1,797	Total expenditure	1,822	1,909	1,921
71	Surplus	88	–	–

Output Class – Management of equipment procurement

Description

The Ministry will acquire significant military equipment in a transparent and fair way, and in accordance with government procurement policies. 'Significant' means equipment that will cost more than NZ\$7 million. The Ministry of Defence is committed to providing competitive local (Australian, New Zealand, Chile and Singaporean) industries with the opportunity to support defence, and to ensuring that the Government and the taxpayer get value for money.

This output class involves:

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

Performance Measure	2008/09 Budget	2008/09 Actual
New equipment procurement or refurbishment projects will be managed within the approved budget, to the agreed delivery schedule and to the quality standards negotiated for each project.	Achieved	Within budget and agreed standard but with some time delays
Confirmation by the Defence Industry Committee of New Zealand that the Ministry of Defence and its agent, the Industry Capability Network have adequately promoted domestic suppliers capabilities to overseas based prime contractors.	Confirmation received	Confirmation received

Explanatory note on the project cost summaries included in this output class report

Foreign exchange variances

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

The approval by Cabinet to commit to total project costs uses foreign exchange rates prevailing at the time of seeking Cabinet approval. The subsequent recording of project expenditure in ledgers uses exchange rates prevailing at the date of the transaction (as required by New Zealand International Accounting Standard (NZ IAS) 21 – the effects of changes in foreign exchange rates) and creates a

difference between the estimated costs included in the Cabinet approval and the amounts recorded in ledgers as project expenditure.

The project cost summaries that follow include a line to show the total foreign exchange variance between Cabinet approval and recorded expenditure as at 30 June 2009.

Definitions

The following definitions apply to words used in the project cost summary tables:

Prime contract

Payments made by the Ministry to a contractor(s) manufacturing or supplying the major equipments.

Ancillary contracts

Payments made by the Ministry to suppliers of all other items not the responsibility of the prime contractor(s).

Project management

Costs incurred to support the management of the project. Includes travel, legal advice, risk assessment fees, consultants, costs of project staff located overseas (housing, utilities, allowances etc).

Contingency

A provision in a project costing to meet uncertain events that may arise.

The project cost summary tables show the balance remaining of the contingency provision. Amounts spent to date from the contingency provision are recorded against prime contract, ancillary contracts, project management, as appropriate.

Commitments

Contractual obligations to purchase goods and services that are unpaid at balance date.

Forecasts

Expenditure likely to be incurred, but not committed at balance date.

Commitments and forecasts denominated in foreign currency at 30 June 2009 have been translated to New Zealand dollars using Treasury fiscal reporting rates at balance date. The rates were:

AUD = 0.80540	CAD = 0.75510	EUR = 0.46280	GBP = 0.39265
JPY = 62.6900	NOK = 4.17835	SEK = 5.00095	USD = 0.65370

GST

GST is an element of cost in the calculation of a project costing and an amount is included in Cabinet approvals for such payments to be made. The project cost summaries included in this Annual Report identify separately the GST component from net expenditure amounts.

1. The Ministry has progressed the following projects, which have received Government approval:

1.1 Army Engineering Equipment

This project has been split into three components; two will be undertaken by the NZDF and one (Gap Crossing System) by the Ministry of Defence.

1.2 Gap Crossing System

This project is to acquire up to six sets of rapid bridge crossing systems to support the mobility of the motorised land force.

Objective	Performance
<ul style="list-style-type: none"> In 2008/2009 it was planned to: <ul style="list-style-type: none"> complete the tender process evaluate responses award a contract to the successful tenderer. 	<ul style="list-style-type: none"> Tender responses have been evaluated however a decision on the affordability of this project is under review by the NZDF.

1.3 Replacement Helicopter Capability: Training Light Utility Helicopter

This project is to acquire up to six training/light utility helicopters. This project proposes the replacement of the Sioux training helicopter with a capability that meets the NZDF's contemporary needs.

Objective	Performance
<ul style="list-style-type: none"> In 2008/2009 it was planned to: <ul style="list-style-type: none"> conduct the Preliminary Design Review conduct the Critical Design Review 	<ul style="list-style-type: none"> The Preliminary Design review was held in February 2009. The Critical Design Review was held in May 2009. Several documents will not be presented until November 2009 and part payment of the attendant milestone payment has been withheld.

[A] Project expenditure in 2008/09	Actual \$
Prime contract	45,085,486
Ancillary contracts	255,395
Project management	1,146,012
Total net expenditure	46,486,893
GST payments	597
Total project expenditure in 2008/09	46,487,490

[B] Total project cost summary As at 30 June 2009	Actual costs to 30 Jun 09 \$	Future commitments & forecasts** \$	Estimated outturn 30 Jun 09 \$
Prime contract	80,202,164	44,507,000	124,709,164
Ancillary contracts	255,395	5,418,364	5,673,759
Project management	1,430,188	5,045,846	6,476,034
Contingency	–	7,850,738	7,850,738
Project net expenditure	81,887,747	62,821,948	144,709,695
GST	15,986	17,392,264	17,408,250
Estimated project outturn	81,903,733	80,214,212	162,117,945
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval			(5,443,695)
			156,674,250
Project costs approved by Cabinet (net expenditure)			139,266,000
GST costs approved by Cabinet			17,408,250
Total costs approved by Cabinet			156,674,250

** All future prime and ancillary contracts costs are considered commitments.

1.4 Upgrade of ANZAC Ships Close in Weapon Systems

This project will upgrade the Phalanx Close in Weapon System that provides a last line of defence and protection from Anti Ship Missiles and Strike Aircraft and provides an inner layer of defence against threats which have defeated the outer layer of defence.

Objective

- In 2008/2009 it was planned to:
 - to complete the delivery of the 1st system to the USA
 - monitor system during upgrade
 - return the system to New Zealand over the period November 2009 – February 2010.

Performance

- The 1st system was shipped to the USA in August 2008.
- Monitoring activity is continuing.
- The Contractor is currently forecasting to ship the 1st system back to New Zealand in December 2009.

[A] Project expenditure in 2008/09	Actual \$
Prime contract	5,257,424
Ancillary contracts	41,024
Project management	84,346
Total net expenditure	5,382,794
GST payments	4,866
Total project expenditure in 2008/09	5,387,660

[B] Total project cost summary As at 30 June 2009	Actual costs to 30 Jun 09 \$	Future commitments & forecasts** \$	Estimated outturn 30 Jun 09 \$
Prime contract	15,001,218	6,047,200	21,048,418
Ancillary contracts	41,024	1,717,149	1,758,173
Project management	137,988	1,454,717	1,592,705
Contingency	–	1,010,183	1,010,183
Project net expenditure	15,180,230	10,229,249	25,409,479
GST	11,228	3,113,147	3,124,375
Estimated project outturn	15,191,458	13,342,396	28,533,854
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval			(414,479)
			28,119,375
Project costs approved by Cabinet (net expenditure)			24,995,000
GST costs approved by Cabinet			3,124,375
Total costs approved by Cabinet			28,119,375

** All future prime and ancillary contracts costs are considered commitments.

1.5 ANZAC Frigate Platform Systems Upgrade

The platform systems upgrade involves work on the ANZAC frigates' hull propulsion system, heating, ventilation and air conditioning systems, and control and monitoring system.

Financial approval of \$9.250 million has been given to an initial phase of work, being \$4.500 million for the purchase of long lead items and \$4.750 million for project start up costs.

Objective

- In 2008/2009 it was planned to:
 - contract a Design Authority
 - undertake a Preliminary Design Study
 - procure long lead items
 - issue a tender to undertake the Heating, Ventilation and Air Conditioning upgrade and the Integrated Platform Management System.

Performance

- Contract awarded July 2008.
- Contract awarded July 2008.
- Contract awarded August 2008.
- Tender has yet to be issued.

[A] Project expenditure in 2008/09	Actual \$
Prime contract	2,502,574
Ancillary contracts	2,511,602
Project management	304,851
Total net expenditure	5,319,027
GST payments	16,138
Total project expenditure in 2008/09	5,335,165

[B] Total project cost summary As at 30 June 2009	Actual costs to 30 Jun 09 \$	Future commitments & forecasts** \$	Estimated outturn 30 Jun 09 \$
Prime contract	2,502,574	18,080,212	20,582,786
Ancillary contracts	2,511,602	–	2,511,602
Project management	333,040	822,572	1,155,612
Contingency	–	–	–
Project net expenditure	5,347,216	18,902,784	24,250,000
GST	19,661	3,011,589	3,031,250
Estimated project outturn	5,366,877	21,914,373	27,281,250
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval			–
			27,281,250
Project costs approved by Cabinet (net expenditure)			24,250,000
GST costs approved by Cabinet			3,031,250
Total costs approved by Cabinet			27,281,250

** All future prime and ancillary contracts costs are considered commitments.

2. The Ministry continued management of the following projects:

2.1 Replacement Helicopter Capability: Medium Utility Helicopter

This project is the acquisition of eight operational TNZA NH90 helicopters. These helicopters will be delivered to the NZDF over the period from 2010 to 2011.

Objective

- In 2008/09 it was planned to:
 - conduct the Test Procedures Review
 - conduct Ground Test of TNZA 01
 - conduct first flight of TNZA 01.

Performance

- Test Readiness Review held September 2008.
- Completed May 2009
- First flight of TNZA 01 conducted 4 May 2009.

[A] Project expenditure in 2008/09	Actual \$
Prime contract	25,793,572
Ancillary contracts	199,127
Project management	1,095,906
Total net expenditure	27,088,605
GST payments	3,271
Total project expenditure in 2008/09	27,091,876

[B] Total project cost summary As at 30 June 2009	Actual costs to 30 Jun 09 \$	Future commitments & forecasts** \$	Estimated outturn 30 Jun 09 \$
Prime contract	358,245,928	353,768,076	712,014,004
Ancillary contracts	3,719,050	19,241,636	22,960,686
Project management	2,734,691	7,044,774	9,779,465
Contingency	–	7,700,000	7,700,000
Project net expenditure	364,699,669	387,754,486	752,454,155
GST	26,415	96,437,376	96,463,791
Estimated project outturn	364,726,084	485,191,862	848,917,946
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval			19,256,171
			868,174,117
Project costs approved by Cabinet (net expenditure)			771,710,326
GST costs approved by Cabinet			96,463,791
Total costs approved by Cabinet			868,174,117

** All future prime and ancillary contracts costs are considered commitments.

2.2 Acquisition of new vessels for the Royal New Zealand Navy

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 MRV will provide tactical sealift for the NZDF, support disaster relief and peace support operations, provide diplomatic and military presence, and provide training for the RNZN. The MRV was delivered on 31 May 2007. A number of MRV warranty claims are being pursued with the contractor. The Crown is waiting for the contractor to offer the remaining two vessels for delivery. This is expected when the vessels are fully compliant with the appropriate requirements.

Objective

- In 2008/09 it was planned to:
 - take delivery of two OPVs and four IPVs and pass to the NZDF
 - continue to manage the project, including delivery of all logistic support and training material, until completion in early 2009
 - monitor the construction of the ships during the period
 - monitor warranty issues with respect to the ships delivered.

Performance

- The two OPVs are forecast for delivery in the second half of 2009. The four IPVs were delivered on 16 April, 1 May, 14 May and 28 May 2009 respectively.
- Project management continues.
- Construction monitored.
- A number of warranty claims have been raised with and satisfied by the contractor. Others remain under discussion between the Crown and BAE.

[A] Project expenditure in 2008/09	Actual \$
Prime contract	36,529,372
Ancillary contracts	(9,786,086)
Project management	583,753
Total net expenditure	27,327,039
GST payments	1,889,470
Total project expenditure in 2008/09	29,216,509

[B] Total project cost summary As at 30 June 2009	Actual costs to 30 Jun 09 \$	Future commitments & forecasts** \$	Estimated outturn 30 Jun 09 \$
Prime contract	451,972,708	16,371,044	468,343,752
Ancillary contracts	15,303,631	244,480	15,548,111
Project management	7,971,558	821,624	8,793,182
Project net expenditure	475,247,897	17,437,148	492,685,045
GST	36,476,622	25,989,378	62,466,000
Estimated project outturn	511,724,519	43,426,526	555,151,045
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval			(1,440,739)
			553,710,306
Project costs approved by Cabinet (net expenditure)			499,724,161
GST costs approved by Cabinet			62,466,000
Total costs approved by Cabinet			562,190,161

** All future prime and ancillary contracts costs are considered commitments.

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

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

Objective	Performance
<ul style="list-style-type: none"> In 2008/09 it was planned to: <ul style="list-style-type: none"> deliver the second batch of Command Launch Unit spares to the NZDF deliver initial spares for the support of the training device to the NZDF. 	<ul style="list-style-type: none"> Current forecast delivery is June 2010. Current forecast delivery is June 2010.

[A] Project expenditure in 2008/09	Actual \$
Prime contract	132,785
Ancillary contracts	–
Project management	–
Total net expenditure	132,785
GST payments	–
Total project expenditure in 2008/09	132,785

[B] Total project cost summary As at 30 June 2009	Actual costs to 30 Jun 09 \$	Future commitments & forecasts** \$	Estimated outturn 30 Jun 09 \$
Prime contract	16,815,190	29,038	16,844,228
Ancillary contracts	910,765	16,052	926,817
Project management	248,241	143,489	391,730
Contingency	–	3,689,393	3,689,393
Project net expenditure	17,974,196	3,877,972	21,852,168
GST	1,575,069	1,406,931	2,982,000
Estimated project outturn	19,549,265	5,284,903	24,834,168
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval			2,003,822
			26,837,990
Project costs approved by Cabinet (net expenditure)			23,856,000
GST costs approved by Cabinet			2,982,000
Total costs approved by Cabinet			26,838,000

** All future prime and ancillary contracts costs are considered commitments.

2.4 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 New Zealand Army's Mistral air defence system up to an improved operational standard.

Objective

- In 2008/09 it was planned to:
 - complete the project in accordance with the approved variation.

Performance

- All items delivered. Investigation of problems with the integration of New Zealand Army radios to be concluded by June 2010.

[A] Project expenditure in 2008/09	Actual \$
Prime contract	–
Ancillary contracts	337,104
Project management	7,627
Total net expenditure	344,731
GST payments	41,392
Total project expenditure in 2008/09	386,123

[B] Total project cost summary As at 30 June 2009	Actual costs to 30 Jun 09 \$	Future commitments & forecasts** \$	Estimated outturn 30 Jun 09 \$
Prime contract	13,589,112	–	13,589,112
Ancillary contracts	672,496	100,180	772,676
Project management	267,764	–	267,764
Contingency	–	129,805	129,805
Project net expenditure	14,529,372	229,985	14,759,357
GST	1,565,521	219,276	1,784,797
Estimated project outturn	16,094,893	449,261	16,544,154
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval			(578,311)
			15,965,843
Project costs approved by Cabinet (net expenditure)			14,278,376
GST costs approved by Cabinet			1,784,797
Total costs approved by Cabinet			16,063,173

** All future prime and ancillary contracts costs are considered commitments.

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

This project will extend the life of the RNZAF C-130H Hercules aircraft by upgrading the aircraft mechanical and electrical equipment, undertaking a level of structural refurbishment work and an upgrade of communication/navigation systems.

The first aircraft was scheduled to be completed in 2008, with the final aircraft scheduled to be completed in 2011.

Objective

- In 2008/09 it was planned to:
 - deliver the prototype aircraft to the NZDF
 - deliver the first production aircraft to the NZDF
 - induct aircraft 03 into the programme.

Performance

- Delivery of the prototype aircraft originally scheduled for December 2007 is now forecast for late 2009. The delay is the result of issues relating to the scope and performance of the Flight Management System Software.
- The second aircraft has been inducted into the programme and is undergoing modification. The aircraft is currently forecast to be delivered also in late 2009.
- Induction date for aircraft 03 is yet to be established pending delivery of the first two aircraft.

[A] Project expenditure in 2008/09	Actual \$
Prime contract	8,125,085
Ancillary contracts	1,999,947
Project management	1,084,365
Total net expenditure	11,209,397
GST payments	1,218,334
Total project expenditure in 2008/09	12,427,731

[B] Total project cost summary As at 30 June 2009	Actual costs to 30 Jun 09 \$	Future commitments & forecasts** \$	Estimated outturn 30 Jun 09 \$
Prime contract	192,873,171	38,799,697	231,672,868
Ancillary contracts	5,372,494	1,250,048	6,622,542
Project management	4,957,365	1,239,283	6,196,648
Contingency	–	6,543,000	6,543,000
Project net expenditure	203,203,030	47,832,028	251,035,058
GST	5,888,148	25,978,852	31,867,000
Estimated project outturn	209,091,178	73,810,880	282,902,058
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval			1,234,444
			284,136,502
Project costs approved by Cabinet (net expenditure)			254,939,000
GST costs approved by Cabinet			31,867,000
Total costs approved by Cabinet			286,806,000

** All future prime and ancillary contracts costs are considered commitments.

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

This project will upgrade the sensors, mission management systems and communication/navigation system required for the RNZAF's P-3K Orion maritime patrol aircraft to conduct surface surveillance tasks.

The first aircraft, originally scheduled to be delivered in June 2008, is now forecast to be completed in mid-2009 with the final aircraft completed in late 2011. Delays have been caused by the late delivery of the radar, and problem resolution of the integration of individual sensors and of the total integrated system.

Objective	Performance
<ul style="list-style-type: none"> In 2008/09 it was planned to: <ul style="list-style-type: none"> monitor the modification of the prototype aircraft conduct Systems Integrated training Laboratory factory acceptance testing commence training conduct Aircraft Ground Test Procedures Review delivery of prototype aircraft to the NZDF. 	<ul style="list-style-type: none"> Monitoring of the prototype aircraft modification is progressing. Testing of the integrated systems in the Systems Integration and Training Laboratory completed. Training continues. Ground test readiness review underway. Delivery of prototype aircraft to the NZDF delayed until late 2009.

[A] Project expenditure in 2008/09	Actual \$
Prime contract	22,996,146
Ancillary contracts	24,200
Project management	1,656,390
Total net expenditure	24,676,736
GST payments	335,767
Total project expenditure in 2008/09	25,012,503

[B] Total project cost summary As at 30 June 2009	Actual costs to 30 Jun 09 \$	Future commitments & forecasts** \$	Estimated outturn 30 Jun 09 \$
Prime contract	237,276,588	81,295,541	318,572,129
Ancillary contracts	8,330,532	806,144	9,136,676
Project management	6,534,473	4,008,502	10,542,975
Contingency	–	6,669,502	6,669,502
Project net expenditure	252,141,593	92,779,689	344,921,282
GST	1,206,065	45,427,602	46,633,667
Estimated project outturn	253,347,658	138,207,291	391,554,949
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval			27,714,099
			419,269,048
Project costs approved by Cabinet (net expenditure)			373,069,314
GST costs approved by Cabinet			46,633,667
Total costs approved by Cabinet			419,702,981

** All future prime and ancillary contracts costs are considered commitments.

2.7 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 RNZAF in a passenger configuration. The intention is to modify them to provide a dual passenger/freight capability. Both aircraft were scheduled to be completed by 2008.

Objective

- In 2008/09 it was planned to:
 - deliver the first modified aircraft to the NZDF
 - deliver the second modified aircraft to the NZDF.

Performance

- Delivery of aircraft one took place 4 August 2008.
- Delivery of aircraft two took place 9 February 2009.

[A] Project expenditure in 2008/09	Actual \$
Prime contract	19,131,271
Ancillary contracts	9,496,616
Project management	2,187,820
Total net expenditure	30,815,707
GST payments	9,038,796
Total project expenditure in 2008/09	39,854,503

[B] Total project cost summary As at 30 June 2009	Actual costs to 30 Jun 09 \$	Future commitments & forecasts** \$	Estimated outturn 30 Jun 09 \$
Prime contract	163,800,145	14,863	163,815,008
Ancillary contracts	45,506,454	1,407,741	46,914,195
Project management	5,824,044	640,600	6,464,644
Contingency	–	–	–
Project net expenditure	215,130,643	2,063,204	217,193,847
GST	22,154,885	5,420,490	27,575,375
Estimated project outturn	237,285,528	7,483,694	244,769,222
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval			(823,253)
			243,945,969
Project costs approved by Cabinet (net expenditure)			220,603,771
GST costs approved by Cabinet			27,575,375
Total costs approved by Cabinet			248,179,146

** All future prime and ancillary contracts costs are considered commitments.

2.8 Defence Command and Control System

The Defence Command and Control System (DC2S) will provide to the NZDF the common operating environment for enhanced access to data and collaboration tools, together with requisite hardware and infrastructure for planning and control of all of its operations.

The core of the DC2S is based on the United States Global Command and Control System and is being procured through the United States Government Foreign Military Sales system.

[A] Project expenditure in 2008/09	Actual \$
Prime contract	–
Ancillary contracts	2,214,212
Project management	7,098
Total net expenditure	2,221,310
GST payments	110,583
Total project expenditure in 2008/09	2,331,893

[B] Total project cost summary As at 30 June 2009	Actual costs to 30 Jun 09 \$	Future commitments & forecasts** \$	Estimated outturn 30 Jun 09 \$
Prime contract	–	5,813,067	5,813,067
Ancillary contracts	2,214,212	5,514,607	7,728,819
Project management	7,098	5,000,000	5,007,098
Contingency	–	5,590,040	5,590,040
Project net expenditure	2,221,310	21,917,714	24,139,024
GST	110,583	2,749,667	2,860,250
Estimated project outturn	2,331,893	24,667,381	26,999,274
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval			(1,257,025)
			25,742,249
Project costs approved by Cabinet (net expenditure)			22,882,000
GST costs approved by Cabinet			2,860,250
Total costs approved by Cabinet			25,742,250

** All future prime and ancillary contracts costs are considered commitments.

3. The Ministry completed the following projects:

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

This project provides the New Zealand 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.

Objective

- In 2008/09 it was planned to:
 - continue to manage the project against warranty obligations.

Performance

- Warranty issues are being attended to by the contractor as and when they arise.

[A] Project expenditure in 2008/09	Actual \$
Prime contract	271,777
Ancillary contracts	17,749
Project management	2,832
Total net expenditure	292,358
GST payments	1,345
Total project expenditure in 2008/09	293,703

[B] Total project cost summary As at 30 June 2009	Actual costs to 30 Jun 09 \$	Future commitments & forecasts** \$	Estimated outturn 30 Jun 09 \$
Prime contract	91,917,441	11,550	91,928,991
Ancillary contracts	364,612	–	364,612
Project management	1,113,539	–	1,113,539
Contingency	889,631	205,590	1,095,221
Project net expenditure	94,285,223	217,140	94,502,363
GST	10,505,347	1,160,653	11,666,000
Estimated project outturn	104,790,570	1,377,793	106,168,363
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval			(1,184,993)
			104,983,370
Project costs approved by Cabinet (net expenditure)			93,333,000
GST costs approved by Cabinet			11,666,000
Total costs approved by Cabinet			104,999,000

** All future prime and ancillary contracts costs are considered commitments.

3.2 Light armoured vehicles (LAV) for the New Zealand Army

Deliveries are complete. The Contractor is addressing all latent defect issues raised under the terms of the Prime Contract. None of these issues affect the operation of the LAV fleet.

[A] Project expenditure in 2008/09	Actual \$
Prime contract	–
Ancillary contracts	144,167
Project management	523
Total net expenditure	144,690
GST payments	65
Total project expenditure in 2008/09	144,755

[B] Total project cost summary As at 30 June 2009	Actual costs to 30 Jun 09 \$	Future commitments & forecasts** \$	Estimated outturn 30 Jun 09 \$
Prime contract	494,176,974	–	494,176,974
Ancillary contracts	83,979,041	361,909	84,340,950
Works infrastructure	5,602,147	–	5,602,147
Project management	2,583,324	–	2,583,324
Contingency	7,347,485	209,407	7,556,892
Project net expenditure	593,688,971	571,316	594,260,287
GST	53,376,182	19,160,862	72,537,044
Estimated project outturn	647,065,153	19,732,178	666,797,331
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval			(13,530,819)
			653,266,512
Project costs approved by Cabinet (net expenditure)			580,296,353
GST costs approved by Cabinet			72,537,044
Total costs approved by Cabinet			652,833,397

** All future prime and ancillary contracts costs are considered commitments.

3.3 Replacement or Upgrade of Tactical Mobile Communications for the New Zealand Army

The project acquired tactical mobile communications equipment for the New Zealand Army and the RNZAF. Financial closure of the project is progressing.

[A] Project expenditure in 2008/09	Actual \$
Prime contract	–
Ancillary contracts	(326,429)
Project management	–
Total net expenditure	(326,429)
GST payments	–
Total project expenditure in 2008/09	(326,429)

[B] Total project cost summary As at 30 June 2009	Actual costs to 30 Jun 09 \$	Future commitments & forecasts** \$	Estimated outturn 30 Jun 09 \$
Prime contract	108,480,304	–	108,480,304
Ancillary contracts	10,629,299	–	10,629,299
Works infrastructure	8,720	–	8,720
Project management	587,440	–	587,440
Contingency	35,370	664,290	699,660
Project net expenditure	119,741,133	664,290	120,405,423
GST	11,571,294	3,331,706	14,903,000
Estimated project outturn	131,312,427	3,995,996	135,308,423
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval			(1,182,423)
			134,126,000
Project costs approved by Cabinet (net expenditure)			119,223,000
GST costs approved by Cabinet			14,903,000
Total costs approved by Cabinet			134,126,000

** All future prime and ancillary contracts costs are considered commitments.

Defence Industry

Objective

The Ministry of Defence will:

- continue to facilitate effective communication between Defence and New Zealand industries to provide appropriate goods and services as required
- provide support for the Defence Industry Committee of New Zealand (DICNZ)
- 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 publication *Procurement: A Statement of Good Practice* The Ministry of Economic Development publication *Government Procurement in New Zealand – Policy Guidance for Purchasers*, and the Government's *Mandatory Rules for Procurement by Government Departments*
- conduct industry briefing sessions on current Defence projects and activities.

Performance

The Ministry of Defence presented the current status of projects at the Defence Industry conference held in Wellington over the period 7 – 8 October 2008.

Support was provided for the DICNZ at the meetings held on 9 July 2008, 26 November 2008 and 19 March 2009.

Competitive tenders were issued in October 2008 for the Advanced Pilot Training Capability and November 2008 for the Gap Crossing System.

Quality Measures and Standards

Objective

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

Delivery of this output will be subject to the following quality standards in accordance with good practice:

- 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
- 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
- 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 arguments will be logical and supported by facts
- evidence will be provided about 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 DICNZ 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.

The quality of management of equipment procurement will be assessed in terms of whether it is credible, effective, respected and contributes to the achievement of the Government's defence and security policy objectives by:

- seeking the Minister's views
- seeking the views of key stakeholders in management of equipment procurement
- maintaining ISO accreditation.

Performance

The Ministry maintains quality control procedures throughout the acquisition process. Advice is clear, and supported by facts and consultation. Prices agreed for projects are based on a competitive tender

process where possible and contract awards are subject to considerations of through-life cost, quality and delivery schedules. Contracts are negotiated in a timely manner once Government approval is received. Payments to suppliers are made following achievement of agreed contract milestones at the contracted price.

The financial summaries of project costs include a valuation of future commitments and forecasts using the exchange rates as at 30 June 2009. The financial summary for each project indicates that each project will be acquired within its approved budget.

Delivery schedules are agreed at contract and may be varied from time to time in accordance with the contract.

Risk profiles of projects are continually updated so that potential risks and corrective actions can be identified and any problems with implementation, technical feasibility or and timeframes can be addressed.

The DICNZ confirms with the Industry Capability Network that it has promoted domestic suppliers to overseas-based prime contractors. Where the DICNZ undertakes defence industry research, outcomes are summarised and raised with the Minister.

Process management issues are discussed regularly with the Minister and the views of other stakeholders are obtained at Executive Capability Board and DICNZ meetings to ensure that the management of equipment procurement is credible, effective, respected and contributes to the achievement of the Government's defence and security policy objectives.

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

For the year ended 30 June 2009

30/6/2008 Actual \$000		30/6/2009 Actual \$000	30/6/2009 Main estimates \$000	30/6/2009 Supp. estimates \$000
Revenue				
3,615	Crown	3,660	3,665	3,660
127	Other	160	68	1,519
3,742	Total revenue	3,820	3,733	5,179
Expenditure				
2,108	Personnel	2,306	2,382	2,306
1,568	Operating	3,989	1,351	2,873
3,676	Total expenditure	6,295	3,733	5,179
66	Surplus	(2,475)	–	–

Non-departmental project financial performance

For the year ended 30 June 2009

30/6/2008 Actual \$000		30/6/2009 Actual \$000	30/6/2009 Main estimates \$000	30/6/2009 Supp. estimates \$000
Vote: Defence				
	Capital receipts			
253,230	Sale of defence equipment to NZDF	228,583	261,999	228,583
253,230		228,583	261,999	228,583
	Capital expenditure			
279,757	Purchase of defence equipment	181,120	190,275	280,977
279,757		181,120	190,275	280,977

Part 4 : Departmental financial statements



Statement of financial performance

For the year ended 30 June 2009

Actual 2008	Note	Actual 2009	Main estimates 2009	Supp. estimates 2009
\$000		\$000	\$000	\$000
Income				
9,398	Revenue Crown	9,688	9,398	9,688
233	Revenue other	273	203	1,654
9,631	<i>Total income</i>	9,961	9,601	11,342
Expenditure				
6,204	Personnel expenses	6,485	6,622	6,612
2,754	Operating expenses	5,179	2,352	4,202
262	Depreciation and amortisation expense	272	371	272
256	Capital charge	256	256	256
9,476	<i>Total expenditure</i>	12,192	9,601	11,342
155	Net operating surplus/(deficit)	(2,231)	–	–

The accompanying notes form part of these financial statements.

Statement of financial position

As at 30 June 2009

Actual 2008	Note	Actual 2009	Main estimates 2009	Supp. estimates 2009
\$000		\$000	\$000	\$000
Assets				
Current assets				
1,917	Cash and cash equivalents	2,074	1,318	1,642
195	Debtors and other receivables	169	250	245
14	Prepayments	0	13	15
2,126	<i>Total current assets</i>	2,243	1,581	1,902
Non-current assets				
2,510	Property, plant and equipment	2,493	2,662	2,563
148	Intangible assets	176	143	198
2,658	<i>Total non-current assets</i>	2,669	2,805	2,761
4,784	Total assets	4,912	4,386	4,663
Liabilities				
Current liabilities				
628	Creditors and other payables	3,043	317	617
155	Repayment of surplus	–	–	–
375	Employee entitlements	412	425	400
1,158	<i>Total current liabilities</i>	3,455	742	1,017
Non-current liabilities				
210	Employee entitlements	272	228	230
210	<i>Total non-current liabilities</i>	272	228	230
1,368	Total liabilities	3,727	970	1,247
3,416	Net assets	1,185	3,416	3,416
Taxpayer's funds				
3,416	General funds	1,185	3,416	3,416
3,416	Total taxpayers' funds	1,185	3,416	3,416

The accompanying notes form part of these financial statements.

Statement of changes in taxpayers' funds

For the year ended 30 June 2009

Actual 2008	Note	Actual 2009	Main estimates 2009	Supp. estimates 2009
\$000		\$000	\$000	\$000
3,416	Balance at 1 July	3,416	3,416	3,416
155	Surplus/(deficit) for the year	(2,231)	–	–
155	Total recognised income and expense	(2,231)	–	–
(155)	Repayment of surplus to the Crown	–	–	–
–	Capital contribution	–	–	–
3,416	Balance at 30 June	1,185	3,416	3,416

The accompanying notes form part of these financial statements.

Statement of cash flows

For the year ended 30 June 2009

Actual 2008	Note	Actual 2009	Main estimates 2009	Supp. estimates 2009
\$000		\$000	\$000	\$000
Cash flows from operating activities				
9,398		9,688	9,398	9,688
250		278	203	1,654
(6,095)		(6,386)	(6,278)	(6,359)
(2,734)		(2,724)	(2,759)	(4,847)
(256)		(256)	(256)	(256)
(1)		(5)	–	120
562	13	595	308	–
Cash flows from investing activities				
–		–	–	–
(323)		(206)	(350)	(275)
(26)		(77)	–	–
(349)		(283)	(350)	(275)
Cash flows from financing activities				
–		–	–	–
(740)		(155)	(244)	–
(740)		(155)	(244)	–
(527)		157	(286)	(275)
2,444		1,917	1,604	1,917
1,917		2,074	1,318	1,642

The Goods and Services Tax (net) component of operating activities reflects the net GST paid and received with the Inland Revenue Department. The Goods and Services Tax (net) component has been presented on a net basis, as the gross amounts do not provide meaningful information for financial statement purposes.

The accompanying notes form part of these financial statements.

Statement of commitments

As at 30 June 2009

Capital commitments

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

The Ministry has no capital commitments (2008 = Nil).

Non-cancellable operating lease commitments

The Ministry leases property, plant and equipment in the normal course of its business. The lease of premises in Defence House has a non-cancellable leasing period of 18 years.

Actual 2008 \$000		Actual 2009 \$000
	Non-cancellable operating lease commitments	
457	Not later than one year	457
457	Later than one year and not later than two years	457
1,370	Later than two years and not later than five years	1,370
5,328	Later than five years	4,871
7,612	<i>Total non-cancellable operating lease commitments</i>	7,155
7,612	Total commitments	7,155

Statement of contingent liabilities and contingent assets

As at 30 June 2009

Contingent liabilities

The Ministry has no contingent liabilities (2008 = Nil).

Contingent assets

The Ministry has no contingent assets (2008 = Nil).

Guarantees and indemnities

No guarantees and indemnities have been given outside the normal course of business (2008 = Nil).

The accompanying notes form part of these financial statements.

Statement of departmental output expenses against appropriations

For the year ended 30 June 2009

Actual 2008 \$000		Actual 2009 \$000	Main estimates 2009 \$000	Supp. estimates 2009 \$000
Vote: Defence				
Appropriations for output expenses				
4,003	Policy advice	4,075	3,959	4,242
1,797	Audit and assessment of performance	1,822	1,909	1,921
3,676	Management of equipment procurement	6,295	3,733	5,179
9,476	Total appropriations for output expenses	12,192	9,601	11,342

Statement of departmental unappropriated expenditure and capital expenditure

For the year ended 30 June 2009

The Ministry had departmental unappropriated expenditure of \$1.116m within the Management of equipment procurement. These costs relate to extended contract negotiations (2008 = Nil).

The Ministry is seeking approval through section 26C of the Public Finance Act.

The accompanying notes form part of these financial statements.

Notes to the financial statements

For the year ended 30 June 2009

Note 1: Statement of accounting policies

Reporting Entity

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

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

The primary objective of the Ministry is to provide services to the public rather than making a financial return. Accordingly, the Ministry has designated itself as a public benefit entity for the purpose of New Zealand equivalents to International Financial Reporting Standards (NZ IFRS).

The financial statements of the Ministry are for the year ended 30 June 2009. The financial statements were authorised for issue by the Chief Executive of the Ministry on 30 September 2009.

Basis of preparation

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

These financial statements have been prepared in accordance with, and comply with, NZ IFRS as appropriate for public benefit entities.

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

The financial statements have been prepared on a historical cost basis, modified by the revaluation of certain financial instruments (including derivative instruments).

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

Standards, amendments and interpretations issued but not yet effective and have not been early adopted

Standards, amendments and interpretations issued but not yet effective and have not been early adopted, and which are relevant to the Ministry include:

NZ IAS *Presentation of Financial Statements* (revised 2007) replaces NZ IAS 1 *Presentation of Financial Statements* (issued 2004) and is effective for reporting periods beginning on or after 1 January 2009.

The revised standard requires information in financial statements to be aggregated on the basis of shared characteristics and to introduce a statement of comprehensive income. This will enable readers to analyse changes in equity resulting from transactions with the Crown in its capacity as “owner” separately from “non-owner” changes. The revised standard gives the Ministry the option of presenting items of income and expense and components of other comprehensive income either in a single statement of comprehensive income with subtotals, or in two separate statements (a separate income statement followed by a statement of comprehensive income). The Ministry expects it will apply the revised standard for the first time for the year ended 30 June 2010, and is yet to decide whether it will prepare a single statement of comprehensive income or a separate income statement followed by a statement of comprehensive income.

Note 1 continued overleaf ...

Note 1: Statement of accounting policies – continued

Amendments to NZ IFRS 7 *Financial Instruments: Disclosures* and is effective for reporting periods beginning on or after 1 January 2009. In the first year of application, the Ministry does not need to provide comparative information for the disclosures required by the amendments.

The amendments introduce a three-level fair value disclosure hierarchy that distinguishes fair value measurements by the significance of the inputs used. These disclosures are expected to provide more information about the relative reliability of fair value measurements. In addition, the amendments enhance disclosure requirements on the nature and extent of liquidity risk arising from financial instruments to which an entity is exposed. The amendments clarify current requirements to address application issues. The amendments also reinforce the principles of NZ IFRS 7 to ensure that information disclosed enables users to evaluate the nature and extent of liquidity risk arising from financial instruments and how the entity manages this risk. The Ministry intends to adopt this standard for the year ending 30 June 2010 and has not determined the potential impact of the new standard.

Revenue

Revenue is measured at the fair value of consideration received.

Revenue Crown

Revenue earned from the supply of outputs to the Crown is recognised as revenue when earned.

Interest

Interest income is recognised using the effective interest method.

Capital charge

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

Operating leases

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

Financial instruments

Financial assets and financial liabilities are initially measured at fair value plus transaction costs unless they are carried at fair value through profit or loss in which case the transaction costs are recognised in the statement of financial performance.

Cash and cash equivalents

Cash includes cash on hand and funds on deposit with banks.

Debtors and other receivables

Debtors and other receivables are initially measured at fair value and subsequently measured at amortised cost using the effective interest rate, less impairment changes.

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

Note 1 continued overleaf ...

Note 1: Statement of accounting policies – *continued*

Property, plant and equipment

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

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

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

Additions

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

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

Disposals

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

Subsequent costs

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

Depreciation

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

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

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

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

Intangible assets

Software acquisition

Computer software that is not integral to the operation of the hardware is recorded as an intangible asset at cost and amortised on a straight line basis.

Costs associated with maintaining computer software are recognised as an expense when incurred. Direct costs that are associated with the development of the software are recognised as an intangible asset. Direct costs include the software development, employee costs and an appropriate portion of relevant overheads.

Staff training costs are recognised as an expense when incurred.

Note 1 continued overleaf ...

Note 1: Statement of accounting policies – *continued*

Amortisation

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

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

Acquired computer software	3–5 years
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Impairment of non-financial assets

Intangible assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. An intangible asset that is not yet available for use at the balance sheet date is tested for impairment annually.

Property, plant and equipment and intangible assets that have a finite useful life are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

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

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

Any impairment loss is recognised in the statement of financial performance.

Creditors and other payables

Creditors and other payables are initially measured at fair value and subsequently measured at amortised cost using the effective interest method.

Employee entitlements

A provision is made in respect of the Ministry's liability for annual, sick, long service and retirement leave. Entitlements which are expected to be paid within twelve months of the reporting date are measured at nominal values on an actual entitlement basis, at current rates of pay. These include salaries and wages accrued up to balance date, annual leave earned but not yet taken at balance date, retiring and long service leave entitlements expected to be settled within 12 months and sick leave.

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

Entitlements payable beyond twelve months, such as long service and retirement leave, are calculated based on the present value of expected future entitlements.

Superannuation schemes

Defined superannuation schemes

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

Note 1 continued overleaf ...

Note 1: Statement of accounting policies – *continued*

Provisions

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

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

Taxpayers' funds

Taxpayers' funds is the Crown's investment in the Ministry and is measured as the difference between total assets and total liabilities. Taxpayers' funds is disaggregated and classified as general funds and property, plant and equipment revaluation reserves.

Commitments

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

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

Goods and Services Tax (GST)

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

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

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

Commitments and contingencies are disclosed exclusive of GST.

Income tax

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

Budget figures

The budget figures are those included in the Ministry's statement of intent for the year-ended 30 June 2009, which are consistent with the financial information in the Main Estimates. In addition, the financial statements also present the updated budget information from the Supplementary Estimates.

Statement of cost accounting policies

The Ministry has determined the cost of outputs using the cost allocation system outlined below:

- Criteria for direct and indirect costs
 - "Direct costs" are those costs directly attributed to an output.

Note 1 continued overleaf ...

Note 1: Statement of accounting policies – *continued*

- “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 2009, direct costs accounted for 65% of the Ministry’s costs (30 June 2008 = 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 2009, indirect costs accounted for 35% of the Ministry’s costs (30 June 2008 = 29%).

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

Critical accounting estimates and assumptions

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

- Retirement and long service leave – Note 11 provides an analysis of the exposure in relation to estimates and uncertainties surrounding retirement and long service leave liabilities.

Critical judgements in applying the Ministry’s accounting policies

Management has not exercised any critical judgements in applying the Ministry’s accounting policies for the period ended 30 June 2009.

Note 2: Revenue other

Actual 2008 \$000		Actual 2009 \$000
163	State Sector Retirement Saving Scheme recovery	161
52	Pre-acquisition project costs from NZDF	103
18	Pay and Employment Equity Review recovery	9
233	Total revenue other	273

Note 3: Personnel costs

Actual 2008 \$000		Actual 2009 \$000
5,989	Salaries and wages	6,168
217	Employer contributions to defined contributions plans	218
(2)	Increase/(decrease) in employee entitlements	99
6,204	Total personnel costs	6,485

Employer contributions to defined contribution plans include contributions to the State Sector Retirement Savings Scheme, Kiwisaver and Government Superannuation Fund.

Note 4: Capital charge

The Ministry pays a capital charge to the Crown on its taxpayers' funds as at 30 June and 31 December each year. The capital charge rate for the year ended 30 June 2009 was 7.5% (2008 = 7.5%).

Note 5: Other operating expenses

Actual 30/6/2008 \$000		Actual 20/6/2009 \$000
	Operating expenses	
250	Consultancy	1,988
167	Professional services	90
114	Audit fees for financial statements	116
16	Auditors – fees for transition to NZ IFRS	–
475	Share of NZDF costs for maintaining services	507
68	Grants and contributions	82
25	Subscriptions	23
56	General maintenance and servicing	31
371	Travel and related costs	260
100	Courses, conferences and exhibitions	51
399	Rental of premises	458
147	Legal	954
32	Printing and stationery	46
132	Computer expenses	211
78	Electronic information, Acts and Regulations	78
324	Other operating costs	284
2,754	Total operating	5,179

Note 6 continued overleaf ...

Note 6: Debtors and other receivables

Actual 2008 \$000		Actual 2009 \$000
195	Debtors	169
–	Less: provision for doubtful debts	–
195	Net debtors	169
–	GST receivable	–
195	Total debtors and other receivables	169

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

As at 30 June 2008 and 2009, all overdue receivables have been assessed for impairment and appropriate provisions applied, as detailed below:

	2008			2009		
	Gross	Impairment	Net	Gross	Impairment	Net
Not past due	128	–	128	169	–	169
Past due 1–30 days	66	–	66	–	–	–
Past due 31–60 days	1	–	1	–	–	–
Past due 61–90 days	–	–	–	–	–	–
Past due > 91 days	–	–	–	–	–	–
Total	195	–	195	169	–	169

Note 7: Property, plant and equipment

	Leasehold improvements	Office Furniture	Office and Computer Equipment	Total
	\$000	\$000	\$000	\$000
Cost or valuation				
Balance at 1 July 2007	2,378	228	1,057	3,663
Additions	17	17	69	103
Disposals	(15)	–	–	(15)
Balance at 30 June 2008	2,380	245	1,126	3,751
Balance at 1 July 2008	2,380	245	1,126	3,751
Additions	3	34	164	201
Disposals	–	–	–	–
Balance at 30 June 2009	2,383	279	1,290	3,952
Accumulated depreciation and impairment losses				
Balance at 1 July 2007	40	38	952	1,030
Depreciation expense	134	21	56	211
Eliminate on disposal	–	–	–	–
Impairment losses	–	–	–	–
Balance at 30 June 2008	174	59	1,008	1,241
Balance at 1 July 2008	174	59	1,008	1,241
Depreciation expense	170	21	27	218
Eliminate on disposal	–	–	–	–
Impairment losses	–	–	–	–
Balance at 30 June 2009	344	80	1,035	1,459
Carrying amounts				
At 1 July 2007	2,338	190	105	2,633
At 30 June and 1 July 2008	2,206	186	118	2,510
At 30 June 2009	2,039	199	255	2,493

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

Note 8: Intangible assets

	Acquired software \$000	Total \$000
Cost		
Balance at 1 July 2007	527	527
Additions	61	61
Disposals	–	–
Balance at 30 June 2008	588	588
Balance at 1 July 2008	588	588
Additions	82	82
Disposals	–	–
Balance at 30 June 2009	670	670
Accumulated amortisation and impairment losses		
Balance at 1 July 2007	389	389
Amortisation expense	51	51
Disposals	–	–
Impairment losses	–	–
Balance at 30 June 2008	440	440
Balance at 1 July 2008	440	440
Amortisation expense	54	54
Disposals	–	–
Impairment losses	–	–
Balance at 30 June 2009	494	494
Carrying amounts		
At 1 July 2007	138	138
At 30 June and 1 July 2008	148	148
At 30 June 2009	176	176

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

Note 9: Creditors and other payables

Actual 2008 \$000		Actual 2009 \$000
169	Creditors	897
316	Accrued expenses	2,090
121	GST payable	34
22	Accrued expenses for property, plant and equipment	22
628	Total creditors and other payables	3,043

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

Note 10: Repayment of surplus

Actual 2008 \$000		Actual 2009 \$000
155	Net surplus/(deficit)	(2,231)
155	Total repayment of surplus	–

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

Note 11: Employee entitlements

Actual 2008 \$000		Actual 2009 \$000
	Current provisions are represented by:	
360	Annual leave	410
15	Sick leave	2
–	Retirement and long service leave	–
375	<i>Total current provision</i>	412
	Non-current employee entitlements are represented by:	
210	Retirement and long service leave	272
585	Total employee entitlements	684

Note 14 continued overleaf ...

Note 12: Taxpayers' funds

Actual 2008 \$000		Actual 2009 \$000
General Funds		
3,416	Balance at 1 July	3,416
155	Net surplus/(deficit)	(2,231)
–	Capital contribution from the Crown	–
(155)	Provision for repayment of surplus to the Crown	–
3,416	General funds at 30 June	1,185

Note 13: Reconciliation of net surplus/(deficit) to net cash from operating activities

Actual 2008 \$000		Actual 2009 \$000
155	Net Surplus/(deficit)	(2,231)
	Add/(less) non-cash items:	
262	Depreciation and amortisation expense	272
22	Inc/(Dec) in non current employee entitlements	62
284	<i>Total non-cash items</i>	334
	Add/(less) movements in working capital items:	
11	(Inc)/Dec in debtors and other receivables	26
(1)	(Inc)/Dec in prepayments	14
108	Inc/(Dec) in creditors and other payables	2,415
5	Inc/(Dec) in current employee entitlements	37
123	<i>Net movements in working capital items</i>	2,492
562	Net cash from operating activities	595

Note 14: Related party transactions and key management personnel

Related party transactions

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 entities and state-owned enterprises on an arm's length basis. Those transactions that occur within a normal supplier or client relationship on terms and conditions no more or less favourable than those which it is reasonable to expect the Ministry would have adopted if dealing with that entity at arm's length in the same circumstance are not disclosed.

Note 14: Related party transactions and key management personnel – *continued*

Key management personnel compensation

Actual 2008 \$000		Actual 2009 \$000
1,136	Salaries and other short-term employee benefits	1,315
–	Post employment benefits	37
–	Other long term benefits	–
–	Termination benefits	–
1,136	Total key management personnel compensation	1,352

Key management personnel include the Chief Executive, five Deputy Secretaries and for an interim period, two Acting Deputy Secretaries.

Note 15: Events after the balance sheet date

There have been no significant events after the balance sheet date.

Note 16: Financial instruments risks

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

Market risk

Currency risk

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

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

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

Interest rate risk

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

The Ministry has no interest bearing financial instruments and, accordingly, has no exposure to interest rate risk.

Note 20 continued overleaf ...

Note 16: Financial instruments risks – continued

Credit risk

Credit risk is the risk that a third party will default on its obligation to the Ministry, causing the Ministry to incur a loss.

In the normal course of its business, credit risk arises from debtors, deposits with banks and derivative financial instrument assets.

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

The Ministry's maximum credit exposure for each class of financial instrument is represented by the total carrying amount of cash and cash equivalents, net debtors (note 6), and derivative financial instrument assets. There is no collateral held as security against these financial instruments, including those instruments that are overdue or impaired.

The Crown Retail Deposit Guarantee Scheme for deposits held with banks that have opted into the scheme provides a guarantee of \$1 million per deposit or per guaranteed institution. Deposits beyond this level are not covered by this scheme.

Liquidity risk

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

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

The table below analyses the Ministry's financial liabilities that will be settled based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed are the contractual undiscounted cash flows.

	Less than 6 months \$000	Between 6 months and 1 year \$000	Between 1 year and 5 years \$000	Over 5 years \$000	Total \$000
Assets					
Current assets					
Cash and cash equivalents	2,074	–	–	–	2,074
Debtors and other receivables	169	–	–	–	169
<i>Total current assets</i>	2,243	–	–	–	2,243
Total assets	2,243	–	–	–	2,243
Liabilities					
Current liabilities					
Creditors and other payables	3,043	–	–	–	3,043
<i>Total current liabilities</i>	3,043	–	–	–	3,043
Total liabilities	3,043	–	–	–	3,043
Net liquidity of continuing operations	(800)	–	–	–	(800)

Note 17: Categories of financial instruments

Actual 2008 \$000		Actual 2009 \$000
	<i>Loans and receivables</i>	
1,917	Cash and cash equivalents	2,074
195	Debtors and other receivables (note 6)	169
2,112	Total loans and receivables	2,243
	<i>Financial liabilities measured at amortised cost</i>	
628	Creditors and other payables (note 9)	3,043

Note 18: Capital management

The Ministry's capital is its equity (or taxpayers' funds), which comprise general funds only. Equity is represented by net assets.

The Ministry manages its revenues, expenses, assets, liabilities, and general financial dealings prudently. The Ministry's equity is largely managed as a by-product of managing income, expenses, assets, liabilities, and compliance with the Government Budget processes and with Treasury Instructions.

The objective of managing the Ministry's equity is to ensure the Ministry effectively achieves its goals and objectives for which it has been established, whilst remaining a going concern.

Note 19: Explanation of major variances against budget

The major variances from the Ministry's estimated figures in the statement of intent contained within the operating expenses and other payables relate to costs incurred with extended contract negotiations.

Part 5 : Non-departmental statements and schedules

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

Schedule of non-departmental income

For the year ended 30 June 2009

Actual 2008		Actual 2009	Main estimates 2009	Supp. estimates 2009
\$000		\$000	\$000	\$000
Income				
32	Other operating revenue	–	–	–
14,681	Foreign exchange gains	21,719	–	–
2,275	Realised gains on derivatives	1,839	–	–
42,163	Unrealised gains on derivatives	3,572	–	–
579	Interest	152	400	400
59,730	Total non-departmental income	27,282	400	400

Schedule of non-departmental capital receipts

For the year ended 30 June 2009

Sales of defence equipment to the NZDF in 2008/09 were:

Actual 2008		Actual 2009	Main estimates 2009	Supp. estimates 2009
\$000		\$000	\$000	\$000
21,142	P-3K Orion systems upgrade	11,094	22,930	11,094
15,175	B-757 aircraft modification	14,591	28,213	14,591
36,645	C-130H life extension	21,998	35,971	21,998
100,730	Medium utility helicopter	67,739	72,585	67,739
–	Training light utility helicopter	42,972	–	42,972
76,378	Project Protector vessels	50,867	84,374	50,867
51	Close-in weapon system	15,042	17,298	15,042
–	Platform systems upgrade	3,012	–	3,012
606	Light armoured vehicles	66	138	66
(628)	Tactical communications	(12)	–	(12)
741	Medium range anti-armour weapon	324	139	324
1,326	Light operational vehicles	878	351	878
1,064	Air defence system	12	–	12
253,230	Total non-departmental capital receipts	228,583	261,999	228,583

The accompanying notes form part of these financial statements.

For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated Financial Statements of the Government for the year ended 30 June 2009.

Schedule of non-departmental expenses

For the year ended 30 June 2009

Actual 2008		Actual 2009	Main estimates 2009	Supp. estimates 2009
\$000		\$000	\$000	\$000
Expenditure				
319	Foreign exchange losses	7	–	–
190	Realised losses on derivatives	1,674	–	–
229	Unrealised losses on derivatives	5,536	–	–
8,355	GST input expense	12,658	–	–
9,093	Total non-departmental expenditure	19,875	–	–

Schedule of non-departmental assets

As at 30 June 2009

Actual 2008	Note	Actual 2009
\$000		\$000
Assets		
Current assets		
114,819	Cash and cash equivalents	154,186
724	Debtors and other receivables	4,245
153,632	Inventory – work in progress	100,811
10	Prepayments	–
1,323	Derivatives in gain	140
270,508	Total current assets	259,382
Non current assets		
331	Derivatives in gain	587
331	Total non-current assets	587
270,839	Total non-departmental assets	259,969

The accompanying notes form part of these financial statements.

For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated Financial Statements of the Government for the year ended 30 June 2009.

Schedule of non-departmental liabilities

As at 30 June 2009

Actual 2008 \$000	Note	Actual 2009 \$000
Liabilities		
Current Liabilities		
1,114	Creditors and other payables 3	10,974
5,787	Derivatives in loss	17,181
6,901	<i>Total current liabilities</i>	28,155
Non current liabilities		
14,822	Derivatives in loss	–
14,822	<i>Total non-current liabilities</i>	–
21,723	Total non-departmental liabilities	28,155

Schedule of non-departmental capital commitments

As at 30 June 2009

Non-cancellable capital commitments

The schedule sets out the level of capital commitments made against out-year appropriations and funding baselines for non-departmental capital expenditure. The Ministry on behalf of the Crown has entered into non-cancellable contracts for the purchase of defence equipment.

Actual 2008 \$000	Actual 2009 \$000
Non-cancellable capital commitments	
247,474	Not later than one year 287,069
217,391	Later than one year and not later than two years 222,545
204,012	Later than two years and not later than five years 91,202
–	Later than five years –
668,877	Total non-cancellable capital commitments 600,816

The accompanying notes form part of these financial statements.

For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated Financial Statements of the Government for the year ended 30 June 2009.

Schedule of non-departmental contingent liabilities and contingent assets

As at 30 June 2009

Contingent liabilities

The Ministry on behalf of the Crown has no contingent liabilities (2008 = Nil).

Contingent assets

The Ministry on behalf of the Crown may receive a financial settlement from a warranty dispute with a Project Protector contractor. As at 30 June 2009, this was not quantifiable (2008 = Nil).

Guarantees and indemnities

On 12 August 2008 the Ministry on behalf of the Crown gave an indemnity to BMT Defence Services Limited, John Coles, Graham Baxter and John Clayton in relation to the independent review of the acquisition and introduction into service of the Multi-Role Vessel HMNZS *Canterbury* (2008 = Nil).

Statement of non-departmental capital expenditure against appropriation

For the year ended 30 June 2009

Actual 2008		Actual 2009	Main estimates 2009	Supp. estimates 2009
\$000		\$000	\$000	\$000
Vote Defence				
	Appropriations for non-departmental capital expenditure			
279,757	Purchase of defence equipment	181,120	190,275	280,977
279,757	Total appropriation for non-departmental capital expenditure	181,120	190,275	280,977

Statement of non-departmental unappropriated capital expenditure

For the year ended 30 June 2009

There has been no unappropriated expenditure for the year ended 30 June 2009 (2008 = Nil).

The accompanying notes form part of these financial statements.

For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated Financial Statements of the Government for the year ended 30 June 2009.

Schedule of non-departmental capital expenditure

For the year ended 30 June 2009

Project payments made in 2008/09 were:

Actual 2008 \$000	Project	Actual 2009 \$000
–	Defence command and control system	2,221
13,412	P-3K Orion systems upgrade	24,677
5,067	B-757 aircraft modification	30,816
29,950	C-130H life extension	11,209
108,848	Medium utility helicopter	27,089
35,401	Training/light utility helicopter	46,487
–	Advanced pilot training capability	4
74,959	Project Protector vessels	27,327
9,797	Close-in weapon system	5,383
28	Platform systems upgrade	5,319
667	Light armoured vehicles	144
(12)	Tactical communications	(326)
348	Medium range anti-armour weapon	133
1,116	Light operational vehicles	292
176	Air defence system	345
279,757	Total	181,120

(Figures are GST exclusive)

The accompanying notes form part of these financial statements.

For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated Financial Statements of the Government for the year ended 30 June 2009.

Notes to the non-departmental financial statements

Note 1: Statement of accounting policies for the year ended 30 June 2009

Reporting entity

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

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

Accounting policies

The non-departmental schedules and statements have been prepared in accordance with the Government's accounting policies as set out in the Financial Statements of the Government, and in accordance with relevant Treasury Instruments and Treasury Circulars.

Measurement and recognition rules applied in the preparation of these non-departmental schedules and statements are consistent with New Zealand generally accepted accounting practice as appropriate for public benefit entities. Reference should be made to the accounting policies, contained in note one to the departmental financial statements.

The following particular accounting policies have been applied.

Foreign exchange

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

Goods and services tax

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

Accounting for derivative financial instruments, hedging activities and foreign currency transactions

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

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

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

Note 2: Debtors and other receivables

Actual 2008 \$000	Actual 2009 \$000
– Balance at 1 July	–
– Additional provisions made during the year	–
– Receivables written off during period	–
– Balance at 30 June	–

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

	2008			2009		
	Gross	Impairment	Net	Gross	Impairment	Net
Not past due	658	–	658	4,245	–	4,245
Past due 1–90 days	66	–	66	–	–	–
Past due 90–180 days	–	–	–	–	–	–
Past due 180–360 days	–	–	–	–	–	–
Past due > 360 days	–	–	–	–	–	–
Total	724	–	724	4,245	–	4,245

Note 3: Creditors and other payables

Actual 2008 \$000	Actual 2009 \$000
1,114 Creditors	10,974
1,114 Total creditors and other payables	10,974

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

Note 4: Explanation of major variances against budget

There are no significant variances to budget.

Note 5: Financial instruments risks

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

Market risk**Currency risk**

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

The Ministry purchases capital equipment internationally and is exposed to currency risk arising from various currency exposures, primarily with respect to the United States, Canadian and Australian dollars and Euro.

Note 5 continued overleaf ...

Currency risk arises from future capital purchases and recognised liabilities, which are denominated in a foreign currency.

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

Interest rate risk

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

The Ministry has no interest bearing financial instruments and, accordingly, has no exposure to interest rate risk.

Credit risk

Credit risk is the risk that a third party will default on its obligation to the Ministry, causing the Ministry to incur a loss.

In the normal course of its business, credit risk arises from debtors, deposits with banks and derivative financial instrument assets.

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

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

The Crown Retail Deposit Guarantee Scheme for deposits held with banks that have opted into the scheme provides a guarantee of \$1 million per deposit or per guaranteed institution. Deposits beyond this level are not covered by this scheme.

Sensitivity analysis – Cash and cash equivalents

At 30 June 2009, if the NZ dollar strengthened by 5% against the major currencies held with all other variables held constant, the unrealised gain for the year would have been \$7.080 million lower. Conversely, if the NZ dollar weakened by 5% against all hedged currencies with all other variables held constant, the unrealised gain for the year would have been \$7.826 million higher.

Decrease in gain if NZ dollar strengthened by 5% (\$000)

	<u>2008</u>	<u>2009</u>
AUD	369	646
CAD	52	635
EUR	533	3,786
USD	3,198	2,013
	<u>4,152</u>	<u>7,080</u>

Increase in gain if NZ dollar weakened by 5% (\$000)

	<u>2008</u>	<u>2009</u>
AUD	408	714
CAD	58	702
EUR	589	4,185
USD	3,534	2,259
	<u>4,589</u>	<u>7,826</u>

Note 5 continued overleaf ...

Sensitivity analysis – Derivatives

At 30 June 2009, if the NZ dollar strengthened by 5% against all the hedged currencies with all other variables held constant, the unrealised loss for the year would have been \$19.425 million lower. Conversely, if the NZ dollar weakened by 5% against all the hedged currencies with all other variables held constant, the unrealised loss for the year would have been \$21.470 million higher. The movements are a result of the exchange losses on translation of overseas currencies.

Liquidity risk

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

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

The table below analyses the Ministry's financial instruments that will be settled based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed are the contractual undiscounted cash flows.

	Less than 6 months \$000	Between 6 months and 1 year \$000	Between 1 year and 5 years \$000	Over 5 years \$000	Total \$000
Assets					
Current assets					
Cash and cash equivalents	154,186	–	–	–	154,186
Debtors and other receivables	4,245	–	–	–	4,245
Derivative financial instruments	341,819	–	–	–	341,819
<i>Total current assets</i>	500,250	–	–	–	500,250
Non-current assets					
Derivative financial instruments	–	–	49,657	–	49,657
<i>Total non-current assets</i>	–	–	49,657	–	49,657
Total assets	500,250	–	49,657	–	549,907
Liabilities					
Current liabilities					
Creditors and other payables	10,974	–	–	–	10,974
Derivative financial instruments	358,860	–	–	–	358,860
<i>Total current liabilities</i>	369,834	–	–	–	369,834
Non-current liabilities					
Derivative financial instruments	–	–	49,070	–	49,070
<i>Total non-current liabilities</i>	–	–	49,070	–	49,070
Total liabilities	369,834	–	49,070	–	418,904
Net liquidity of continuing operations	130,416	–	587	–	131,003

Note 6: Categories of financial instruments

Actual 2008 \$000		Actual 2009 \$000
	<i>Loans and receivables</i>	
114,819	Cash and cash equivalents	154,186
724	Debtors and other receivables (note 2)	4,245
115,543	Total loans and receivables	158,431
	<i>Fair value through profit and loss – designated as such upon initial recognition</i>	
1,654	Derivative financial instrument assets	727
20,609	Derivative financial instrument liabilities	17,181
	<i>Financial liabilities measured at amortised cost</i>	
1,114	Creditors and other payables (note 3)	10,974

Note 7: Derivative financial instruments

The notional principal amount of outstanding forward exchange contracts at 30 June 2009 was \$410,949,316. These were EUR 165,096,117 and USD 23,148,000 and AUD 515,403.

The fair value of forward exchange contracts has been determined using a discounted cash flows valuation technique based on quoted market rates.

Part 6 : 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. A conflict of interest register is maintained.

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.

Financial performance highlights

	2008/09 Supp. estimates \$000	2008/09 Estimated actual \$000	2008/09 Actual \$000
Departmental activities			
Revenue: crown	9,688	9,688	9,688
Revenue: other	1,654	203	273
Output expenses	11,342	11,342	12,192
Net operating surplus/(deficit)	–	–	(2,231)
Additions to physical assets	375	375	207
Disposals of physical assets	–	–	–
Taxpayers' funds	3,416	3,416	1,185
Net cash flows from operating, investing and financing activities	–	308	595
Non-departmental activities			
Capital expenditure-defence equipment	280,977	190,275	181,120
Total crown revenue and receipts	228,583	261,999	228,583

Summary of appropriations (GST exclusive)

	Policy advice (\$000)	Audit and assessment of performance (\$000)	Management of equipment procurement (\$000)	Capital expenditure defence equipment (\$000)
Main estimates appropriation	4,242	1,921	5,179	190,275
Supplementary estimates change	–	–	–	90,702
Change by order in council under section 26A of the Public Finance Act 1989	–	–	–	–
Total amount appropriated for 2008/09	4,242	1,921	5,179	280,977
Estimated actual outturn for 2008/09 as reported in 2008/09 estimates	4,242	1,921	5,179	227,039
Audited actual outturn for 2008/09				
Unappropriated expenditure, expenses or liabilities approved under section 26C of the Public Finance Act 1989	–	–	–	1,116
Unappropriated expenditure, expenses or liabilities requiring validating legislation	–	–	–	1,116

Historical financial performance of significant items

(a) Payments on behalf of the Crown – Defence equipment

	2008–09 \$(000)	2007–07 \$(000)	2006–07 \$(000)	2005–06 \$(000)	2004–05 \$(000)	2003–04 \$(000)
Voted in Estimates	190,275	290,275	614,523	492,490	377,184	335,870
Actual Expenditure	181,120	279,757	469,787	414,639	313,075	301,466
Variance	9,155	10,518	144,736	77,851	64,109	34,404

(b) GST on defence equipment

	2008–09 \$(000)	2007–07 \$(000)	2006–07 \$(000)	2005–06 \$(000)	2004–05 \$(000)	2003–04 \$(000)
Planned	32,750	54,349	78,669	27,395	24,245	48,224
Actual Expenditure	12,658	8,355	26,639	12,945	14,585	47,272
Variance	20,092	45,994	52,030	14,450	9,660	952

(c) Capital receipts – Sales of equipment to NZDF (GST excl)

	2008–09 \$(000)	2007–07 \$(000)	2006–07 \$(000)	2005–06 \$(000)	2004–05 \$(000)	2003–04 \$(000)
Planned	228,583	253,230	509,207	395,882	282,348	462,298
Actual Expenditure	228,583	253,230	509,207	395,882	282,357	462,298
Variance	–	–	–	–	(9)	–



MINISTRY OF
DEFENCE

Manatū Kaupapa Waonga