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MINISTRY OF DEFENCE
Manatū Kaupapa Waonga

Annual Report

for the year ended 30 June 2014

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

New Zealand Government

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Secretary of Defence's overview

Introduction

2013/14 has been a significant year for the Ministry of Defence. This year we completed the Defence Midpoint Rebalancing Review, working closely with the New Zealand Defence Force (NZDF) and Central Agency partners to provide a pathway for a sustainable defence force that can deliver on the Government's policy objectives well into the future. We saw the first major outputs from our new approach to Defence evaluations, and started the 2014 Defence Assessment.

In addition to delivering a high tempo of business as usual in the year to 30 June 2014, the Ministry has taken important steps to foster a high-performing and resilient agency that is well-run and an increasingly integrated part of the defence and security sector.

The Ministry's role

The role of the 73 Ministry staff members is to:

- look out to the strategic environment and ahead to what New Zealand will need from its military;
- define, with the NZDF, what defence capability is needed, acquire that capability, and assess its effectiveness;
- help shape the international environment in the interests of New Zealand's security, through its part in the management of New Zealand's international defence engagements; and
- through the evaluation function, deliver a work programme agreed with the Minister of Defence to provide advice on the effectiveness of New Zealand's military capability and the performance of the NZDF.

Delivering defence capability that balances policy, capability and cost

In 2013/14 the Ministry has worked with NZDF to deliver a significant volume of advice on new defence capability projects. This has involved Cabinet approval of $1.2 billion in new capital projects, including the ANZAC Frigate Systems Upgrade, Individual Weapon Replacement, Maritime Sustainment Capability, Pilot Training Capability, Battle Training Facility and Secret Information Environment. In addition, Cabinet approved changes within existing Defence baselines to provide additional funding for the ANZAC Platform Systems Upgrade.

These proposals were presented to the Cabinet through a maturing framework that takes a strategic view across the defence capital investment portfolio. Key to this in 2013/14 has been the delivery to Ministers of the Defence Midpoint Rebalancing Review (DMRR).

The *Defence White Paper 2010* identified defence capability requirements through to 2030.[1] The DMRR costed these requirements, providing advice to Government on how to achieve a balance between policy objectives, capability and cost.

This collaborative process involved the Ministry, NZDF, Treasury, Department of the Prime Minister and Cabinet, and State Services Commission. A total of 220 possible capability choices were costed and scored against five policy-based criteria, and the criteria weighted relative to each other. The choices covered all aspects of the NZDF's business out to 2030 – from front-line military capabilities to support elements within NZDF. Ministers used this information to identify options to deliver on the expected needs and, through this strategic plan, committed an additional $535 million in operating expenditure over the next four years. A Capital Plan with indicative provisions of up to $16 billion out to 2030 was also agreed.

[1] The *Defence White Paper 2010* is available from the Ministry's website at http://defence.govt.nz/defence-review.html

This capability programme was set out in the joint Ministry-NZDF *Defence Capability Plan* published in June 2014.[2] This Plan turns the Government Defence policy articulated in the *Defence White Paper 2010* into real deliverables, and signals the Government's capability intent to industry, security partners and the public. It is militarily credible, affordable and achievable.

Projects in the Plan still in the development phase will be subject to rigorous scrutiny, not only within Defence as part of a sound capability management framework, but also by other Government agencies as part of the better business cases process. This reflects the guiding principle that, with any Defence project, the aim will always be to achieve the capability effects, rather than to acquire a particular platform or piece of equipment.

To support strategic planning, including on Defence's medium-term capability requirements, work commenced in 2013/14 on a Defence Assessment. This will be delivered in 2014/15 and, if the Government agrees that a White Paper is needed, then one will be delivered in 2015. Initial work this year has involved an assessment of the strategic environment, and brought together contributions from more than a dozen government agencies.

The funding certainty through to 2030 provided by the Government has allowed us to increasingly treat New Zealand's defence capability with portfolio disciplines. Maturing these is a work in progress for Defence, but the transparency it offers for Defence and Ministers has been warmly welcomed.

Certainty about the Defence baseline provides obvious encouragement for the NZDF to operate effectively as a business. The Ministry will be working very closely with the NZDF to help them achieve this.

Acquiring and upgrading military capability

The year has seen a key legacy project near completion: upgrades of the P-3K Orions. Two recent projects – for pilot training capability and medium and heavy operating vehicles – have also made significant progress.

The Ministry is completing major upgrade projects, with five P-3K Orions and three C-130H Hercules so far delivered to the Royal New Zealand Air Force. The last of the six Orions has now been delivered to the NZDF, which was able to take advantage of the enhanced surveillance and reconnaissance capability as part of the New Zealand support for the search for Malaysian Airline's MH370. The fourth Hercules will be delivered later this year, and an upgraded craft was utilised in the withdrawal from Afghanistan. Work on the Hercules by Ministry staff at Woodbourne Air Base continues to be the largest ever undertaken on any aircraft in New Zealand, and will extend the life and availability of these aircraft for airlift and transport tasks through to at least 2020.

We are also in the final stages of closing the A109 project, with the helicopters in use by the RNZAF for training.

Following approval to purchase medium and heavy operating vehicles in 2012/13, production has been underway and 130 were delivered to the NZDF, with a further 62 in transit. The first of these trucks are in use with the Army.

A total of seven NH90 medium utility helicopters have now been delivered by the manufacturer, and the pilot training capability approved in 2012/13 has moved through the production phase, with the first two aircraft scheduled to arrive in New Zealand in August 2014. Although not yet released for full military operations, the NH90s have been utilised in a range of domestic tasking, including supporting the removal of debris from the Pike River ventilation shaft.

The Ministry's team based in Connecticut in the United States has supported acquisition of the SH2G(I) Super Seasprite maritime helicopters, which will commence delivery in 2015 – providing the Royal New Zealand Navy with an upgraded naval helicopter fleet. The platform system upgrade of *Te Kaha* and *Te Mana* ANZAC frigates continues – supporting the systems that enable the frigates to move, float, generate power and recover from damage. Work on the Protector Remediation project is now 80 per cent complete.

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[2] The *Defence Capability Plan* is available from the Ministry's website at http://defence.govt.nz/reports-publications.html

The Global Command and Control System has been progressively introduced across the NZDF. Phase 1 of the Strategic Bearer Network has seen the first anchor station installed, and the first two land terminals delivered.

To streamline interaction between the two agencies, the Ministry and NZDF have worked this year to standardise project methodologies and support a shared project language.

International Defence Engagements

Advancing New Zealand's global interests through international defence engagements is a priority for the Ministry. Major bilateral developments in 2013/14 included advancing the relationship with the United States through the re-establishment of bilateral defence talks and increasing the level of bilateral defence engagement with China.

The Ministry continued to lead New Zealand's international defence engagements through regular bilateral talks with partner countries and supporting a busy programme of high level visits in both directions. At the regional level, New Zealand completed a successful term co-chairing the ASEAN Defence Ministers' Meeting Plus Experts' Working Group on Peacekeeping Operations and took up the co-chair role for Maritime Security. Our first activity was to host a regional counter-piracy workshop in Auckland.

Working with the Ministry of Foreign Affairs and Trade and the NZDF, the Ministry provided advice to Ministers on New Zealand's overseas deployments, including in particular the draw down of forces from Afghanistan and the deployment of assets and personnel to counter-piracy operations in the Gulf of Aden/Indian Ocean. A Cabinet review of New Zealand's international peace support operations policy was completed, refreshing New Zealand's policy in this area.

Evaluations

A key part of work to improve the Ministry's effectiveness has been implementation of a new business model that has fundamentally changed the focus of the Ministry's Evaluation Division. The team has moved from a pure compliance audit focus to a continuous improvement focus predicated on quantitative, evidence-based evaluation. Work has a strategic risk analysis basis and is focused on providing a platform for organisational change and improvement.

The evaluation report *Maximising Opportunities for Military Women in the New Zealand Defence Force* is an example of the progress made on the new approach.[3] Released in February 2014, the report found that while New Zealand compares well with other forces, continued improvement is needed in the way the NZDF attracts and retains the people it needs to succeed in modern conflicts. The review examined international literature and NZDF policies, information sourced from NZDF administration data and organisational surveys, as well as interviews with current and former NZDF personnel across a range of ranks, services and roles. Along with publishing the report, the Ministry has visited NZDF bases and camps to discuss the findings with personnel.

The NZDF has developed a detailed work programme drawing on the findings, including progress indicators, and is integrating this into the overall NZDF personnel strategy.

Improvements to the Ministry

Over the year, the Ministry has taken up the challenges set in its 2012 Performance Improvement Framework (PIF) Review.[4] Key to this has been clarity about the Ministry's role and purpose that all of our people and our partners understand.

Through a process involving staff, stakeholders and partners, the Ministry has defined its purpose: *to give civilian advice on defence matters to enhance New Zealand's security*. This work has produced clarity about what the Ministry stands for, and what we want to achieve over the next four years.[5] It gives the Ministry the ability to articulate the value it delivers within a much broader sector

[3] This evaluation report is available from the Ministry's website at http://defence.govt.nz/reports-publications/evaluation-report-maximising-opportunities-military-women-nzdf/contents.html

[4] The 2012 PIF Review of the Ministry is available from the State Services Commission website at: http://www.ssc.govt.nz/sites/all/files/pif-mod-review-sept12.pdf

[5] Further detail about the Ministry's medium-term strategy is set out in its *Strategic Intentions 1 July 2014 – 30 June 2018*, which is available from the Ministry website at: http://defence.govt.nz/reports-publications.html

as we move into a challenging period of delivery. It has also helped the Ministry identify key priorities for the way we operate: having the right people; supporting them to make partnered work effective; ensuring they carry a clear sense of the organisation's purpose, priorities and values; and having aligned priorities with other sector agencies.

In support of our priorities and the way we want to work, in 2014 the Ministry made new arrangements with the NZDF for the supply of IT, property and some security services. This supports a "held separately but leveraged together" approach for the NZDF-Ministry partnership that seeks to make the most of the tension between the agencies, provide well-tested choices and advice, and ensure the cost of holding NZDF and the Ministry separate are negligible.

Joint governance arrangements with NZDF around capability have matured in the form of the Capability Management Board. In 2013, a leadership team-led Defence Business Committee has also been established to support work between the agencies on organisational and policy priorities, and to govern work programmes in respect of evaluation and international defence engagements. In 2014, this committee will also take on responsibility for shared services arrangements between the two agencies.

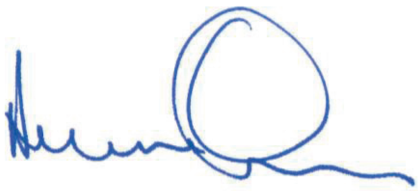
During 2014, the Ministry has also established shared services arrangements for its human resources services with the Intelligence Community Shared Services. This change will make an important contribution to organisational stability and resilience. It will provide services that reflect State sector best practice and enable the Ministry to link with the civilian partners in our defence and security sector as we develop talent.

To support a high-performing organisation, in 2013 the Ministry introduced a new talent management system, and a strategic framework to identify and mitigate risks to the Ministry's ability to achieve its strategy and do business. The Ministry has also had a review of its legal services and management of legal risks undertaken by the Government Legal Network.

The Ministry made improvements in 2014 to its financial management and allocation of resources, to maximise value from its baseline. Through better internal planning, budgeting and ongoing financial review we have improved our financial performance, fully utilising financial resources to those appropriately-identified higher priorities.

A core element for the Ministry is ensuring that we use contemporary practice to exploit existing data, build a digital workplace and ensure that our analysts in policy, evaluation and acquisition have the tools necessary to manage the knowledge they create. To progress this, we have completed a Knowledge Management Strategy that proposes a digital workplace that allows us to work on projects across Defence, create communities of practice, and manage our data and documents effectively. We also have progressed work around a shared source of data across Defence that allows real time analysis based on agreed data. This will enable more rigorous analysis from our analysts who will be able to formulate and answer more in-depth policy and operational questions with confidence.

These organisational changes are the first steps to achieve the four year excellence horizon identified in the Ministry's 2012 PIF Review. A Follow-up PIF Review has been undertaken in 2014 that confirms we are on the right trajectory to achieve this, and that we have the capability to deliver. The Follow-up Review has confirmed that the Ministry is at an early stage of a substantial change. It is a priority for us to maintain our rate of progress through 2014/15 and deliver on the expectations of the Minister of Defence and Government.



Helene Quilter
Secretary of Defence
11 September 2014

Part 2: Statement of responsibility and audit report

Statement of responsibility

In terms 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 for the judgements made in them.

I have the responsibility of establishing a system of internal control designed to provide reasonable assurance as to the integrity and reliability of financial reporting.

In my opinion, the financial statements and statement of service performance fairly reflect the financial position and operations of the Ministry for the year ended 30 June 2014.

In my opinion forecast financial statements fairly reflect the forecast financial position and operations of the Ministry for the financial year to which they relate.

Signed by:

Helene Quilter
Secretary of Defence

11 September 2014

Countersigned by:

Bryan Westbury
Deputy Secretary (Finance) and
Chief Financial Officer
11 September 2014

AUDIT NEW ZEALAND
Mana Arotake Aotearoa

Independent Auditor's Report

To the readers of the Ministry of Defence's financial statements, non-financial performance information and schedules of non-departmental activities for the year ended 30 June 2014

The Auditor-General is the auditor of the Ministry of Defence (the Ministry). The Auditor-General has appointed me, Phil Kennerley, using the staff and resources of Audit New Zealand, to carry out the audit of the financial statements, the non-financial performance information and the schedules of non-departmental activities of the Ministry on her behalf.

We have audited:

- the financial statements of the Ministry on pages 42 to 63, that comprise the statement of financial position, statement of commitments, statement of contingent liabilities and contingent assets as at 30 June 2014, the statement of comprehensive income, statement of changes in equity, statement of departmental expenses and capital expenditure against appropriations, statement of unappropriated expenditure and capital expenditure and statement of cash flows for the year ended on that date and the notes to the financial statements that include accounting policies and other explanatory information;

- the non-financial performance information of the Ministry that comprises the statement of service performance on pages 14 to 40, which includes outcomes; and

- the schedules of non-departmental activities of the Ministry on pages 66 to 81 that comprise the schedule of assets, schedule of liabilities and revaluation reserves, schedule of commitments and schedule of contingent liabilities and contingent assets as at 30 June 2014, the schedule of expenses, schedule of expenditure and capital expenditure against appropriations, schedule of unappropriated expenditure and capital expenditure, schedule of income and statement of trust monies, for the year ended on that date and the notes to the schedules that include accounting policies and other explanatory information.

Opinion

In our opinion:

- the financial statements of the Ministry on pages 42 to 63:
  - comply with generally accepted accounting practice in New Zealand; and
  - fairly reflect the Ministry's:
    - financial position as at 30 June 2014;
    - financial performance and cash flows for the year ended on that date;

- 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 2014; and
- unappropriated expenses and capital expenditure for the year ended 30 June 2014.

- the non-financial performance information of the Ministry on pages 14 to 40:
  - complies with generally accepted accounting practice in New Zealand; and
  - fairly reflects the Ministry's service performance and outcomes for the year ended 30 June 2014, including for each class of outputs:
    - its service performance compared with the forecasts in the statement of forecast service performance at the start of the financial year; and
    - its actual revenue and output expenses compared with the forecasts in the statement of forecast service performance at the start of the financial year.
- the schedules of non-departmental activities of the Ministry on pages 66 to 81 fairly reflect, in accordance with the Treasury Instructions:
  - the assets, liabilities, contingencies, commitments and trust monies as at 30 June 2014 managed by the Ministry on behalf of the Crown; and
  - the revenues, expenses, expenditure and capital expenditure against appropriations and unappropriated expenditure and capital expenditure for the year ended on that date managed by the Ministry on behalf of the Crown.

Our audit was completed on 11 September 2014. This is the date at which our opinion is expressed.

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

Basis of opinion

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

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

An audit involves carrying out procedures to obtain audit evidence about the amounts and disclosures in the financial statements, the non-financial performance information and the schedules of non-departmental activities. The procedures selected depend on our judgement, including our assessment of risks of material misstatement of the financial statements, the non-financial performance information and the schedules of non-departmental activities, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Ministry's preparation of the financial statements, the non-financial performance information and the schedules of non-departmental activities that fairly reflect the matters to which they relate. We consider internal control in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Ministry's internal control.

An audit also involves evaluating:

- the appropriateness of accounting policies used and whether they have been consistently applied;
- the reasonableness of the significant accounting estimates and judgements made by the Secretary of Defence;
- the appropriateness of the reported non-financial performance information within the Ministry's framework for reporting performance;
- the adequacy of all disclosures in the financial statements, the non-financial performance information and the schedules of non-departmental activities; and
- the overall presentation of the financial statements, the non-financial performance information and the schedules of non-departmental activities.

We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements, the non-financial performance information and the schedules of non-departmental activities. Also we did not evaluate the security and controls over the electronic publication of the financial statements, the non-financial performance information and the schedules of non-departmental activities.

We have obtained all the information and explanations we have required and we believe we have obtained sufficient and appropriate audit evidence to provide a basis for our audit opinion.

Responsibilities of the Secretary of Defence

The Secretary of Defence is responsible for preparing:

- financial statements and non-financial performance information that:
- comply with generally accepted accounting practice in New Zealand;
    - fairly reflect the Ministry's financial position, financial performance, cash flows, expenses and capital expenditure incurred against each appropriation and its unappropriated expenses and capital expenditure; and
    - fairly reflect its service performance and outcomes; and

- schedules of non-departmental activities, in accordance with the Treasury Instructions, that fairly reflect those activities managed by the Ministry on behalf of the Crown.

The Secretary of Defence is also responsible for such internal control as is determined is necessary to enable the preparation of financial statements, non-financial performance information and schedules of non-departmental activities that are free from material misstatement, whether due to fraud or error. The Secretary of Defence is also responsible for the publication of the financial statements, non-financial performance information and schedules of non-departmental activities, whether in printed or electronic form.

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

Responsibilities of the Auditor

We are responsible for expressing an independent opinion on the financial statements, the non-financial performance information and the schedules of non-departmental activities and reporting that opinion to you based on our audit. Our responsibility arises from section 15 of the Public Audit Act 2001 and 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 External Reporting Board.

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

Phil Kennerley
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 2014

Objectives

The Estimates of Appropriations and the Statement of Intent formed the framework for defining objectives and performance indicators within the Ministry. Each quarter, divisions evaluated 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 the Ministry's 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 1989. Regular monitoring and reporting of expenditure against output forecasts was undertaken. Systems are in place to ensure working capital is managed at an optimum level and foreign currency exposure is minimised.

Outcomes measures – Assessing current security and likely changes

The Ministry of Defence's Outcome Framework identifies two primary outcomes to which the Ministry contributes:

- **New Zealand is secure;**
- **the security of other nations is enhanced by New Zealand's efforts.**

Assessing the state of a security environment, against a dynamic and unpredictable global backdrop, requires complex judgements. The Ministry has assessed the security environment at the end of period covered by this Annual Report as part of the development of the 2014 Defence Assessment.[6] The Defence White Paper 2010's assumptions on the security outlook provided the starting point for considering developments during the period covered by this report.

High level assessments have been made in respect of five areas of interest:

- New Zealand and its Exclusive Economic Zone;
- Australia;
- South Pacific;
- Asia-Pacific;
- Global.

[6] A Defence Assessment is a comprehensive review of defence policy settings, military capability and resources. It is a vehicle for the Secretary of Defence to provide advice to the Government on the long-term priorities for New Zealand's defence and security. It will form part of briefing material to the incoming Minister following the 20 September 2014 General Election.

The assessments considered two aspects of security:

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

Strategic context

The international developments that have most affected the overall security environment since the Defence White Paper 2010 are:

- the continuing, and longer than anticipated, effects of the global financial crisis;
- heightened tensions in North and South East Asia over maritime boundaries;
- intensifying turmoil across the Middle East and North Africa;
- the rapid evolution and spread of cyber capabilities.

New Zealand and its Exclusive Economic Zone

There have been no material changes to New Zealand's security outlook during the period of this report.

The security outlook for New Zealand and its Exclusive Economic Zone is 'very low' with a 'stable' outlook.

A direct security threat to New Zealand and our Exclusive Economic Zone remains unlikely.

Australia

The security outlook for Australia is 'low' with a 'stable' outlook and little change over the next 12 months is foreseen to the factors bearing on Australia's security outlook, based on developments during the period of this report.

A direct security threat to Australia remains unlikely.

South Pacific

The security outlook for the South Pacific on the whole is 'moderate' with a 'stable' outlook in respect of the direct threats to security.

A direct military threat from outside the region remains unlikely. Threats to security are due instead to many Pacific states' vulnerability to internal instability caused by chronic social, economic, demographic, environmental and governance stresses. Such stresses have the potential to develop into situations where nations' security could be compromised.

Rising levels of transnational organised crime, including illegal, unregulated and unreported fishing, is placing added stress on Pacific states, hindering economic development.

Asia-Pacific[7]

The security outlook for the Asia-Pacific region overall is 'moderate' with a 'deteriorating' outlook. Threat factors relate primarily to heightened tensions over maritime territorial disputes in the East and South China Seas, as well as ongoing concerns around proliferation and terrorism.

These concerns are partly offset by the high level of economic interdependence between all states except North Korea, as well as established regional security structures.

[7] For the purposes of this assessment 'Asia-Pacific' is defined as North, East, South and Southeast Asia and the Western Pacific Ocean.

Global

The global security outlook is assessed as ’mixed’ with both positive and negative trends. The assessed direction of change is ‘unclear’.

The world continues to experience volatility and change. As outlined in the Ministry’s Statement of Intent, ongoing security challenges include:

- challenges to the rules-based international order;
- the ability of international institutions to forge consensus on trans-boundary problems;
- the emergence of new centres of economic strength that are shifting the global balance of power;
- new technologies creating new threats, including remotely piloted systems and cyber capabilities;
- the risk of weapons proliferation, both conventional and chemical, biological and nuclear;
- terrorism continuing to challenge state authority.

Ministry contribution

The Ministry contributes to the primary outcomes in three main ways.

Firstly, it undertakes the acquisition of major platforms and items of military equipment for use by the NZDF in undertaking defence and security tasks.

Secondly, it provides the Government with policy advice concerning defence and security issues, including the security environment, the military capabilities of the NZDF, the deployment of military forces and the conduct of international defence relations.

Thirdly, it undertakes evaluations, audits and assessments of the NZDF and the acquisition function of the Ministry to examine and help improve their efficiency and effectiveness.

Output Class – Policy advice and related outputs MCOA

Description

Under this Multi-Class Output Appropriation (MCOA) 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 resource implications and the relative merits and risks associated with proposed capability options;
- management and enhancement of bilateral and multilateral defence relations; and
- responses to Ministerial and Parliamentary Questions, Official Information Act enquiries and Ombudsmen correspondence.

	2012/13	2013/14	
Performance Measures	**Actual**	**Budget**	**Actual**
Total cost per output hour[1]	New measure	< $160	$159.43
Total cost per output hour updated[1]	New measure	N/A	$109.75
Policy Advice			
Technical quality of policy advice, as assessed by independent review of a sample of policy papers.	New measure	Mean ≥ 70%	72.5%
Minister's satisfaction with the quality of policy advice, as assessed by survey.	New measure	≥ 70%	50%[2]
Timeliness, as assessed by the percentage of papers that were submitted by the directed deadline.	New measure	≥ 95%	100%
Technical quality robustness, as assessed by the Common Indicator Set tool.	New measure	≥ 70%	100%
Policy Support			
Minister's satisfaction with the quality of policy support, as assessed by survey.	New measure	≥ 70%	65%[2]
Timeliness, as assessed by the percentage of papers that were submitted by the directed deadline.	New measure	≥ 95%	100%
Ministerial Services			
Quality, as assessed by the percentage of first draft of all correspondence accepted by the Minister.	New measure	≥ 90%	98.9%
Timeliness, as assessed by the percentage of papers that were submitted by the timeframe set in legislation, or otherwise agreed with the Minister.	New measure	≥ 95%	100%

Notes on performance measures:

1. The 'Total cost per output hour' formula has recently been updated by the Treasury to better align it with the amended definition of policy advice costs. Performance measures calculated using both the original and updated formulae have been provided to help readers understand how this change has affected the assessment of performance.

	Original formula	Updated formula
Total cost per output hour	Total Policy Unit Costs / Total Policy Output and Non-Policy Output Hours	Total Policy Advice Costs / Total Policy Output Hours (excluding Non-Policy Advice Hours)

2. These scores reflect a shared rating for advice and support across both Defence agencies.

The Ministry is assessing ways to improve its policy advice and policy support, in close coordination with the Minister and his office. The focus of this is to ensure our Ministerial engagement is effective and timely, as well as reflecting a joined up approach between the two Defence agencies (and other sector partners, as appropriate). We have responded to feedback in order to satisfy Ministerial expectations, and are committed to continuous improvement in our performance.

During 2013/14, the Ministry delivered a larger than usual volume of work, including business cases to Cabinet for a number of new defence capability projects (further details are provided in the next section), as well as significant one-off projects in the form of the Defence Midpoint Rebalancing Review (DMRR) and commencement of the Defence Assessment. The DMRR work will be a key tool for improving future policy decisions by providing long-term guidance on defence funding and capability requirements. Defence will use this framework to provide greater transparency to decision-makers on how future capability decisions fit within the overarching plan for defence spending.

Deployments

Objective

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

Performance

Substantive progress was made in ensuring our major deployments were well managed in a way that maintained the confidence of our international partners and furthered New Zealand's security interests.

The Ministry, in partnership with the NZDF and MFAT, developed advice on the draw-down from Afghanistan.

Extensive advice has also been provided to Ministers on future deployments including to the Combined Maritime Taskforces in the Gulf of Aden/Indian Ocean to combat piracy. Advice has also been provided to Ministers on renewing mandates for existing deployments.

International relations

Objective

To manage New Zealand international defence relationships to support enhanced national security.

Performance

The Ministry has primary responsibility for leading New Zealand's international defence relationships. Defence engagement with traditional and emerging partners supported defence and wider foreign policy objectives.

The Ministry supported travel by the Minister of Defence on bilateral visits to China, Vietnam, the US, Italy, Singapore, the UN in New York and participation in the ASEAN Defence Ministers' Meeting Plus meeting, NATO/ISAF Defence Ministers' meeting, the Shangri La Dialogue and the Five Power Defence Arrangements Ministers' meeting.

New Zealand's contribution to enhancing trust and confidence through regional security arrangements was demonstrated through our co-chairing of the ASEAN Defence Ministers' Meeting Plus Experts Working Group on Peacekeeping Operations with the Philippines, and then moving to co-chair with Brunei the Experts' Working Group on Maritime Security.

Defence cooperation was promoted through the conclusion of defence agreements with the Republic of Korea, Japan and France. The Ministry continued to lead the programme of bilateral defence consultations with a range of partner countries from across the region.

Capability development and acquisition

The Ministry provides advice during the capability development and acquisition phases of major capability projects. We undertake capability reviews in cooperation with the NZDF to identify the options for achieving the Government's defence policy goals and the Ministry of Defence's outcomes.

Performance

The capabilities the Government may acquire, enhance or replace in order to support its White Paper policy objectives are set out in the Defence Capability Plan. The Ministry continued to implement the Plan, providing policy and technical advice on a number of land, air, and maritime capability projects:

- Land and Special Forces projects, including a land transport programme, new medium and heavy operational vehicles (trucks), a new special operations training facility, network enabled army, and new individual weapons.
- Maritime projects, including the ANZAC frigate upgrades, a maritime sustainment capability to replace HMNZS *Endeavour*, and options for the replacement of the NZDF's diving, mine counter-measures, and hydrographic support capability.
- Air projects, including an underwater surveillance capability for the P3 Orions.

The major deliverables for the Ministry to support government decision-making on defence capability are business cases, which are submitted to Cabinet.

This year, Cabinet approved:

- single stage business cases for an individual weapon replacement, an Underwater Intelligence, Surveillance and Reconnaissance capability, and Secret Information Environment;
- a detailed business case for a Maritime Sustainment Capability; and
- implementation business cases for a new Pilot Training Capability, Battle Training Capability, and Frigate Systems Upgrade.

The Ministry and NZDF produced a new Defence Capability Plan in June 2014, resetting priorities for delivering defence capability over the next 10 years, and illustrating how the Government's decisions of defence capability development are guided. The document is available on the Ministry's website.

The Ministry has also provided the fourth Defence Major Projects Report to the Foreign Affairs, Defence and Trade Committee (and it is currently before the committee). The report provides a detailed analysis of the progress of each major defence acquisition project.

Shifting Resources

Objective

To work with the NZDF to assist implementation of the savings plan, while ensuring the NZDF can deliver on the Government's operational expectations over the longer term.

Performance

The Defence Mid-point Rebalancing Review (DMRR) was completed in November 2013. Commissioned by Ministers, the DMRR developed a robust long-term funding plan that balances defence policy, funding and capability. This thorough analytical analysis was a combined effort undertaken by a team of military and civilian staff from the NZDF, Ministry, State Services Commission, Treasury and Department of the Prime Minister and Cabinet.

Legislative change

Objective

To provide advice on the detailed legislative amendments required to the Defence Act 1990. The changes are designed to ensure that organisational reform (within the NZDF and the Ministry) will meet the White Paper goals of improving accountability and leadership and the way the two organisations work together.

Performance

The Foreign Affairs, Defence and Trade Committee reported back on the Defence Amendment Bill on 3 July 2012. As at 30 June 2014 the Bill was awaiting its second reading.

Cost of Output Class – Policy advice and related outputs MCOA (GST exclusive)

For the year ended 30 June 2014

Actual 2013 $000		Main estimates 2014 $000	Supp* estimates 2014 $000	Actual 2014 $000
5,629	**Total revenue**	**6,222**	**6,175**	**6,175**
	Expenses			
3,271	Policy advice	3,929	3,717	3,716
652	Ministerial services	311	741	741
1,511	Policy Support	1,982	1,717	1,717
5,434	**Total expenditure**	**6,222**	**6,175**	**6,174**
195	**Net surplus**	**-**	**-**	**1**

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

Output Class – Evaluation, audit and assessment of performance

Description

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

Objective

To satisfactorily complete an approved schedule of evaluations, audits and assessments, and conduct other audits and assessments as required by the Minister of Defence.

	2012/13	2013/14	
Performance Measures	**Actual**	**Budget**	**Actual**
Evaluations, audits and/or assessments are in accordance with work priorities identified and advised by the Minister of Defence.	New measure	Standard met	Standard met
Evaluations, audits and assessments follow the Ministry's quality assurance processes. Measured by an internal review of a random sample of reports produced in the year to assess if they comply with the Ministry's minimum quality assurance standards.	New measure	Standard met	Standard met
A review of the evaluations, audits and assessments confirm that they meet acceptable standards based on pre-determined criteria. The standard for this measure is based on a continuum of standard not met, standard met and standard exceeded.	New measure	Standard met	Standard met

Performance

The Ministry's Evaluation Division conducts strategic risk based assessments for the Minister of Defence, the Ministry and the NZDF. The Division's work programme:

- is derived from an overarching strategic evaluation framework set at Defence level;
- is determined using input from the strategic risk and assessment;
- is aligned to the Ministry's and NZDF's risk management and strategy priorities; and
- reflects Government priorities.

The Evaluation Division completed five reports and one briefing over the reporting period. As part of this, it communicated the results of the *Maximising Opportunities for Military Women in the New Zealand Defence Force* report to all camps and bases and has worked closely on the follow-up work with the NZDF.[8]

As at 30 June 2014, the Evaluation Division is undertaking four reports.

During this reporting period, the Evaluation Division completed a post-implementation review of its new business model, and led work on the Ministry's Knowledge Management and Shared Data strategies. It coordinated the Government's response for Transparency International's work on its Defence Anti Corruption Index.

[8] The evaluation report entitled *Maximising Opportunities for Military Women in the New Zealand Defence Force* is available from the Ministry's website at www.defence.govt.nz/reports-publications.html.

Cost of Output Class – Evaluation, audit and assessment of performance (GST exclusive)

For the year ended 30 June 2014

Actual 2013 $000		Main estimates 2014 $000	Supp* estimates 2014 $000	Actual 2014 $000
2,070	Total revenue	2,008	2,151	2,151
2,066	Total expenditure	2,008	2,151	2,149
4	**Net surplus**	**-**	**-**	**2**

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

Output Class – Management of equipment procurement

Description

The Ministry will acquire major military equipment in a transparent and fair way, and in accordance with government procurement policies. 'Major' means equipment that will have more than NZ$15 million whole-of-life cost. The Ministry is committed to providing competitive industries with the opportunity to support defence, and to ensuring that the Government and the taxpayer 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 the 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 to the NZDF; and
- the provision of advice to industry on defence requirements.

	2012/13	2013/14	
Performance Measures	**Actual**	**Budget**	**Actual**
Cost: Each procurement or refurbishment project will be managed within its approved budget, inclusive of approved variations to the contract price and project budget. The measure is the % of all project-related expenditure incurred in the year that is in excess of the approved project expenditure.	New measure	0%	0%[1]
Quality of deliverable: Each procurement or refurbishment project will achieve on delivery the agreed/contracted specifications that are critical to acceptance. This is measured by test, trial, evaluation, demonstration, independent audit or certification, and other measurements as agreed for each project. The measure is the number of accepted projects that do not meet all specifications that are critical to acceptance.	New measure	0	0[2]
Schedule: Each equipment procurement or refurbishment project will be managed to schedule, without avoidable schedule over-run. The measure is the % of all projects where, during the year, the project delivery schedule is extended by more than 10%.	New measure	<10%	25%[3]

Notes on performance measures:

1. Information on projects current underway is on the following pages.
2. Projects currently underway are anticipated to meet the agreed/contracted specifications and other contractual arrangements on the delivery of the capability.

3. Of the projects currently underway there are three that have been rescheduled to enable availability for operational purposes.

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 2014.

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 and 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 2014 have been translated to New Zealand dollars using Treasury fiscal reporting rates at balance date. The rates were:

AUD	0.93025	CAD	0.93465	EUR	0.64215	GBP	0.51445
JPY	88.75850	NOK	5.37060	SEK	5.90465	USD	0.87630

New projects that have received government approval:

Cabinet approved two new projects in 2013/14:

- In March 2014, Cabinet approved the Pilot Training Capability project to deliver basic and advanced pilot training for the RNZAF, with a total budget of $142.3 million. The package will include aircraft, training devices, maintenance and a pilot selection tool.
- In April 2014, Cabinet approved the ANZAC Frigate Systems Upgrade project, with a total budget of $446.2 million. This follows on from the Close-In Weapons Support and Platform Systems Upgrade as part of the ANZAC Frigates' mid-life upgrade. The work will restore the ships' combat capability to match current and future threats and will address obsolescence of some of the current systems.

Further detail about work on these projects in 2013/14 is set out below.

In addition to the two projects above, the acquisition aspects of the following projects, currently in the capability development phase, have been considered by Cabinet: Individual Weapon Replacement, Maritime Sustainment, and Underwater Intelligence, Surveillance & Reconnaissance.

The Ministry continued management of the following projects:

1. ANZAC Frigates' Platform Systems Upgrade

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

Phase 1: propulsion upgrade, stability enhancements and compartment enhancement elements were successfully integrated on both HMNZ ships *Te Kaha* and *Te Mana*, and phase 1 completed in 2010. The ships returned to operational service on time and within the approved phase 1 budget of $24.3 million.

Phase 2: The upgrade work on the integrated platform management systems (IPMS), and the heating, ventilation and air conditioning (HVAC) aboard HMNZS *Te Kaha* commenced in February 2013.

During the year the project fell behind schedule and incurred a significant increase in cost. In December 2013, Cabinet approved a $6 million increase in the appropriation in order to complete work on the first ship. In April 2014, Cabinet approved a further increase in appropriation to cover the work on the second ship, HMNZS *Te Mana.* The adjustments to appropriation were fiscally neutral and came from under spends in identified Defence projects, bringing the total appropriation for the PSU project to $87.6 million.

Phase 2 work on HMNZS *Te Kaha* is now due to finish in September 2014, and the upgrade of HMNZS *Te Mana* is expected to start in January 2015. The PSU project is now scheduled to complete in late 2016.

Objective	Performance
In 2013/14 it was planned to:	
HMNZS *Te Kaha*	
• Integrate, set to work and commission the HVAC systems.	• Subsequent to the schedule delay and cost increase the HVAC system has been installed and commissioning is underway.
• Integrate, set to work and commission the IPMS systems.	• Subsequent to the schedule delay and cost increase the IPMS system has been installed and commissioning is underway.
HMNZS *Te Mana*	
• Establish an integrated project team and undertake preliminary work prior to project commencement in January 2015.	• Integrated project team was established and commenced work plan in June 2014.

Project expenditure in 2013/14	Actual $000
Prime contract	8,045
Ancillary contracts	-
Project management	1,231
Total project expenditure in 2013/14	**9,276**

Total project cost summary As at 30 June 2014	Actual costs to 30 Jun 14 $000	Future commitments & forecasts ** $000	Estimated outturn 30 Jun 14 $000
Prime contract	53,315	5,316	58,631
Ancillary contracts	-	-	-
Project management	2,910	227	3,137
Production	-	22,200	22,200
Contingency	-	2,397	2,397
Project net expenditure	**56,225**	**30,140**	**86,365**
Effect of foreign exchange movements against the foreign exchange rates in the Cabinet approval favourable/(unfavourable)			1,235
			87,600
Project costs approved by Cabinet			**87,600**

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

2. ANZAC Frigates Systems Upgrade

The primary objective of the Frigate Systems Upgrade (FSU) project is to upgrade the ANZAC Frigates' combat capabilities to return their policy utility to the level provided on delivery. This is required to counter the combined problems of an increase in the level of sophistication of threats, coupled with obsolescence of certain systems. The project will dove-tail with the Platform Systems Upgrade.

Cabinet approved the Detailed Business Case in November 2012 and Requests for Tenders were released to industry in February and March 2013. In April 2014, Cabinet approved the Project Implementation Business Case, including NZ$446.2 million of capital expenditure between the Ministry and NZDF. Contracts were awarded to Lockheed Martin Canada (LMC) and others as required for equipment and services. Following due diligence activities, Cabinet approved LMC as the preferred Combat System Integrator.

Contract management and preliminary design work will be undertaken in the remainder of the 2014 calendar year.

Objective	Performance
In 2013/14 it was planned to:	
• Complete the evaluation of the responses to the Requests for Tender.	• Responses from five Combat System Integrators and 15 companies offering other systems were evaluated between May-August 2013.
• Undertake due diligence on the preferred tenderers.	• Due diligence conducted on preferred tenderers in August/ September 2013.

• Develop Requests for a Best and Final Offer (BAFO) if required.	• A Request for BAFO was issued to LMC in February 2014 to finalise system requirements and costs.
• Prepare and seek approval of the Project Implementation Business Case (PIBC).	• PIBC approved by Cabinet in April 2014.
• Prepare and negotiate contracts.	• Contracts were awarded in May-June 2014 to: – LMC as the Prime Systems Integrator; – ThyssenKrupp Marine Systems Australia for the preliminary design phase; – MBDA (UK) for the supply of Sea Ceptor missiles; – Thales (Australia) for the upgrade to the hull mounted sonar and supply and installation of a replacement underwater telephone.

Project expenditure in 2013/14	Actual $000
Prime contract	3,753
Ancillary contracts	4,240
Project management	637
Total project expenditure in 2013/14	**8,630**

Total project cost summary As at 30 June 2014	Actual costs to 30 Jun 14 $000	Future commitments & forecasts ** $000	Estimated outturn 30 Jun 14 $000
Prime contract	3,753	202,190	205,943
Ancillary contracts	4,240	163,301	167,541
Project management	637	11,533	12,171
Contingency	-	30,156	30,156
Project net expenditure	**8,630**	**407,180**	**415,811**
Effect of foreign exchange movements against the foreign exchange rates in the Cabinet approval favourable/(unfavourable)			14,792
			430,603
Project costs approved by Cabinet			**430,785**

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

3. Protector Remediation Project

Project Protector delivered a Multi-Role Vessel, two Offshore and four Inshore Patrol Vessels (OPVs and IPVs). These vessels were acquired to perform a range of sealift and naval patrol tasks for the NZDF and civilian agencies. The ships were delivered with capability shortfalls and deficiencies that were subject to a mediation claim and settlement.

These capability shortfalls and deficiencies are being remediated through the Protector Remediation Project. Solutions are being implemented in a staged fashion around the ships' operational commitments and maintenance periods, thereby minimising overheads. Ship work is projected to be complete in late 2015 with project closure in 2015/16.

Work has continued to plan throughout 2013/14, with major components installed on all vessels. All mission systems equipment has been delivered, with installation of gun systems on the OPVs substantially complete and with final commissioning and acceptance firings scheduled for September 2014. The overall project is scheduled for completion in June 2016.

Objective	Performance
In 2013/14 it was planned to:	
• Install ship Monitoring and Data Acquisition System throughout the fleet.	• All vessels have the systems installed and operating.
• Have the replacement gun and electro optical systems ready for installation on vessels.	• All gun and electro optical systems have been delivered. • Gun installation on HMNZS *Otago* and *Wellington* is advanced and will undergo acceptance firing in September 2014 as planned.
• Complete the communications detection systems factory acceptance test.	• First article testing has been completed and follow on systems are in production. • Installation of the systems commenced in July 2014 and is to be completed by June 2015.
• Complete design and production planning on HMNZS *Canterbury*.	• All design and preproduction work is complete for HMNZS *Canterbury* with the production period scheduled for September–December 2014.

Project expenditure in 2013/14	Actual $000
Prime work	5,013
Total project expenditure in 2013/14	**5,013**

Total project cost summary As at 30 June 2014	Actual costs to 30 Jun 14 $000	Future commitments & forecasts ** $000	Estimated outturn 30 Jun 14 $000
Primary work	42,060	15,763	57,823
Contingency	-	1,750	1,750
Project net expenditure	**42,060**	**17,513**	**59,573**
Project costs approved by Cabinet			**59,870**

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

4. Maritime Helicopter

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

Support facilities for the helicopters are expected to be completed, and the simulator and first aircraft delivered, in 2014/15. The final aircraft and the software support systems are expected to be delivered in the 2015 calendar year.

Objective	Performance
In 2013/14 it was planned to:	
• Regenerate the 10 helicopters from storage, make minor modifications for New Zealand's requirements and commence testing.	• The helicopters were regenerated from storage and the first tranche have completed modifications and commenced flight testing.

Project expenditure in 2013/14	Actual $000
Prime contract	20,873
Ancillary contracts	3,643
Project management	1,769
Total project expenditure in 2013/14	**26,285**

Total project cost summary As at 30 June 2014	Actual costs to 30 Jun 14 $000	Future commitments & forecasts ** $000	Estimated outturn 30 Jun 14 $000
Prime contract	38,236	102,905	141,141
Ancillary contracts	3,643	28,009	31,652
Project management	1,861	5,307	7,168
Contingency	-	20,873	20,873
Project net expenditure	**43,740**	**157,094**	**200,834**
Effect of foreign exchange movements against the foreign exchange rates in the Cabinet approval favourable/(unfavourable)			18,196
			219,030
Project costs approved by Cabinet			**220,342**

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

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

This project is extending the life of the five RNZAF C-130H Hercules aircraft by upgrading the aircrafts' mechanical and electrical equipment, undertaking comprehensive structural refurbishment work and performing an extensive upgrade of the communication and navigation systems.

The first aircraft was scheduled to be completed in 2008, with the final aircraft originally scheduled to be completed in 2011. The programme is running more than three years late as a result of significant contractual and technical difficulties including the closedown of the original overseas prime contractor. The Woodbourne facility was established by the Ministry to continue the refurbishment of the remaining three aircraft. It has now completed the first and 95% of the second aircraft, as at 30 June 2014. Experience gained on the first aircraft is proving invaluable as work continues on the remaining two aircraft. The first three completed aircraft are delivering outputs for NZDF transport requirements.

The fourth aircraft is expected to be delivered in the 2014 calendar year. The fifth and final aircraft and final software is expected to be delivered in the 2015 calendar year.

Objective	Performance
In 2013/14 it was planned to:	
• Deliver the fourth (second production) aircraft in August 2014.	• On track for delivery in August 2014.
• Deliver the fifth (final production) aircraft in August 2015.	• Planned for delivery in August 2015.

Project expenditure in 2013/14	Actual $000
Prime contract	289
Production and Part Task Trainer	6,949
Ancillary contracts	67
Project management	45
Total project expenditure in 2013/14	**7,350**

Total project cost summary As at 30 June 2014	Actual costs to 30 Jun 14 $000	Future commitments & forecasts ** $000	Estimated outturn 30 Jun 14 $000
Prime contract	215,441	267	215,708
Production and Part Task Trainer	23,651	6,416	30,067
Ancillary contracts	6,367	264	6,631
Project management	8,341	556	8,897
Contingency	-	-	-
Project net expenditure	**253,800**	**7,503**	**261,303**
Effect of foreign exchange movements against the foreign exchange rates in the Cabinet approval favourable/(unfavourable)			3,402
			264,705
Project costs approved by Cabinet			**264,789**

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

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

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

The first aircraft, originally scheduled to be delivered in June 2008, was provisionally accepted in April 2011. Significant delays to this first aircraft were caused by the late delivery of the radar, problems with the integration of individual sensors, software issues, and structural, aerodynamic and serviceability problems with the prototype aircraft.

Following the provisional acceptance of the prototype aircraft, Defence negotiated a further six-month extension to the upgrade of the last two aircraft to enable the Orion fleet to maintain capability until the upgraded aircraft could be introduced into service.

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

Upgraded aircraft are now providing search and rescue and maritime surveillance tasks. Final software delivery is expected in 2014/15.

Objective	Performance
In 2013/14 it was planned to:	
• Deliver the fifth aircraft in late 2013.	• Delivered in early 2014.
• Deliver the sixth aircraft in mid 2014.	• The aircraft was delivered in July 2014.

Project expenditure in 2013/14	Actual $000
Prime contract	7,623
Ancillary contracts	606
Project management	490
Total project expenditure in 2013/14	**8,719**

Total project cost summary As at 30 June 2014	Actual costs to 30 Jun 14 $000	Future commitments & forecasts ** $000	Estimated outturn 30 Jun 14 $000
Prime contract	304,385	4,747	309,132
Ancillary contracts	12,243	-	12,243
Project management	8,798	522	9,320
Contingency	-	703	703
Project net expenditure	**325,426**	**5,972**	**331,398**
Effect of foreign exchange movements against the foreign exchange rates in the Cabinet approval favourable/(unfavourable)			43,953
			375,351
Project costs approved by Cabinet			**377,288**

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

7. Replacement Helicopter Capability: Medium Utility Helicopter

This project covers the acquisition of eight operational NH90 helicopters. These helicopters will be delivered to the NZDF between 2011 and 2014.

Helicopter 08 is expected to be delivered and accepted in the 2014 calendar year. The final stage of the project is expected to be implemented in 2014/15.

Objective	Performance
In 2013/14 it was planned to:	
• Complete retro-fit from interim to final configuration for helicopters 01–04.	• The retrofit was completed in July 2014.
• Deliver helicopters 07 and 08 in final configuration.	• Helicopter 07 delivered. Helicopter 08 delayed at manufacturers.
• Complete technical acceptance of electronic technical publications.	• Completed.

Project expenditure in 2013/14	Actual $000
Prime contract	30,730
Ancillary contracts	4,924
Project management	966
Total project expenditure in 2013/14	**36,620**

Total project cost summary **As at 30 June 2014**	Actual costs to 30 Jun 14 $000	Future commitments & forecasts ** $000	Estimated outturn 30 Jun 14 $000
Prime contract	609,441	25,766	635,207
Ancillary contracts	15,461	9,471	24,932
Project management	12,550	545	13,095
Contingency	-	3,785	3,785
Project net expenditure	**637,452**	**39,567**	**677,019**
Effect of foreign exchange movements against the foreign exchange rates in the Cabinet approval favourable/(unfavourable)			94,663
			771,682
Project costs approved by Cabinet			**771,710**

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

8. Replacement Helicopter Capability: Training/Light Utility Helicopter

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

Final aspects of the project are being worked through ahead of project closure in 2014/15,

Objective	Performance
In 2013/14 it was planned to:	
• Complete the 'final retrofit' of helicopters 1–5 to Qualification Review 3 (QR3) configuration.	• Problems identified with the QR3 software were remedied by AgustaWestland during the period and retrofitted in November 2013.
• Complete acceptance of the Flight Planning System (FPS) software.	• Following further development on the FPS undertaken by AgustaWestland the software was accepted by the Crown after final testing in July 2013.
• Close the project.	• The late delivery of the two major software deliverables above has delayed the closure of the project. Preparations for closing the project in 2014/15 are underway.

Project expenditure in 2013/14	Actual $000
Prime contract	4,768
Ancillary contracts	606
Project management	5
Total project expenditure in 2013/14	**5,379**

Total project cost summary As at 30 June 2014	Actual costs to 30 Jun 14 $000	Future commitments & forecasts ** $000	Estimated outturn 30 Jun 14 $000
Prime contract	118,986	-	118,986
Ancillary contracts	4,533	926	5,459
Project management	5,453	78	5,531
Contingency	-	2,224	2,224
Project net expenditure	**128,972**	**3,228**	**132,200**
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval favourable/(unfavourable)			4,023
			136,223
Project costs approved by Cabinet			**140,529**

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

9. Pilot Training Capability

This project is providing an upgraded capability for RNZAF Pilot training consisting of 11 aircraft, two simulators, an integrated training package and on-going logistics support. The project was approved by Cabinet in March 2014 with a total budget of $142.3 million. The aircraft are being acquired from Beechcraft LLC, Simulators and training packages from CAE and logistics support for the aircraft will be provided by Safe Air Ltd. In all cases Beechcraft is the Prime contractor for both the acquisition contract and the support contract.

The aircraft and simulators are expected to be delivered in 2014/15.

Objective	Performance
In 2013/14 it was planned to:	
• Complete contract signature for the solution by end December 2013.	• Contract signature for both the Acquisition and the Logistics Support contract was completed 24 January 2014.

Project expenditure in 2013/14	Actual $000
Prime contract	73,260
Ancillary contracts	60
Project management	622
Total project expenditure in 2013/14	**73,942**

Total project cost summary **As at 30 June 2014**	Actual costs to 30 Jun 14 $000	Future commitments & forecasts ** $000	Estimated outturn 30 Jun 14 $000
Prime contract	73,260	44,978	118,238
Ancillary contracts	60	982	1,042
Project management	622	2,982	3,604
Contingency	-	13,507	13,507
Project net expenditure	**73,942**	**62,449**	**136,391**
Effect of foreign exchange movements against the foreign exchange rates in the Cabinet approval favourable/(unfavourable)			5,949
			142,340
Project costs approved by Cabinet			**142,340**

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

10. Medium and Heavy Operating Vehicles

The Medium and Heavy Operational Vehicles (MHOVs) project is part of the Land Transport Capability Programme. This project will provide the NZDF with a fully supported and enhanced land mobility capability consisting of a range of medium and heavy trucks appropriate to meet the challenges of the contemporary operating environment and future operating concepts. Joint Ministers approved the procurement of up to 200 MHOVs with Rheinmetal MAN Military Vehicles Australia in March 2013, following authorisation from Cabinet in December 2012, at a total cost of up to $112.7 million. Apart from some minor modifications, the purchase was largely off-the-shelf and utilised a current run of production for the British Army.

MHOV deliveries are scheduled to be completed in the 2014 calendar year.

Objective	Performance
In 2013/14 it was planned to:	
• Deliver vehicles in accordance with agreed schedules.	• 130 vehicles were delivered and 62 were in transit by end of June 2014.

Project expenditure in 2013/14	Actual $000
Prime contract	80,842
Ancillary contracts	152
Project management	226
Total project expenditure in 2013/14	**81,220**

Total project cost summary As at 30 June 2014	Actual costs to 30 Jun 14 $000	Future commitments & forecasts ** $000	Estimated outturn 30 Jun 14 $000
Prime contract	80,842	13,299	94,141
Ancillary contracts	152	9,888	10,040
Project management	226	363	589
Contingency	-	1,328	1,328
Project net expenditure	**81,220**	**24,878**	**106,098**
Effect of foreign exchange movements against the foreign exchange rates in the Cabinet approval favourable/(unfavourable)			4,801
			110,899
Project costs approved by Cabinet			**112,637**

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

11. Defence Command and Control System

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

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

The project is expected to be completed in the 2015 calendar year.

Objective	Performance
In 2013/14 it was planned to:	
• Subject to Cabinet approval, extend the scope to include GCCS (Joint).	• Cabinet approval issued 30 October 2013. Phase 1 Pilot Installation implemented in March–June 2014.
• Complete implementation of a cross-domain system between two NZDF networks.	• Completed April 2014.
• Complete implementation of GCCS-M onto RNZN ships.	• The objective was modified in October 2013 so that the product to be installed is GCCS-J. Ship installs of GCCS-J are to be completed by June 2015.

Project expenditure in 2012/13	Actual $000
Prime contract	2,306
Ancillary contracts	1,927
Project management	313
Total project expenditure in 2012/13	**4,546**

Total project cost summary **As at 30 June 2014**	Actual costs to 30 Jun 14 $000	Future commitments & forecasts ** $000	Estimated outturn 30 Jun 14 $000
Prime contract	5,189	1,777	6,966
Ancillary contracts	2,970	7,543	10,513
Project management	961	748	1,709
Contingency	-	3,432	3,432
Project net expenditure	**9,120**	**13,500**	**22,620**
Effect of foreign exchange movements against the foreign exchange rates in the Cabinet approval favourable/(unfavourable)			677
			23,297
Project costs approved by Cabinet			**23,559**

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

12. Strategic Bearer Network – Phase 1

Phase 1 of this project will deliver global wide-band (high capacity) Satellite Communications (SATCOM) services to the NZDF. The United States Department of Defense (DOD) Wideband Global SATCOM System (WGS) was identified as the preferred solution and a Memorandum of Understanding to access this constellation was signed with the DOD in January 2012. The infrastructure (mobile land based terminals, maritime terminals and fixed anchor stations) required to access the satellites will be delivered by the Strategic Bearer Network Phase 1 acquisition project managed by the Ministry. A second phase to address the narrow-band (less capacity but more mobile) solution is yet to begin acquisition.

Budget appropriations to the Ministry for the infrastructure acquisition phase were approved for a start in 2012/13. Funding for additional terminals in 2022 has yet to be appropriated.

Implementation of the phase 1 WGS is expected to be completed by the end of 2016.

Objective	Performance
In 2013/14 it was planned to:	
• Deliver an Interim Operational Capability to the NZDF.	• This is expected to be declared in July 2014 and includes the first Anchor Station (operational from April 2014).
• Contract for Maritime Terminals.	• Tender has been completed and contracts are under negotiation for signature in July 2014.

Project expenditure in 2013/14	Actual $000
Prime contract	6,156
Ancillary contracts	0
Project management	418
Total project expenditure in 2013/14	**6,574**

Total project cost summary As at 30 June 2014	Actual costs to 30 Jun 14 $000	Future commitments & forecasts ** $000	Estimated outturn 30 Jun 14 $000
Prime contract	10,473	13,640	24,113
Ancillary contracts	-	-	-
Project management	688	250	938
Contingency	-	-	-
Project net expenditure	**11,161**	**13,890**	**25,051**
Effect of foreign exchange movements against the foreign exchange rates in the Cabinet approval favourable/(unfavourable)			
			25,051
Project costs approved by Cabinet			**26,310**

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

Defence industry

Objective

The Ministry will:

- continue to facilitate effective communication between Defence and New Zealand industries to provide appropriate goods and services as required;
- provide support for the New Zealand Defence Industry Advisory Council (NZDIAC) (formerly known as 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 Rules of Sourcing* issued by the Ministry of Business Innovation and Employment, and the Office of the Controller and Auditor-General's *Procurement guidance for public entities*; and
- conduct industry briefing sessions on current defence projects and activities.

Performance

The Ministry presented the current status of projects at the Defence Industry Conference held in Wellington in November 2013.

Support was provided for the NZDIAC at meetings held in 2013/14. Industry groups have been regularly updated on project opportunities and progress.

A new initiative has been implemented whereby the Ministry publishes the respondents to Requests for Information (issued to inform the Detailed Business Case) to enable New Zealand industry to engage with potential prime contractors at an early stage in a project's life.

The following requests for tenders, proposals and information were issued to industry during the reporting period:

- Individual Weapons Capability – Request for Information;
- Littoral Operations Support Capability Project – Request for Information;
- Strategic Bearer Network Project: Acquisition of Wideband Global Satellite Communications Equipment for Maritime Users – Request for Tender.

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; and
- the NZDIAC will be asked to confirm annually that the Ministry and its agent, the Industry Capability Network, have appropriately notified 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; and
- maintaining ISO 9001 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 the Government's approval is received. Payments to suppliers are made following achievement of agreed contract milestones at the contracted price but are partially or completely withheld when delays or specification shortfalls occur.

The financial summaries of project costs include a valuation of future commitments and forecasts using the exchange rates as at 30 June 2014. The financial summary for each project indicates that each project will be acquired within 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 timeframes can be addressed.

The NZDIAC confirms with the Industry Capability Network that it has promoted domestic suppliers to overseas-based prime contractors. Where the NZDIAC 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 Capability Management Board and NZDIAC 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 2014

Actual 2013 $000		Main estimates 2014 $000	Supp estimates 2014 $000	Actual 2014 $000
5,821	Total revenue	5,390	5,294	5,258
5,787	Total expenditure	5,390	5,294	5,255
34	**Net surplus**	**-**	**-**	**3**

Non-departmental project financial performance

For the year ended 30 June 2014

Actual 2013 $000		Main estimates 2014 $000	Supp* estimates 2014 $000	Actual 2014 $000
	Vote: Defence			
	Capital receipts			
176,315	Sale of defence equipment to NZDF	219,730	286,600	273,572
176,315		**219,730**	**286,600**	**273,572**
	Capital expenditure			
132,789	Purchase of defence equipment	226,665	286,600	273,572
132,789		**226,665**	**286,600**	**273,572**

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

Part 4: Departmental financial statements

Statement of comprehensive income

For the year ended 30 June 2014

Actual 2013 $000		Note	Main estimates 2014 $000	Supp estimates 2014 $000	Actual 2014 $000	Forecast unaudited IPSAS 2015 $000
	Income					
11,366	Revenue Crown		12,116	12,116	12,116	11,566
2,154	Revenue other	**2**	1,504	1,504	1,484	1,756
13,520	*Total income*		13,620	13,620	13,600	13,322
	Expenditure					
7,681	Personnel expenses	**3**	8,235	8,405	7,984	8,385
5,025	Operating expenses	**5**	4,700	4,567	5,007	4,289
308	Depreciation and amortisation expense	**7,8**	412	375	359	375
273	Capital charge	**4**	273	273	228	273
13,287	*Total expenditure*		13,620	13,620	13,578	13,322
233	**Total comprehensive income**		**-**	**-**	**22**	**-**

The accompanying notes form part of these financial statements.

The forecast amounts are based on the Ministry's budget for 2014/15 updated for Cabinet funding approvals and actual financial results to 30 June 2014, as described in note 1.

Explanations of major variances against the Main and Supplementary Estimates are shown in note 18.

Statement of financial position

As at 30 June 2014

Actual 2013 $000		Note	Main estimates 2014 $000	Supp estimates 2014 $000	Actual 2014 $000	Forecast unaudited IPSAS 2015 $000
	Assets					
	Current assets					
3,763	Cash and cash equivalents		2,902	3,434	4,429	3,489
808	Debtors and other receivables	**6**	-	160	137	160
8	Prepayments		-	-	2	-
4,579	*Total current assets*		2,902	3,594	4,568	3,649
	Non-current assets					
1,596	Property, plant and equipment	**7**	1,506	1,471	1,248	1,338
86	Intangible assets	**8**	364	189	36	267
1,682	*Total non-current assets*		1,870	1,660	1,284	1,605
6,261	***Total assets***		**4,772**	**5,254**	**5,852**	**5,254**
	Liabilities					
	Current liabilities					
1,591	Creditors and other payables	**9**	523	806	1,505	806
233	Repayment of surplus	**10**	-	-	22	-
678	Employee entitlements	**11**	486	650	639	650
2,502	*Total current liabilities*		1,009	1,456	2,166	1,456
	Non-current liabilities					
343	Employee entitlements	**11**	347	382	270	382
343	*Total non-current liabilities*		347	382	270	382
2,845	***Total liabilities***		**1,356**	**1,838**	**2,436**	**1,838**
3,416	**Net assets**		**3,416**	**3,416**	**3,416**	**3,416**
	Equity					
3,416	General funds	**12**	3,416	3,416	3,416	3,416
3,416	**Total equity funds**		**3,416**	**3,416**	**3,416**	**3,416**

The accompanying notes form part of these financial statements.

The forecast amounts are based on the Ministry's budget for 2014/15 updated for Cabinet funding approvals and actual financial results to 30 June 2014, as described in note 1.

Explanations of major variances against the Main and Supplementary Estimates are shown in note 18.

Statement of changes in equity

For the year ended 30 June 2014

Actual 2013 $000		Note	Main estimates 2014 $000	Supp estimates 2014 $000	Actual 2014 $000	Forecast unaudited IPSAS 2015 $000
3,416	**Balance at 1 July**		3,416	3,416	3,416	3,416
233	Total comprehensive income		-	-	22	-
(233)	Return of surplus to the Crown	**10**	-	-	(22)	-
-	Capital injection		-	-	-	-
-	Capital withdrawals		-	-	-	-
3,416	**Balance at 30 June**	**12**	**3,416**	**3,416**	**3,416**	**3,416**

The accompanying notes form part of these financial statements.

The forecast amounts are based on the Ministry's budget for 2014/15 updated for Cabinet funding approvals and actual financial results to 30 June 2014, as described in note 1.

Explanations of major variances against the Main and Supplementary Estimates are shown in note 18.

Statement of cash flows

For the year ended 30 June 2014

Actual 2013 $000		Note	Main estimates 2014 $000	Supp estimates 2014 $000	Actual 2014 $000	Forecast unaudited IPSAS 2015 $000
	Cash flows from operating activities					
11,366	Receipts from Crown		12,116	12,116	12,116	11,566
1,479	Receipts from revenue other		1,504	2,161	2,055	1,756
(7,475)	Payments to employees		(8,069)	(8,130)	(8,062)	(8,130)
(4,581)	Payments to suppliers		(4,866)	(5,443)	(4,958)	(5,517)
(273)	Payments for capital charge		(273)	(273)	(228)	(273)
148	Goods and services tax (net)		-	(177)	10	-
664	*Net cash flow from operating activities*	**13**	412	254	933	(598)
	Cash flows from investing activities					
-	Receipts from sale of property, plant and equipment				-	-
(19)	Purchase of property, plant and equipment		(150)	(150)	(19)	(142)
(26)	Purchase of intangible assets		(200)	(200)	(15)	(178)
(45)	*Net cash flow from investing activities*		(350)	(350)	(34)	(320)
	Cash flows from financing activities					
(52)	Repayment of surplus		-	(233)	(233)	(22)
(52)	*Net cash flow from financing activities*		-	(233)	(233)	(22)
567	**Net increase/(decrease) in cash**		**62**	**(329)**	**666**	**(940)**
3,196	Cash at the beginning of the year		2,840	3,763	3,763	4,429
3,763	**Cash at the end of the year**		**2,902**	**3,434**	**4,429**	**3,489**

The Goods and Services Tax (net) component of operating activities reflects the net GST paid and received with the Inland Revenue Department. This is 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.

The forecast amounts are based on the Ministry's budget for 2014/15 updated for Cabinet funding approvals and actual financial results to 30 June 2014, as described in note 1.

Explanations of major variances against the Main and Supplementary Estimates are shown in note 18.

Statement of commitments

As at 30 June 2014

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 (2013 - Nil).

Non-cancellable operating lease commitments

The Ministry leases property, plant and equipment in the normal course of its business. The lease of premises in Freyberg House has a non-cancellable leasing period of around 11 years remaining.

Actual 2013 $000		Actual 2014 $000
	Non-cancellable operating lease commitments	
512	Not later than one year	494
512	Later than one year and not later than two years	494
1,536	Later than two years and not later than five years	1,482
3,413	Later than five years	2,803
5,973	*Total non-cancellable operating lease commitments*	5,273
5,973	**Total commitments**	**5,273**

Statement of contingent liabilities and contingent assets

As at 30 June 2014

Contingent liabilities

The Ministry has no contingent liabilities (2013 – Nil).

Contingent assets

The Ministry has no contingent assets (2013 – Nil).

Guarantees and indemnities

No guarantees and indemnities have been given outside the normal course of business (2013 – Nil).

The accompanying notes form part of these financial statements.

Statement of departmental output expenses and capital expenditure against appropriations

For the year ended 30 June 2014

Actual 2013 $000		Main estimates 2014 $000	Supp estimates 2014 $000	Actual 2014 $000	Forecast unaudited IPSAS 2015 $000
	Vote: Defence				
	Appropriations for output expenses				
	Policy advice and related outputs MCOA **				
3,271	Policy advice	3,929	3,717	3,716	3,593
652	Ministerial services	311	741	741	717
1,511	Policy support	1,982	1,717	1,717	1,660
5,434	Total policy advice and related outputs MCOA **	6,222	6,175	6,174	5,970
2,066	Evaluation, audit and assessment of performance	2,008	2,151	2,149	1,927
5,787	Management of equipment procurement	5,390	5,294	5,255	5,425
13,287	**Total appropriations for output expenses**	**13,620**	**13,620**	**13,578**	**13,322**
	Appropriations for capital expenditure				
45	Capital expenditure	350	560	32	320
45	**Total appropriations for capital expenditure**	**350**	**560**	**32**	**320**

* The Supplementary Estimates amounts presented in this table include transfers made under section 26A of the Public Finance Act 1989, as shown in note 19.

** The policy advice and related outputs multi-class output appropriation (MCOA) will transition to a multi-category appropriation (MCA) for the 2014/15 year. The 2015 forecast presents the MCA compared to the 2014 MCOA as there is no change in the composition of the appropriations and they are directly analogous.

Statement of departmental unappropriated expenditure and capital expenditure

For the year ended 30 June 2014

The Ministry has no instances of departmental unappropriated expenditure and no breaches of projected departmental net asset schedules (2013 – Nil).

The accompanying notes form part of these financial statements.

The forecast amounts are based on the Ministry's budget for 2014/15 updated for Cabinet funding approvals and actual financial results to 30 June 2014, as described in note 1.

Notes to the financial statements

For the year ended 30 June 2014

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 applying New Zealand equivalents to International Financial Reporting Standards (NZ IFRS).

The financial statements of the Ministry are for the year ended 30 June 2014. The financial statements were authorised for issue by the Chief Executive of the Ministry on 11 September 2014.

Basis of preparation

Statement of compliance

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

These financial statements have been prepared in accordance with NZ GAAP. Except for the forecast financial statements, they comply with NZ IFRS and other applicable financial reporting standards as appropriate for public benefit entities.

Forecast financial statements have been prepared in accordance with Public Benefit Entity Accounting Standards, as described in the Forecast section below. The forecast financial statements have not been audited.

Measurement base

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

Functional and presentation currency

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

Changes in accounting policies

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

The Ministry will adopt the new Public Benefit Entity Accounting Standards (PAS) from 1 July 2014. This means the Ministry will transition to the new standards in preparing 30 June 2015 financial statements. The Ministry does not expect any differences between NZ IFRS and PAS to have a material impact on the financial statements.

Due to the change in the Accounting Standards Framework for public benefit entities, it is expected that all new NZ IFRS amendments to existing NZ IFRS will not be applicable to public benefit entities. Therefore, the External Reporting Board (XRB) has effectively frozen the financial reporting requirements for public benefit entities up until the new Accounting Standard Framework is effective. Accordingly, no disclosure has been made about new or amended NZ IFRS that exclude public benefit entities from their scope.

Budget figures

The budget figures ("Main estimates") are those included in the Information Supporting the Estimates of Appropriations for the Government of New Zealand for the year ending 30 June 2014, which are consistent with the financial information in the Main Estimates.

In addition, the financial statements also present the updated budget information from the Supplementary Estimates ("Supp estimates"). This includes transfers made under section 26A of the Public Finance Act 1989, as shown in note 19.

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

Forecast

The Ministry is required by the Public Finance Act to present forecast financial statements for the financial year following the financial year to which the Annual Report relates. The forecast financial statements ("Forecast") are prepared in accordance with NZ FRS-42 Prospective Financial Statements. As the Ministry will adopt Public Benefit Entity Accounting Standards for the 2014/15 financial year the forecast financial information is prepared in accordance with those standards.

The forecast financial statements are based on the Ministry's budget for 2014/15 as approved in the Estimates of Appropriations for 2014/15, updated for:

- subsequent Cabinet funding approvals;
- actual financial results to 30 June 2014.

The significant assumptions underlying the forecast financial statements are:

- the functions performed and the appropriations administered by the Ministry will not change over the forecast period;
- the Ministry will not receive any additional funding during the forecast period.

The forecast financial statements were authorised for issue by the Chief Executive of the Ministry on 10 September 2014.

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

The forecast financial statements have not been audited.

Significant accounting policies

Revenue

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

Revenue Crown

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.

Foreign currency transactions

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

Operating leases

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

Financial instruments

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

Cash and cash equivalents

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

Debtors and other receivables

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

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

Property, plant and equipment

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

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

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

Additions

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

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

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

Disposals

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

Subsequent costs

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

Depreciation

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

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

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

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

Intangible assets

Software acquisition

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

Staff training costs are recognised as an expense when incurred.

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

Amortisation

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

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

Acquired computer software	3-5 years

Impairment of property, plant and equipment and intangible assets

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

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

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

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

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

Creditors and other payables

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

Employee entitlements

Short-term employee entitlements

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

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

Long-term employee entitlements

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

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

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

Presentation of employee entitlements

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

Superannuation schemes

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

Provisions

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

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

Equity

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

Goods and Services Tax (GST)

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

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

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

Commitments and contingencies are disclosed exclusive of GST.

Income tax

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

Statement of cost accounting policies

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

- Criteria for direct and indirect costs
  - "Direct costs" are those costs directly attributed to an output.
  - “Indirect costs” are those costs that cannot be identified in an economically feasible manner with a specific output.
- Direct costs assigned to outputs
  - Direct costs are assigned to outputs by charging payments to specific job numbers. Selection of a “general cost” job number within an output class will treat the expense as a direct cost to the output class even though a specific job within the output class has not been identified.
  - For the year ended 30 June 2014, direct costs accounted for 64% of the Ministry's costs (30 June 2013 – 68%).
- 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 2014, indirect costs accounted for 36% of the Ministry's costs (30 June 2013 – 32%).

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

Critical accounting estimates and assumptions

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

Critical judgements in applying the Ministry's accounting policies

Management has not exercised any critical judgements in applying the Ministry's accounting policies for the period ended 30 June 2014.

Note 2: Other revenue

Actual 2013 $000		Main estimates 2014 $000	Actual 2014 $000	Forecast unaudited IPSAS 2015 $000
2,143	Pre-acquisition project costs from NZ Defence Force	1,504	1,468	1,756
11	Other	-	16	-
2,154	**Total other revenue**	**1,504**	**1,484**	**1,756**

Note 3: Personnel expenses

Actual 2013 $000		Main estimates 2014 $000	Actual 2014 $000	Forecast unaudited IPSAS 2015 $000
7,204	Salaries and wages	7,834	7,639	7,907
290	Employer contributions to defined contribution plans	291	319	348
187	Increase/(decrease) in employee entitlements	110	26	130
7,681	**Total personnel expenses**	**8,235**	**7,984**	**8,385**

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 equity as at 30 June and 31 December each year. The capital charge rate for the year ended 30 June 2014 was 8% (2013 – 8%).

Note 5: Operating expenses

Actual 2013 $000		Main* estimates 2014 $000	Actual** 2014 $000	Forecast unaudited IPSAS 2015 $000
95	Audit fees for financial statements	98	98	105
919	Consultancy	1,920	1,153	1,627
1,413	Professional services	-	560	318
454	Travel and related costs	488	771	493
125	Courses, conferences and exhibitions	69	258	157
705	Rental of premises	529	599	587
513	Legal	237	397	260
108	Grants and contributions	90	67	60
693	Other operating costs	1,269	1,104	682
5,025	**Total operating expenses**	**4,700**	**5,007**	**4,289**

* Operating expenses have been disaggregated from the presentation in the Information Supporting the Estimates to be consistent with the disclosure in the Annual Report.

** Early identification of cost savings from personnel expenses allowed the Ministry to utilise these savings to advance work on implementing the recommendations of the Performance Improvement Framework review, which increased this category of expenses while remaining within the total appropriation.

Note 6: Debtors and other receivables

Actual 2013 $000		Main estimates 2014 $000	Actual 2014 $000
808	Debtors	-	137
-	Less provision for impairment	-	-
808	Net debtors	-	137
-	GST receivable	-	-
808	**Total debtors and other receivables**	**-**	**137**

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

As at 30 June 2014 and 2013, all overdue receivables were assessed for impairment and appropriate provisions applied, as detailed below:

	2013			2014		
	Gross $000	Impairment $000	Net $000	Gross $000	Impairment $000	Net $000
Not past due	808	-	808	137	-	137
Past due 1-30 days	-	-	-	-	-	-
Past due 31-60 days	-	-	-	-	-	-
Past due 61-90 days	-	-	-	-	-	-
Past due > 91 days	-	-	-	-	-	-
Total	**808**	**-**	**808**	**137**	**-**	**137**

Note 7: Property, plant and equipment

	Main estimates Total $000	Actual 2014 Leasehold improvements $000	Actual 2014 Office furniture $000	Actual 2014 Office and computer equipment $000	Actual 2014 Total $000
Cost or valuation					
Balance at 1 July 2012	4,013	2,574	111	1,327	4,012
Additions	147	-	12	6	18
Disposals	-	-	-	(189)	(189)
Balance at 30 June 2013	**4,160**	**2,574**	**123**	**1,144**	**3,841**
Balance at 1 July 2013	4,160	2,574	123	1,144	3,841
Additions	147	-	-	18	18
Disposals	-	-	-	(390)	(390)
Transfers	-	6	(6)	-	-
Balance at 30 June 2014	**4,307**	**2,580**	**117**	**772**	**3,469**
Accumulated depreciation and impairment losses					
Balance at 1 July 2012	2,185	951	46	1,186	2,183
Depreciation expense	308	188	7	56	251
Eliminate on disposal	-	-	-	(189)	(189)
Balance at 30 June 2013	**2,493**	**1,139**	**53**	**1,053**	**2,245**
Balance at 1 July 2013	2,493	1,139	53	1,053	2,245
Depreciation expense	308	271	9	42	322
Eliminate on disposal	-	-	-	(346)	(346)
Balance at 30 June 2014	**2,801**	**1,410**	**62**	**749**	**2,221**
Carrying amounts					
At 30 June and 1 July 2013	1,667	1,435	70	91	1,596
At 30 June 2014	1,506	1,170	55	23	1,248

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

Note 8: Intangible assets

	Main estimates Total $000	Actual 2014 Acquired software $000	Total $000
Cost			
Balance at 1 July 2012	941	942	942
Additions	253	27	27
Disposals	-	-	-
Balance at 30 June 2013	**1,194**	**969**	**969**
Balance at 1 July 2013	1,194	969	969
Additions	203	14	14
Disposals	-	(27)	(27)
Balance at 30 June 2014	**1,397**	**956**	**956**
Accumulated amortisation and impairment losses			
Balance at 1 July 2012	825	826	826
Amortisation expense	104	57	57
Disposals	-	-	-
Balance at 30 June 2013	**929**	**883**	**883**
Balance at 1 July 2013	929	883	883
Amortisation expense	104	37	37
Disposals	-	-	-
Balance at 30 June 2014	**1,033**	**920**	**920**
Carrying amounts			
At 30 June and 1 July 2013	265	86	86
At 30 June 2014	364	36	36

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 2013 $000		Main estimates $000	Actual 2014 $000
912	Creditors	105	496
454	Accrued expenses	370	805
225	GST payable	48	204
1,591	**Total creditors and other payables**	**523**	**1,505**

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

Note 10: Return of operating surplus

Actual 2013 $000		Actual 2014 $000
233	Net surplus/(deficit)	22
233	**Total repayment of surplus**	**22**

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

Note 11: Employee entitlements

Actual 2013 $000		Main estimates 2014 $000	Actual 2014 $000
	Current provisions are represented by:		
642	Annual leave	484	610
4	Sick leave	2	3
32	Retirement and long service leave	-	26
678	*Total current provision*	486	639
	Non-current employee entitlements are represented by:		
343	Retirement and long service leave	347	270
1,021	**Total employee entitlements**	**833**	**909**

Note 12: Equity

Actual 2013 $000		Actual 2014 $000
	Taxpayers' funds	
3,416	Balance at 1 July	3,416
233	Net surplus/(deficit)	22
-	Capital contribution from the Crown	-
(233)	Provision for repayment of surplus to the Crown	(22)
3,416	**Taxpayers' funds at 30 June**	**3,416**

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

Actual 2013 $000		Main estimates 2014 $000	Actual 2014 $000
233	**Net Surplus/(deficit)**	-	22
	Add/(less) non-cash items:		
308	Depreciation and amortisation expense	412	359
-	Loss on disposal of property, plant and equipment	-	73
74	Increase/(decrease) in non current employee entitlements	-	(73)
382	Total non-cash items	412	359
	Add/(less) movements in working capital items:		
(786)	(Increase)/decrease in debtors and other receivables	-	671
(8)	(Increase)/decrease in prepayments	-	6
730	Increase/(decrease) in creditors and other payables	-	(86)
113	Increase/(decrease) in current employee entitlements	-	(39)
49	Net movements in working capital items	-	552
664	**Net cash from operating activities**	**412**	**933**

Note 14: Related party transactions and key management personnel

Related party transactions

All related party transactions have been entered into on an arms' length basis.

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.

Significant transactions with government-related entities

The Ministry has received funding from the Crown of $12.116 million (2013 – $11.366 million) to provide services to the public for the year ended 30 June 2014.

The Ministry received funding from the NZDF of $1,468 million (2013 – $2.143 million) to reimburse costs incurred in advancing acquisition projects to the contract stage (pre-acquisition costs).

Collectively, but not individually significant transactions with government-related entities

In conducting its activities, the Ministry is required to pay various taxes and levies (such as GST, FBT, PAYE, and ACC levies) to the Crown and entities related to the Crown. The payment of these taxes and levies, other than income tax, is based on the standard terms and conditions that apply to all tax and levy payers. The Ministry is exempt from paying income tax.

The Ministry also purchases goods and services from entities controlled, significantly influenced, or jointly controlled by the Crown. Purchases from these government-related entities for the year ended 30 June 2014 totalled $1.796 million (2013 – $1.684 million). These purchases included the purchase of air travel from Air New Zealand, legal services from Crown Law Office, accommodation and international defence relations from the NZDF and postal services from New Zealand Post.

Key management personnel compensation

Actual 2013 $000		Actual 2014 $000
1,502	Salaries and other short-term employee benefits	1,678
50	Post employment benefits	58
-	Termination benefits	104
-	Other long term benefits	-
1,552	**Total key management personnel compensation**	**1,840**

Key management personnel include the Chief Executive and the five members (2013 – six) of the Senior Management Group (Deputy Secretaries and the Director of Strategy and Governance).

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

Note 15: Events after balance date

There have been no significant events after balance date.

Note 16: Financial instruments

Note 16A: Financial instrument categories

The carrying amounts of financial assets and financial liabilities in each of the NZ IAS 39 categories are as follows:

Actual 2013 $000		Actual 2014 $000
	Loans and receivables	
3,763	Cash and cash equivalents	4,429
808	Debtors and other receivables	137
8	Prepayments	2
4,579	Total loans and receivables	4,568
	Financial liabilities measured at amortised cost	
1,591	Creditors and other payables	1,505

Note 16B: Financial instrument risks

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

Market risk

Currency risk

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

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

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

Interest rate risk

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

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

Credit risk

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

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

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

The Ministry's maximum credit exposure for each class of financial instrument is represented by the total carrying amount of cash and cash equivalents, net debtors (note 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.

Liquidity risk

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

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

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

	Less than 6 months $000	6-12 months $000	1-5 years $000	Over 5 years $000	Total $000
Assets					
Current assets					
Cash and cash equivalents	4,429	-	-	-	4,429
Debtors and other receivables	137	-	-	-	137
Prepayments	2	-	-	-	2
Total current assets	4,568	-	-	-	4,568
Total assets	4,568	-	-	-	4,568
Liabilities					
Current liabilities					
Creditors and other payables	1,505	-	-	-	1,505
Total current liabilities	1,505	-	-	-	1,505
Total liabilities	1,505	-	-	-	1,505
Net liquidity of continuing operations	**3,063**	**-**	**-**	**-**	**3,063**

Note 17: Capital management

The Ministry's capital is its equity which comprises 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, Treasury Instructions and the Public Finance Act 1989.

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 18: Explanation of major variances against budget

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

- Personnel expenses
  - Personnel expenses are lower than both Main and Supplementary estimates due to delays in recruiting staff to fill vacancies.
- Operating expenses
  - Early identification of the above personnel expense variances allowed the Ministry to utilise these savings to advance work on implementing the recommendations of the Performance Improvement Framework review.
- Cashflow
  - The increase in cash from operating activities and the year-end cash balance from the Main and Supplementary Estimates is due to a higher than expected year-end creditors balance.

Note 19: Transfers under section 26A of the Public Finance Act 1989

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

	Voted in Suppl. estimates 2014 $000	Section 26A transfers 2014 $000	Total appropriation voted 2014 $000
Vote: Defence **Appropriations for output expenses**			
Policy advice and related outputs MCOA			
Policy advice	3,640	77	3,717
Ministerial services	726	15	741
Policy support	1,681	36	1,717
Total policy advice and related outputs MCOA	6,047	128	6,175
Evaluation, audit and assessment of performance	2,083	68	2,151
Management of equipment procurement	5,490	(196)	5,294
Total appropriations for output expenses	**13,620**	**-**	**13,620**

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 2014

Actual 2013 $000		Note	Main estimates 2014 $000	Supp estimates 2014 $000	Actual 2014 $000	Forecast unaudited IPSAS 2015 $000
7,107	Realised foreign exchange gains		-	901	1,195	-
6	Realised gains on derivatives		-	886	943	-
19,146	Unrealised gains on derivatives		-	-	565	-
67	Unrealised foreign exchange gains		-	1	89	-
273	Interest		-	143	362	-
26,599	**Total non-departmental income**	**4**	**-**	**1,931**	**3,154**	**-**

Schedule of non-departmental expenses

For the year ended 30 June 2014

Actual 2013 $000		Note	Main estimates 2014 $000	Supp estimates 2014 $000	Actual 2014 $000	Forecast unaudited IPSAS 2015 $000
823	Realised foreign exchange losses		-	3,077	18,231	-
34	Realised losses on derivatives		-	-	12,378	-
-	Unrealised foreign exchange losses		-	67	-	-
348	Unrealised losses on derivatives		-	8,296	10,447	-
22,924	GST input expense		16,891	62,397	51,994	23,839
24,129	**Total non-departmental expenditure**	**4**	**16,981**	**73,837**	**93,050**	**23,839**

The accompanying notes form part of these financial statements.

The forecast amounts are based on the Ministry's budget for 2014/15 updated for Cabinet funding approvals and actual financial results to 30 June 2014, as described in note 1.

Explanations of major variances against the Main and Supplementary Estimates are shown in note 4.

For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated Financial Statements of the Government for the year ended 30 June 2014.

Schedule of non-departmental contingent liabilities and contingent assets

As at 30 June 2014

Contingent liabilities

The Ministry on behalf of the Crown has no contingent liabilities (2013 – Nil).

Contingent assets

The Ministry on behalf of the Crown has no contingent assets (2013– Nil).

Schedule of non-departmental assets

As at 30 June 2014

Actual 2013 $000		Note	Main estimates 2014 $000	Supp estimates 2014 $000	Actual 2014 $000	Forecast unaudited IPSAS 2015 $000
	Assets					
	Current assets					
180,143	Cash and cash equivalents	**4**	22,511	206,830	368,898	16,992
91,839	Debtors and other receivables	**2,4**	-	166,137	210,943	132,544
-	Inventory – work in progress	**4**	103,762	-	-	-
16,064	Derivatives in gain		-	1,730	416	440
288,046	*Total current assets*		126,273	374,697	580,257	149,976
	Non-current assets					
3,081	Derivatives in gain		-	-	298	-
3,081	*Total non-current assets*		-	-	298	-
291,127	**Total non-departmental assets**		**126,273**	**374,697**	**580,555**	**149,976**

The accompanying notes form part of these financial statements.

The forecast amounts are based on the Ministry's budget for 2014/15 updated for Cabinet funding approvals and actual financial results to 30 June 2014, as described in note 1.

Explanations of major variances against the Main and Supplementary Estimates are shown in note 4.

For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated Financial Statements of the Government for the year ended 30 June 2014.

Schedule of non-departmental liabilities

As at 30 June 2014

Actual 2013 $000		Note	Main estimates 2014 $000	Supp estimates 2014 $000	Actual 2014 $000	Forecast unaudited IPSAS 2015 $000
	Liabilities					
	Current Liabilities					
34,776	Creditors and other payables	**3,4**	-	-	52,273	-
214	Derivatives in loss		-	764	3,165	-
34,990	*Total current liabilities*		-	764	55,438	-
	Non-current liabilities					
131	Derivatives in loss		-	-	4,481	-
131	*Total non-current liabilities*		-	-	4,481	-
35,121	**Total non-departmental liabilities**		**-**	**764**	**59,919**	**-**

The accompanying notes form part of these financial statements.

The forecast amounts are based on the Ministry's budget for 2014/15 updated for Cabinet funding approvals and actual financial results to 30 June 2014, as described in note 1.

Explanations of major variances against the Main and Supplementary Estimates are shown in note 4.

For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated Financial Statements of the Government for the year ended 30 June 2014.

Schedule of non-departmental capital receipts

For the year ended 30 June 2014

Sales of defence equipment to the New Zealand Defence Force in 2013/14 were:

Actual 2013 $000		Note	Main estimates 2014 $000	Supp estimates 2014 $000	Actual 2014 $000	Forecast unaudited IPSAS 2015 $000
443	Defence command and control system		18,161	3,975	4,546	14,118
4,586	Strategic bearer network		5,778	7,716	6,574	13,177
32,149	P-3K Orion systems upgrade		17,892	8,495	8,719	6,418
544	B-757 aircraft modification		600	(56)	(41)	-
16,084	C-130H life extension		13,828	7,465	7,350	5,839
54,277	Medium utility helicopter		69,338	34,972	36,619	36,184
1,920	Training/light utility helicopter		9,237	8,615	5,379	-
17,455	Maritime helicopter		45,000	30,849	26,285	124,074
-	Pilot training capability		-	73,454	73,942	49,353
863	Project Protector vessels		13	9	10	13
18	Close-in weapon system		431	3	3	-
11,572	Platform systems upgrade		15,020	10,775	9,276	12,463
-	Frigate systems upgrade		-	10,000	8,630	158,000
30,951	Protector remediation		13,850	7,145	5,013	5,309
245	Medium range anti-armour weapon		50	-	47	-
5,208	Army engineering gap crossing system		1,432	47	-	-
-	Medium/heavy operating vehicles		29,100	83,136	81,220	28,036
-	Individual weapons capability		-	-	-	140
-	Portfolio adjustment		(20,000)	-	-	20,000
176,315	**Total non-departmental capital receipts**	**4**	**219,730**	**286,600**	**273,572**	**473,124**

The accompanying notes form part of these financial statements.

The forecast amounts are based on the Ministry's budget for 2014/15 updated for Cabinet funding approvals and actual financial results to 30 June 2014, as described in note 1.

Explanations of major variances against the Main and Supplementary Estimates are shown in note 4.

For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated Financial Statements of the Government for the year ended 30 June 2014.

Schedule of non-departmental capital expenditure

For the year ended 30 June 2014

Project payments made in 2013/14 were:

Actual 2013 $000		Note	Main estimates 2014 $000	Supp estimates 2014 $000	Actual 2014 $000	Forecast unaudited IPSAS 2015 $000
331	Defence command and control system		12,784	3,975	4,546	14,118
4,586	Strategic bearer network		8,550	7,716	6,574	13,177
15,913	P-3K Orion systems upgrade		13,238	8,495	8,719	6,418
544	B-757 aircraft modification		-	(56)	(41)	-
10,711	C-130H life extension		11,803	7,465	7,350	5,839
45,998	Medium utility helicopter		56,623	34,972	36,619	36,184
1,253	Training/light utility helicopter		7,924	8,615	5,379	-
17,455	Maritime helicopter		50,000	30,849	26,285	124,074
-	Pilot training capability		-	73,454	73,942	49,353
320	Project Protector vessels		8	9	10	13
14	Close-in weapon system		325	3	3	-
9,087	Platform systems upgrade		5,550	10,775	9,276	12,463
-	Frigate systems upgrade		-	10,000	8,630	158,000
25,044	Protector remediation		8,432	7,145	5,013	5,309
139	Medium range anti-armour weapon		-	-	47	-
1,394	Army engineering gap crossing system		228	47	-	-
-	Medium/heavy operating vehicles		58,200	83,136	81,220	28,036
-	Individual weapons capability		-	-	-	140
-	Portfolio adjustment		(7,000)	-	-	20,000
132,789	**Total non-departmental capital expenditure**	**4**	**226,665**	**286,600**	**273,572**	**473,124**

The accompanying notes form part of these financial statements.

The forecast amounts are based on the Ministry's budget for 2014/15 updated for Cabinet funding approvals and actual financial results to 30 June 2014, as described in note 1.

Explanations of major variances against the Main and Supplementary Estimates are shown in note 4.

For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated Financial Statements of the Government for the year ended 30 June 2014.

Schedule of non-departmental capital commitments

As at 30 June 2014

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 2013 $000		Actual 2014 $000
	Non-cancellable capital commitments	
242,066	Not later than one year	381,755
180,672	Later than one year and not later than two years	146,341
47,120	Later than two years and not later than five years	143,928
-	Later than five years	-
469,858	**Total non-cancellable capital commitments**	**672,024**

Statement of non-departmental capital expenditure against appropriation

For the year ended 30 June 2014

Actual 2013 $000		Main estimates 2014 $000	Supp estimates 2014 $000	Actual 2014 $000	Forecast unaudited IPSAS 2015 $000
	Vote Defence				
	Appropriations for non-departmental capital expenditure				
132,789	Purchase of defence equipment	226,665	286,600	273,572	473,124
132,789	**Total appropriation for non-departmental capital expenditure**	**226,665**	**286,600**	**273,572**	**473,124**

Statement of non-departmental unappropriated capital expenditure

For the year ended 30 June 2014

There has been no unappropriated expenditure for the year ended 30 June 2014 (2013 – Nil).

The accompanying notes form part of these financial statements.

The forecast amounts are based on the Ministry's budget for 2014/15 updated for Cabinet funding approvals and actual financial results to 30 June 2014, as described in note 1.

Explanations of major variances against the Main and Supplementary Estimates are shown in note 4.

For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated Financial Statements of the Government for the year ended 30 June 2014.

Notes to the non-departmental financial statements

Note 1: Statement of accounting policies

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 the year ended 30 June 2014. For a full understanding of the Crown's financial position, results of operations and cash flows for the year, reference should also be made to the Financial Statements of the Government.

Basis of preparation

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

Measurement and recognition rules applied in the preparation of these non-departmental schedules and statements are consistent with New Zealand generally accepted accounting practice as appropriate for public benefit entities.

Changes in accounting policies

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

The Ministry will adopt the new Public Benefit Entity Accounting Standards (PAS) from 1 July 2014. This means the Ministry will transition to the new standards in preparing 30 June 2015 financial schedules and statements. The Ministry does not expect any differences between NZ IFRS and PAS to have a material impact on the financial schedules and statements.

Due to the change in the Accounting Standards Framework for public benefit entities, it is expected that all new NZ IFRS amendments to existing NZ IFRS will not be applicable to public benefit entities. Therefore, the XRB has effectively frozen the financial reporting requirements for public benefit entities up until the new Accounting Standard Framework is effective. Accordingly, no disclosure has been made about new or amended NZ IFRS that exclude public benefit entities from their scope.

Budget figures

The budget figures ("Main estimates") are those included in the Information Supporting the Estimates of Appropriations for the Government of New Zealand for the year ending 30 June 2014, which are consistent with the financial information in the Main Estimates.

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

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

Forecast

The Ministry is required by the Public Finance Act to present forecast financial statements for the financial year following the financial year to which the Annual Report relates. The non-departmental forecast financial schedules and statements ("Forecast") are prepared in accordance with NZ FRS-42 *Prospective Financial Statements*. As the Ministry will adopt Public Benefit Entity Accounting Standards for the 2014/15 financial year the forecast financial information is prepared in accordance with those standards.

The forecast financial statements are based on the Ministry's budget for 2014/15 as approved in the Estimates of Appropriations for 2014/15, updated for:

- subsequent Cabinet funding approvals;

- actual financial results to 30 June 2014.

The significant assumptions underlying the forecast financial statements are:

- the functions performed and the appropriations administered by the Ministry will not change over the forecast period;
- the Ministry will not receive any additional funding during the forecast period.

The forecast financial schedules and statements were authorised for issue by the Chief Executive of the Ministry on 10 September 2014.

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

The forecast financial statements have not been audited.

Significant accounting policies

Revenue

Interest

Interest income is recognised using the effective interest method.

Foreign currency transactions

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

Goods and services tax

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

Debtors and other receivables

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

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

Derivative financial instruments

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

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently 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.

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

Commitments

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

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

Note 2: Debtors and other receivables

Actual 2013 $000		Actual 2014 $000
91,839	Debtors	210,943
-	Additional provisions made during the year	-
-	Receivables written off during period	-
91,839	**Total debtors and other receivables**	**210,943**

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

	2013			2014		
	Gross $000	Impairment $000	Net $000	Gross $000	Impairment $000	Net $000
Not past due	91,839	-	91,839	210,943	-	210,943
Past due 1-30 days	-	-	-	-	-	-
Past due 31-60 days	-	-	-	-	-	-
Past due 61-90 days	-	-	-	-	-	-
Past due > 91 days	-	-	-	-	-	-
Total	**91,839**	**-**	**91,839**	**210,943**	**-**	**210,943**

Note 3: Creditors and other payables

Actual 2013 $000		Actual 2014 $000
33,543	Creditors	52,273
1,233	Monies received in advance	-
34,776	**Total creditors and other payables**	**52,273**

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

The major variances from the Main Estimates are as follows:

Non-departmental income and expenses

- Foreign exchange impact
  - The gains or losses from movements in foreign exchange rates are not budgeted.
- GST input expense
  - GST input expense was higher than forecast in the Main Estimates due the importation into New Zealand, and resultant GST liability, during the year of medium/heavy operating vehicles. The vehicle delivery schedule had not been negotiated at the time of preparing the budget and it was assumed that vehicles would be delivered later. In addition, the import into New Zealand of two medium utility helicopters was deferred to July 2013 which had been budgeted as the previous financial year.

Non-departmental assets

- Cash and cash equivalents
  - The cash holdings are higher than the Main Estimates due to the requirement to purchase foreign currency for capital expenditure contracted in 2014/15 relating to projects that were approved following the preparation of the budget.
- Debtors and Inventory
  - The Ministry invoices NZDF on a six-monthly basis for non-departmental capital expenditure. In prior years expenditure over the January to June period was charged in July of the following financial year. The Main Estimates were prepared on this basis and assumed that the capital expenditure from January to June 2014 would be held as inventory (work in progress) in the schedule of assets at 30 June 2014. In late 2012/13 NZDF requested that this be invoiced on 30 June of the current financial year. This change in billing date effectively moved the forecast inventory balance to debtors.
  - The debtors balance at 30 June 2014 is higher than the budgeted inventory balance due to additional project expenditure on projects approved following the preparation of the budget. Additionally, the debtors balance is stated inclusive of GST whereas inventory is exclusive.

Non-departmental liabilities

- Creditors
  - The large creditors balance at 30 June 2014 is primarily due to the GST liability resulting from invoicing of capital expenditure to NZDF on 30 June 2014 as described in the debtors and inventory section above.

Non-departmental capital receipts

The variance from the Main Estimates is largely caused by the change in invoicing dates as described in the debtors and inventory section above, coupled with changes to capital expenditure, as described below.

Non-departmental capital expenditure

The increase in project payments from that budgeted in the Main Estimates is mainly due to a new project, pilot training capability, being approved during the year. Other variances arose as contract negotiations on new projects were completed which changed the payment timings from that budgeted.

Note 5: Financial instruments

Note 5A: Financial instrument categories

The carrying amounts of financial assets and financial liabilities in each of the NZ IAS 39 categories are as follows:

Actual 2013 $000		Actual 2014 $000
	Loans and receivables	
180,143	Cash and cash equivalents	368,898
91,839	Debtors and other receivables	210,943
271,982	Total loans and receivables	579,841
	Fair value through profit and loss – designated as such upon initial recognition	
19,145	Derivative financial instrument assets	714
345	Derivative financial instrument liabilities	7,646
	Financial liabilities measured at amortised cost	
34,776	Creditors and other payables	52,273

The notional principal amount of outstanding forward exchange contract derivatives at 30 June 2014 is NZD 322.84 million (2013 – NZD 255.03 million).The contracts consist of the purchase of:

Actual 2013 $000		Actual 2014 $000
11,420	Australian dollars	16,817
5,025	British pounds	77,251
225	Canadian dollars	99,323
53,550	Euros	39,619
109,400	Norwegian krone	20,364
-	Swedish krona	7,654
103,080	United States dollars	61,812

Note 5B: Fair value hierarchy disclosures

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

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

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

		Valuation technique		
	Total $000	Quoted market price $000	Observable inputs $000	Significant non-observable inputs $000
2013				
Financial assets				
Foreign exchange derivatives	19,145	-	19,145	-
Financial liabilities				
Foreign exchange derivatives	345	-	345	-
2014				
Financial assets				
Foreign exchange derivatives	714	-	714	-
Financial liabilities				
Foreign exchange derivatives	7,646	-	7,646	-

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

Note 5C: Financial instrument risks

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

Market risk

Currency risk

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

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

Australian dollars, British pounds and Euro. Currency risk arises from future capital purchases and recognised liabilities, which are denominated in a foreign currency.

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

Interest rate risk

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

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

Credit risk

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

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

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

Liquidity risk

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

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

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

At 30 June 2014	Less than 6 months $000	6-12 months $000	1-5 years $000	Over 5 years $000	Total $000
Assets **Current assets**					
Cash and cash equivalents	368,898	-	-	-	368,898
Debtors and other receivables	210,943	-	-	-	210,943
Derivative financial instruments	295	121	-	-	416
Total current assets	580,136	121	-	-	580,257
Non-current assets					
Derivative financial instruments	-	-	298	-	298
Total non-current assets	-	-	298	-	298
Total assets	**580,136**	**121**	**298**	**-**	**580,555**
Liabilities **Current liabilities**					
Creditors and other payables	52,273	-	-	-	52,273
Derivative financial instruments	2,707	458	-	-	3,165
Total current liabilities	54,980	458	-	-	55,438
Non-current liabilities					
Derivative financial instruments	-	-	4,481	-	4,481
Total non-current liabilities	-	-	4,481	-	4,481
Total liabilities	**54,980**	**458**	**4,481**	**-**	**59,919**
Net liquidity of continuing operations	**525,156**	**(337)**	**(4,183)**	**-**	**520,636**

At 30 June 2013	Less than 6 months $000	6-12 months $000	1-5 years $000	Over 5 years $000	Total $000
Assets					
Current assets					
Cash and cash equivalents	180,143	-	-	-	180,143
Debtors and other receivables	91,839	-	-	-	91,839
Derivative financial instruments	4,259	11,805	-	-	16,064
Total current assets	276,241	11,805	-	-	288,046
Non-current assets					
Derivative financial instruments	-	-	3,081	-	3,081
Total non-current assets	-	-	3,081	-	3,081
Total assets	**276,241**	**11,805**	**3,081**	**-**	**291,127**
Liabilities					
Current liabilities					
Creditors and other payables	34,776	-	-	-	34,776
Derivative financial instruments	35	179	-	-	214
Total current liabilities	34,811	179	-	-	34,990
Non-current liabilities					
Derivative financial instruments	-	-	131	-	131
Total non-current liabilities	-	-	131	-	131
Total liabilities	**34,811**	**179**	**131**	**-**	**35,121**
Net liquidity of continuing operations	**241,430**	**11,626**	**2,950**	**-**	**256,006**

Contractual maturity analysis of derivative financial instrument liabilities

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

	Liability carrying amount $000	Asset carrying amount $000	Contractual cash flows NZ$ $000	Less than 6 months NZ$ $000	6-12 months NZ$ $000	1-2 years NZ$ $000	2-5 years NZ$ $000
Gross settled forward foreign exchange contracts:							
2013	345	19,145					
- outflow			255,029	46,705	152,088	27,692	28,544
- inflow			269,451	50,918	160,923	28,896	28,714
2014	7,646	714					
- outflow			322,840	74,331	41,588	185,094	21,827
- inflow			303,456	71,320	40,194	171,908	20,034

Sensitivity analysis

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

	2013			2014		
	Cash and cash equivalents	Derivatives	Net gain/(loss)	Cash and cash equivalents	Derivatives	Net gain/(loss)
	$000	$000	$000	$000	$000	$000
Effect on surplus if NZ dollar strengthened by 5%						
AUD	(188)	(619)	(807)	(561)	(728)	(1,289)
CAD	(236)	(13)	(249)	(1,801)	(4,442)	(6,243)
EUR	(3,713)	(4,272)	(7,985)	(2,827)	(1,744)	(4,571)
GBP	(5)	(468)	(473)	(1,310)	(3,406)	(4,716)
NOK	-	(1,083)	(1,083)	(31)	(863)	(894)
SEK	-	-	-	(218)	(332)	(550)
USD	(2,268)	(6,284)	(8,552)	(8,042)	(2,710)	(10,752)
Total	**(6,410)**	**(12,739)**	**(19,149)**	**(14,790)**	**(14,225)**	**(29,015)**
Effect on surplus if NZ dollar weakened by 5%						
AUD	208	684	892	620	804	1,424
CAD	261	14	275	1,991	4,909	6,900
EUR	4,104	4,721	8,825	3,125	1,927	5,052
GBP	6	517	523	1,448	3,765	5,213
NOK	-	1,197	1,197	34	954	988
SEK	-	-	-	241	367	608
USD	2,507	6,946	9,453	8,889	2,995	11,884
Total	**7,086**	**14,079**	**21,165**	**16,348**	**15,721**	**32,069**

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 equal employment indicators to ensure employees are treated equitably. Equity metrics are also 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 meeting the Government's defence goals.

Public service integrity

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

Quality

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

New Zealand Government Procurement Reform Programme

The Ministry has indicated its commitment to the Programme.

Financial performance highlights

	2013/14 Main estimates $000	2013/14 Supp estimates $000	2013/14 Actual $000
Departmental activities			
Revenue: Crown	12,116	12,116	12,116
Revenue: other	1,504	1,504	1,484
Output expenses	13,620	13,620	13,578
Net operating surplus/(deficit)	-	-	22
Additions to physical assets & intangibles	350	560	32
Disposals of physical assets & intangibles	-	-	44
Equity	3,416	3,416	3,416
Net cash flows from operating activities	412	254	933
Non-departmental activities			
Capital expenditure - defence equipment	226,665	286,600	273,572
Total Crown capital receipts	219,730	286,600	273,572

Summary of appropriations (GST exclusive)

	Departmental			Non-departmental
	Policy advice and related outputs MCOA $000	Audit and assessment of performance $000	Management of equipment procurement $000	Capital expenditure: defence equipment $000
Main estimates appropriation	6,222	2,008	5,390	226,665
Supplementary estimates change	(175)	75	100	59,935
Change by order in council under section 26A of the *Public Finance Act 1989*	128	68	(196)	-
Total amount appropriated for 2013/14	6,175	2,151	5,294	286,600
Estimated actual outturn for 2013/14 as reported in 2013/14 estimates	6,047	2,083	5,490	286,600
Audited actual outturn for 2013/14	6,174	2,149	5,255	273,572
Unappropriated expenditure, expenses or liabilities approved under section 26B of the *Public Finance Act 1989*	-	-	-	-
Unappropriated expenditure, expenses or liabilities requiring validating legislation	-	-	-	-

Historical financial performance of significant items

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

	2013/14 $000	2012/13 $000	2011/12 $000	2010/11 $000	2009/10 $000	2008/09 $000
Voted in Estimates	286,600	149,914	154,897	228,753	369,004	190,275
Actual Expenditure	273,572	132,789	102,359	144,506	160,094	181,120
Variance	13,028	17,125	69,200	84,247	208,910	9,155

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

	2013/14 $000	2012/13 $000	2011/12 $000	2010/11 $000	2009/10 $000	2008/09 $000
Voted in Estimates	286,600	96,613	154,331	135,797	174,118	228,583
Actual Receipts	273,572	176,315	154,331	135,797	174,118	228,583
Variance	13,028	79,702*	-	-	-	-

* Variance arose from invoicing NZDF for capital expenditure incurred over the period January to June 2013 in the 2012/13 financial year, when the estimates assumed this would occur the following financial year.

MINISTRY OF
DEFENCE
Manatū Kaupapa Waonga