



MINISTRY OF DEFENCE ANNUAL REPORT

for the year ended 30 June 2015

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PART 1: OVERVIEW

BY THE SECRETARY OF DEFENCE

The 2014/15 year included the election of a new Government and the appointment of a new Minister of Defence, Hon Gerry Brownlee. A Ministry focus during the year has been supporting Minister Brownlee's priorities. The 2014 Defence Assessment was completed early in the year and presented to the incoming Government after the election. Thereafter, a focus for the Ministry has been the initiation of a Defence White Paper process. Public consultation on this was undertaken including meetings held in 12 New Zealand communities. I was pleased that we were able to talk directly to New Zealanders and hear their views on a range of security and defence matters. The completed Defence White Paper will have far-reaching implications for Defence, as it sets out the Government's policy statement for Defence and its future intentions for investment.

During the busy 2014/15 year the Ministry:

- surveyed the strategic environment and looked ahead to what New Zealand will need from its military
- defined, with the New Zealand Defence Force, what defence capability will be needed, progressed the acquisition of major capability, and assessed the effectiveness of existing capability
- helped 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 decisions on international operational deployments, and
- delivered a work programme agreed with the Minister of Defence, of evaluations, assessments and audits of Defence performance.

During this period the Government took a significant decision to deploy New Zealand Defence Force personnel to help train Iraqi security forces as part of the international effort to counter the threat of Daesh. Working closely with the Defence Force, the Ministry of Foreign Affairs and Trade, and other departments, the Ministry provided advice to support Cabinet decision making. The deployment to Iraq continues to be a major focus for the Ministry's engagement with international defence partners.

The Ministry continued to contribute strongly to growing New Zealand's international defence relationships through active participation in bilateral and multilateral security fora. In the regional security architecture, our contribution includes co-chairing the ASEAN Defence Ministers Meeting Plus (ADMM-Plus) Experts' Working Group on Maritime Security. The Ministry supported the Minister of Defence in his international engagement programme.

The Evaluation Division published a comprehensive report on maximising opportunities for New Zealand Defence Industry. This made a number of recommendations that aim to improve the access for New Zealand Defence Industry organisations in support of the Defence Force. Both the Ministry and the New Zealand Defence Force have started to implement the report's recommendations.



The Ministry has continued to deliver major defence capability acquisitions projects in the new approach introduced in 2013/14: using off-the-shelf, proven technologies already known to be effective and inter-operable with New Zealand's partners. Capabilities delivered using this approach during the past year included the eleven new T6 Texan pilot training aircraft, 194 Medium-Heavy Operational Vehicles, and the delivery of eight of the 10 SH-2G(I) Super Seasprites.

These projects are part of a broader capability programme that has continued to develop and advance throughout the year. New projects approved by the Government include a new tanker for the Navy, improved communications equipment for the Army, and Special Operation Vehicles. Work was completed on upgrading systems on HMNZS *Te Kaha* and is underway on the final stage of works on HMNZS *Te Mana*. The last of the NH90 helicopters was delivered during the year and work is underway on the fifth and final C-130 Hercules to be upgraded at the facility operated by the Ministry at Woodbourne.

An ongoing priority is the Ministry's organisational reform. In September 2012, a Performance Improvement Framework (PIF) Review was published that highlighted the need for extensive changes to make the Ministry fit for purpose. In August 2014 a follow-up PIF Review was published. This reported very positively on the Ministry's progress. This has been followed by results from our June 2015 staff engagement survey that rate the Ministry of Defence as one of the most highly engaged workforces in the State sector.

The work that went into transforming the organisation has been instrumental in demonstrating that the Ministry of Defence can get value from \$27.1 million in investment that was agreed as part of Budget 2015. The investment will support a programme of reform to the way defence capability is purchased, which is key as we move into a period of complex, expensive defence procurements – with projects worth \$15 billion forecast through to 2030. The Ministry is delivering improvements to the capability system jointly with the New Zealand Defence Force. As part of this work, the Ministry will expand its acquisitions and capability development workforce.

The pace of acquisition-related reforms will increase in 2015/16. Improvements to capability management will ensure Defence has the people and expertise required to deliver capabilities required for the future.

The Ministry is continuing a fast pace of transformative change to ensure it delivers the best service it can for New Zealanders and defence force personnel, that we become an international exemplar for defence capability management, and that the Ministry is a sustainable and resilient organisation.

Helene Quilter
Secretary of Defence

PART 2: THE MINISTRY'S PERFORMANCE AND OPERATIONS

THE MINISTRY'S OBJECTIVES AND OUTCOMES FRAMEWORK

The *Estimates of Appropriations* and *Strategic Intentions* both formed the framework for defining the Ministry's objectives and performance indicators for the year ended 30 June 2015. Divisions regularly evaluated their performance against objectives, comparing results with priorities, resource allocations and targets that were set at the beginning of the year.

The Ministry's outcomes framework is set out below, with three outputs supporting nine core business activities, and five strategic objectives. These contribute to the Ministry's two high-level outcomes.

Figure 1: The Ministry's outcomes framework

HIGH-LEVEL OUTCOMES

New Zealand is secure	New Zealand's efforts enhance the security of other nations
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STRATEGIC OBJECTIVES (THE MINISTRY'S MEDIUM-TERM STRATEGY)

Defence decisions keep pace with the dynamic security environment; and NZ contributes to and benefits from successful defence relationships	Capability advice balances policy, capability and cost, and establishes the true risk and cost of projects early	Major military equipment is acquired on time, on budget and delivers against the government's intentions	The defence agencies successfully manage a period of change and reform	The Ministry becomes sustainable and resilient
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CORE BUSINESS ACTIVITIES

Assessing and giving advice on the strategic defence environment	Contributing to regional and international defence engagements	Supporting New Zealand Defence Force deployments
Undertaking evaluations and assessments directed by the Minister of Defence	Defining and selecting military capability	Acquiring and upgrading military capability
Assessing the benefits of capability and readiness of the Defence system	Administering the joint Ministry/Defence Force Capability Management System	Contributing to a sustainable, resilient defence and security sector workforce

OUTPUTS

Evaluation, audit and assessment of performance	Management of equipment procurement	Policy advice
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A well-run Ministry of Defence (organisational health and capability)

THE MINISTRY'S OPERATING ENVIRONMENT

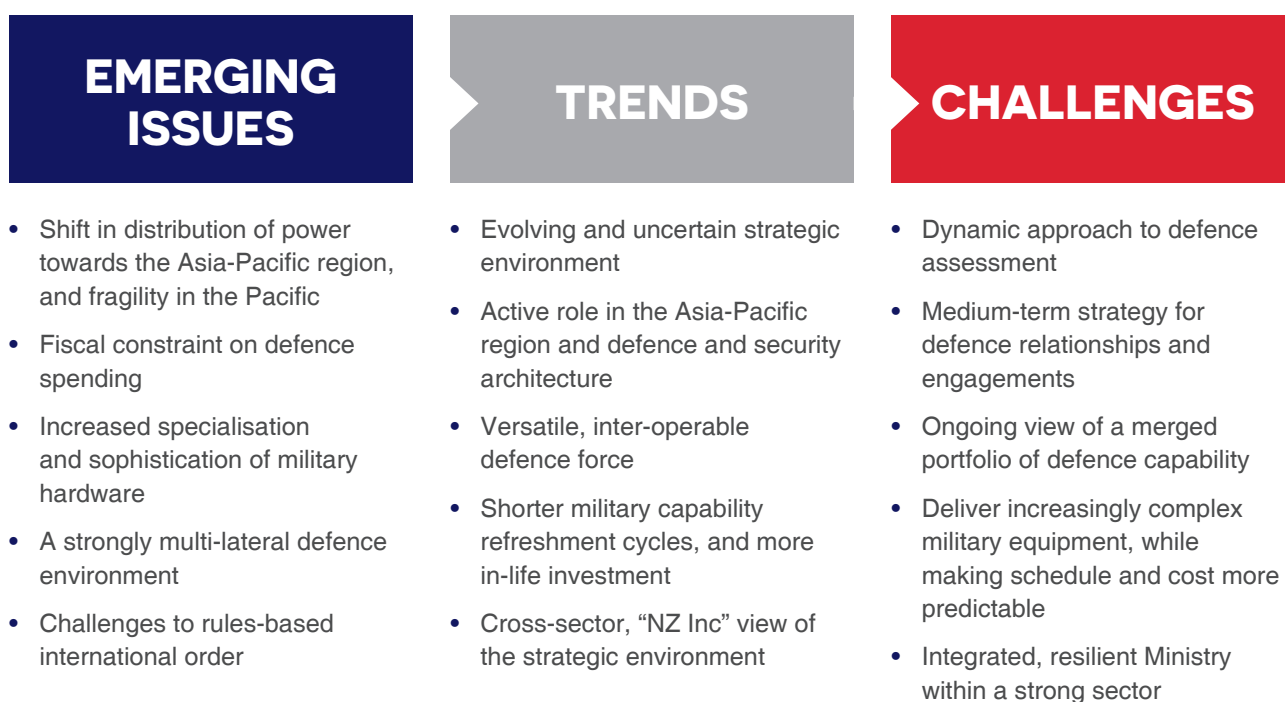
The Ministry operates in three connected contexts:

- it advises on and engages with the strategic defence environment
- it advises the Government on capability choices and procures equipment
- it is part of the Government's defence and security sector.

The Ministry expects increased demands on its activities in respect of each of these contexts. These reflect the demands of a much more sophisticated approach to planning and governing defence capability purchases (arising from the *Defence White Paper 2010*); increased expectations to participate in regional defence and security relationships and architecture; and the improved investment certainty arising from the Defence Midpoint Rebalancing Review work – balancing the policy intent of the *Defence White Paper 2010*, the capabilities required to deliver that policy, and funding.

The *Defence White Paper 2010* reflects a thorough analysis of the likely impacts on New Zealand's defence requirements. It presents the Government's view of the strategic environment.

Figure 2: The Ministry's operating environment



INVESTMENT IN DEFENCE

Further detail on these contexts and their impact on the operations of the Ministry are set out in its *Strategic Intentions 1 July 2014–30 June 2018*.¹ These are still the key characteristics of the Ministry's operating environment, but a new and important feature of the coming period is changes to the way defence capability is managed, arising from the Government's Budget 2015 investment of \$27.1 million to the Ministry's baseline over the coming four years.

In the last few years, there have been a number of reviews, reports and public sector processes that have given the Ministry and New Zealand Defence Force a challenging array of improvements to make in its capability management system.

Accordingly, the Ministry and Defence Force have together embarked on a significant change programme of work for capability management. The vision for this programme is to become an international exemplar of military capability management (within the New Zealand context).

The programme provides a clear pathway that integrates, prioritises, sequences and schedules the work the Ministry needs to do to implement improvements. The Budget investment over the next four years will help the Ministry grow its workforce and make one-off investments in systems.

In addition, the Ministry is working with the Defence Force to enhance its capability management performance through:

- end-to-end management of capability definition, acquisition and introduction into service
- a partnered approach between the Ministry and the New Zealand Defence Force at every stage
- greater support for projects in such key areas as cost, risk, contracting and industry engagement
- leadership and management of defence capability acquisitions as a portfolio, underpinned by strong systems and consistent practices and a commitment to continuous improvement.



¹ This document is available from the Ministry's website at: <http://defence.govt.nz/reports-publications/strategic-intentions-2014/contents.html>.

MEASURING DEFENCE OUTCOMES: ASSESSING CURRENT SECURITY AND LIKELY CHANGES

The Ministry contributes to two high-level outcomes:

- New Zealand is secure
- New Zealand's efforts enhance the security of other nations.

The Ministry constantly monitors the security environment. A summary of developments is provided below.

ASSESSING THE STATE OF THE SECURITY ENVIRONMENT

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 the period covered by this Annual Report as part of developing the Defence White Paper 2015, building on the judgements in the *Defence Assessment 2014*.² The assumptions in the *Defence White Paper 2010* on the security outlook provided the starting point for considering developments during the period.

Below are the Ministry's high-level assessments of the security environment for five geographical areas of interest for the reporting period. The assessments consider two aspects of security:

- *the current security outlook risk status* – the likelihood that security will be compromised by use of destructive or deadly force, or hostile incursion. This is 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 is assessed according to the classifications: Improving, Stable, Deteriorating and Unclear.

The government's view of the strategic context is set out in the *Defence White Paper 2010*. Work is currently underway on a new Defence White Paper, which will be publicly released on the Ministry's website when completed.

² 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. The *Defence Assessment 2014* is available from the Ministry's website at: <http://defence.govt.nz/reports-publications/defence-assessment-2014/contents.html>.

CURRENT SECURITY STATE

Region	Current security risk outlook	Direction of change	Commentary
New Zealand and its Exclusive Economic Zone	Very low	Stable	There have been no material changes to New Zealand's outlook during the period of this report. A direct security threat to New Zealand and its Exclusive Economic Zone remains unlikely.
Australia	Low	Stable	An armed attack on Australia is unlikely. Australia remains vigilant in the face of continued non-traditional threats such as terrorism and cyber security.
South Pacific	Moderate	Stable	A direct military threat from outside the region remains unlikely. Threats to security arise from 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.
Asia-Pacific ³	Moderate	Deteriorating	Threat factors relate primarily to heightened tensions over maritime territorial disputes in the East and South China Seas, as well as ongoing concerns around Weapons of Mass Destruction proliferation and terrorism.
Global	Mixed	Unclear	<p>The world continues to experience volatility and change. This includes a number of ongoing security challenges:</p> <ul style="list-style-type: none"> • turmoil across the Middle East and North Africa • continued weakness in the global economy since the Global Financial Crisis • challenges to the rules-based international order • constraints on 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 • swiftly evolving technologies including cyber capabilities create the emergence of new threats • the risk of weapons proliferation, both conventional and chemical, biological and nuclear • terrorism continuing to challenge state authority.

³ 'Asia-Pacific' is defined as North, East, South and Southeast Asia and the Western Pacific Ocean.

HOW DOES THE MINISTRY CONTRIBUTE TO THE ACHIEVEMENT OF THESE OUTCOMES?

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

1. it undertakes the acquisition of major platforms and items of military equipment for use by the New Zealand Defence Force in undertaking defence and security tasks
2. it provides the government with policy advice concerning defence and security issues, including the security environment, the military capabilities of the Defence Force, the deployment of military forces and the conduct of international defence relations
3. it undertakes evaluations, audits and assessments of the Defence Force and the acquisition function of the Ministry to examine and help improve their efficiency and effectiveness.

DELIVERING ON THE MINISTRY'S STRATEGIC INTENTIONS

The Ministry has five strategic objectives that make up its medium-term strategy:

1. Defence decisions keep pace with the dynamic security environment; and New Zealand contributes to, and benefits from, successful defence relationships.
2. Capability advice balances policy, capability and cost, and establishes the true risk and cost of projects early on.
3. Major military equipment is acquired on time, on budget and delivers against the government's intentions.
4. The defence agencies successfully manage a period of change and reform.
5. The Ministry becomes sustainable and resilient.

To deliver on this medium-term strategy, the Ministry undertakes nine core business activities. Each of these contributes to one or more of the strategic objectives, and manages fiscal and strategic risks for the government.

Below is each core business activity, the associated four-year milestones from the Ministry's *Strategic Intentions*, and details of the progress made during the reporting period.

ASSESSING AND GIVING ADVICE ON THE STRATEGIC DEFENCE ENVIRONMENT

The Ministry is responsible for undertaking Defence Assessments and providing advice on defence policy, engagements, and strategic policy advice on defence capability.

Over
2014–2018
this work will involve the Ministry:

- undertaking a Defence Assessment in 2014, and completing a White Paper in 2015 or as directed by the Government
- providing advice between formal assessments, focused on the capability/material, infrastructure and people needed to respond to changes in the security environment.

In 2014, the Ministry produced the *Defence Assessment 2014*. The Assessment was a formal review of the global strategic environment out to 2040, conducted in partnership with the Defence Force and in collaboration with a wide range of agencies. It is available on the Ministry's website.⁴ The Assessment identified major changes in the strategic environment since the publication of the *Defence White Paper 2010* (as noted in *Assessing the State of the Security Environment* on page 10).

Following the completion of the Assessment, the Government directed the Ministry and the Defence Force to begin development of a new Defence White Paper, to ensure defence policy is appropriately set to meet requirements.

A key part of the policy development process for the Defence White Paper has been a broad-based public consultation process. The formal consultation process included meetings at 12 locations around the country, 11 meetings at Defence Force camps and bases and an electronic submission process that solicited nearly 300 responses. There was also formal engagement with academics with expertise in national security matters. A summary of submissions received during the public consultation process will be published by the end of the year.

⁴ The *Defence Assessment 2014* is available from the Ministry's website at: <http://defence.govt.nz/reports-publications/defence-assessment-2014/contents.html>.

CONTRIBUTING TO REGIONAL AND INTERNATIONAL DEFENCE ARRANGEMENTS

The Ministry manages New Zealand's international defence engagement in conjunction with the New Zealand Defence Force and in support of the Ministry of Foreign Affairs and Trade. It provides the direction for the development of international defence partnerships to maximise the benefit to New Zealand security and foreign policy interests. This includes leading bilateral policy talks, supporting high level defence diplomacy activities, and representing New Zealand in regional and international defence arrangements.

Over
2014–2018
this work will involve the Ministry:

- implementing a strategic approach with the New Zealand Defence Force to international defence engagements in pursuit of medium and long-term security and foreign policy objectives
- managing greater intensity of the highest priority defence relationships and commitments to the Asia-Pacific regional defence architecture
- responding, as required, to any new security developments in the Asia-Pacific region and beyond.



Defence engagement with traditional and emerging partners supported defence and wider foreign policy objectives. With the New Zealand Defence Force, the Ministry continues to implement a strategic approach, to international defence engagements.

During 2014/15 the Ministry supported travel by the Minister of Defence on bilateral visits to Australia, Singapore, Canada, the United States, Fiji, the United Kingdom, participation in the Halifax Forum, South Pacific Defence Ministers' Meeting and the Shangri-La Dialogue. The Ministry also supported the Minister's travel to Australia and Belgium for commemorations at Albany and of Anzac Day respectively.

New Zealand is an active participant in the region's security architecture and is a member of the East Asia Summit, the ASEAN Regional Forum, and the ASEAN Defence Ministers' Meeting-Plus (ADMM-Plus). New Zealand's contribution to enhancing trust and confidence through regional security arrangements was demonstrated through our co-chairing (with Brunei Darussalam) of the ADMM-Plus Experts' Working Group on Maritime Security.

The Ministry continued to lead the programme of bilateral defence consultations with a range of partner countries in the Asia-Pacific region and beyond.

UNDERTAKING EVALUATIONS AND ASSESSMENTS DIRECTED BY THE MINISTER OF DEFENCE

The Ministry's Evaluation Division undertakes evaluations, assessments and audits as directed by the Minister of Defence to assess the capability of the defence system.

Over
2014–2018

this work will involve the Ministry:

- implementing a strategic risk framework that systemically profiles defence system risk
- redesigning and implementing a new set of evaluation and assessment products
- introducing empirical, data-driven reporting on the defence system
- sustaining, over the four years, a programme of in-depth assessment of areas of particular government priority and risk, including implementation of the Defence Midpoint Rebalancing Review.



The Evaluation Division delivers a work programme approved by the Minister of Defence. The evaluation work programme addresses strategic risks to the defence system. Of particular note in 2014/15, is the report on *Optimising New Zealand Industry Involvement in the New Zealand Defence Sector*, which was released at the 2014 New Zealand Defence Industry Association Forum.⁵

This review has helped improve relationships between the Defence Industry and the defence sector and laid a foundation for improvements in the way the Ministry and Defence Force engage with Defence Industry. The report's recommendations – including New Zealand Industry Engagement Plans – are being actioned, and have been taken up with the Defence Industry and the New Zealand Defence Force.

In addition to the work programme, the Ministry is developing relationships with partner governments to identify ways to prevent, or detect and respond to defence sector fraud and corruption.

⁵ This report is available from the Ministry's website at: <http://defence.govt.nz/reports-publications/evaluation-report-optimising-nz-industry-involvement/contents.html>.

SUPPORTING NEW ZEALAND DEFENCE FORCE DEPLOYMENTS

The Ministry provides advice to Government on the deployment of New Zealand defence forces.

Over
2014–2018
this work will involve the Ministry:

- as determined by developments in the strategic environment, and in individual theatres where defence personnel are deployed
- on potential new New Zealand Defence Force deployments.

In 2014/15 the Ministry provided advice to Government on a new deployment, the Building Partner Capacity Mission in Iraq. It continued to ensure that existing deployments were managed in a way that maintained the confidence of international partners and furthered New Zealand's security interests.

Advice was provided to Ministers on future deployments including to the Combined Task Force in the Gulf of Aden/Indian Ocean. Advice has also been provided to Ministers on renewing mandates for existing deployments to the Afghan National Army Officer Academy, the United Nations Mission in South Sudan and the United Nations Truce Supervision Organisation.

Current New Zealand Defence Force deployments



DEFINING AND SELECTING MILITARY CAPABILITY

The Ministry leads the process, which it undertakes with the New Zealand Defence Force, of defining and selecting what military capability is needed to meet the Government's priorities.

Over
2014–2018
this work will involve the Ministry:

- delivering business cases for projects totalling \$3.7 billion (identified in the Defence Midpoint Rebalancing Review and *Defence Capability Plan*), and capital and capability plans that reflect the 2014 Defence Assessment and, potentially, a 2015 Defence White Paper
- exercising leadership and influence early in the capability process to ensure issues are identified early and all options (including 'do nothing') are considered
- engaging Acquisitions project directors early in each capability project to provide practical expertise and continuity of personnel.



The *Defence Capability Plan* sets out the capabilities the Government may acquire, enhance or replace to support its policy objectives for defence (as articulated in the Defence White Paper).⁶ In 2014/15, the Ministry continued to implement the Plan, providing policy and technical advice on a number of projects:

Type of projects	Includes
Land Combat projects	Special operations vehicles, options to upgrade the Light Armoured Vehicles, and a new expeditionary counter-explosive hazards capability.
Naval Combat projects	Options for the replacement of the New Zealand Defence Force's diving, mine counter-measures, and hydrographic support capability (currently provided by HMNZS <i>Manawanui</i>).
Projection and Sustainment projects	A programme to improve the overall efficiency and affordability of logistics (the consolidated logistics programme) and options to replace the Boeing 757 and C-130 Hercules fleets.
Command, Control, Computers and Communication/Intelligence, Surveillance and Reconnaissance projects	Options to upgrade and consolidate the Defence Force's high frequency radio infrastructure, the modernisation of the Army's and Special Forces communications equipment (network enabled army), and the upgrade of the ANZAC Frigates' external communications.

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:

- a single-stage business case for new Special Operations Vehicles
- indicative business cases for a new littoral operations support capability to replace HMNZS *Manawanui* and the consolidation of New Zealand Defence Force logistics, and
- the first tranche of the Network Enabled Army programme of work.

Details of the subsequent work the Ministry has undertaken on these projects following Cabinet approval (where applicable), is provided in the Current Projects section from page 35.

⁶ The *Defence Capability Plan 2014* is available from the Ministry's website at: <http://defence.govt.nz/reports-publications/defence-capability-plan-2014/contents.html>.

ASSESSING THE BENEFITS OF CAPABILITY AND READINESS OF THE DEFENCE SYSTEM

The Ministry provides contestable advice on whether the defence system is efficient and capable, and can deliver on the Government's priorities.

Over
2014–2018

this work will involve the Ministry providing:

- assurance on individual capability projects and issues, and periodic assessments of the New Zealand Defence Force's whole-of-organisation performance
- contemporaneous, whole-of-system advice on performance.

The Ministry has worked with the Defence Force on a shared 'Defence Inc' approach on various ongoing policy matters. This has included engagement with the central agencies, and working with other government agencies on the implications arising from new health and safety legislation, the Defence Force's continuing efforts for improving efficiency and effectiveness – including its Continuous Improvement work programme, the Defence Estate, youth development, housing and accommodation, and other policy issues.

ACQUIRING AND UPGRADING MILITARY CAPABILITY

The Ministry has primary responsibility – working closely with the New Zealand Defence Force – to procure major military capability. It is also responsible for major upgrades, and is itself undertaking an upgrade of C-130 Hercules aircraft.

Over
2014–2018

this work will involve the Ministry:

- completing major upgrades to New Zealand's C-130 Hercules and P-3K Orion fleets at Woodbourne Air Base in Blenheim. The work on the Hercules is led by Ministry staff and is the largest work ever undertaken on any aircraft in New Zealand
- acquiring major military equipment as approved by the Government, and in conjunction with the New Zealand Defence Force
- ensuring all acquisitions projects have the right expertise and support, including in project management, risk and scheduling.



During the 2014/15 year, the Ministry has been involved in the acquisition of 17 major defence capability projects (where 'major' refers to projects with a value of over \$15 million).

New projects	In flight projects	Projects where capabilities are being introduced into service or due for completion
<ul style="list-style-type: none"> • Maritime Sustainment Capability • Underwater Intelligence, Surveillance and Reconnaissance • Individual Weapon Replacement • Special Operations Vehicle • Network Enabled Army – Tranche 1 	<ul style="list-style-type: none"> • ANZAC Frigates' Platform System Upgrade • ANZAC Frigate Systems Upgrade • C-130 Hercules Life Extension (final aircraft) • Protector Remediation • Maritime Helicopter Replacement • Defence Command and Control System • Strategic Bearer Network – Phase 1 	<ul style="list-style-type: none"> • P-3K Orion Mission Systems Upgrade • Replacement Helicopter Capability: NH90 Medium Utility Helicopter • Pilot Training Capability • Medium-Heavy Operational Vehicles • Replacement Helicopter Capability: Training/Light Utility Helicopter

Highlights of the acquisition work during the 2014/15 year were:

- Second-phase work on the Platform Systems Upgrade of HMNZS *Te Kaha* was completed and this frigate is now undertaking operations. Phase 2 work commenced on HMNZS *Te Mana*.
- Eight of the 10 SH2G(I) Super Seasprite helicopters were delivered to New Zealand.
- The fourth upgraded C-130 Hercules was returned to operations, and work commenced on upgrading the fifth and final aircraft as part of the C-130 Hercules Life Extension project. This aircraft requires the most structural work of the fleet, so the final deadline was pushed into 2015/16.
- The final NH90 medium utility helicopter was delivered. The NH90 fleet took over from the Iroquois in May/June this year. This new defence capability was tested during the Exercise Talisman Sabre 2015.
- All 11 Beechcraft T6 Texan aircraft for the Pilot Training Capability project were delivered to New Zealand, as well as the associated simulators, training aids and key infrastructure at Ohakea.
- On 25 June 2015, a formal handover ceremony was held at Trentham Military Camp, as part of the Ministry and Defence Force receiving and accepting the last of the 194 trucks acquired for the Medium-Heavy Operational Vehicle project.

Five new projects were set up in 2014/15. Tenders were sought for the Maritime Sustainment Capability project, Individual Weapon Replacement project and the Underwater Intelligence, Surveillance and Reconnaissance project. Early-stage work commenced on the Network Enabled Army programme – Tranche 1 and the Special Operations Vehicle project.

The Ministry provided ongoing support to facilitate effective communications between Defence and New Zealand industries. This included regular updates to industry groups on project opportunities and progress – particularly at the New Zealand Defence Industry Association Annual Forum held in Wellington in October 2014.

Full details about the progress of all current acquisition projects in the reporting period are provided in the Current Projects section starting on page 35. Information about requests for information and tenders undertaken is provided from page 31.

ADMINISTERING THE JOINT MINISTRY/NEW ZEALAND DEFENCE FORCE CAPABILITY MANAGEMENT SYSTEM

The Ministry administers, with the New Zealand Defence Force, the capability management governance arrangements that are the shared responsibility of the Chief of Defence Force and the Secretary of Defence.

Over

2014–2018

this work will involve the Ministry and New Zealand Defence Force developing improved shared datasets and approaches. The Ministry will apply these to taking an ongoing portfolio view of defence capability, to build on the Defence Midpoint Rebalancing Review and Defence Assessment processes

Building on the direction set by the *Defence White Paper 2010*, the Ministry is increasingly operating in partnership with the New Zealand Defence Force on capability decisions. Defence Capability is jointly governed and managed within the Capability Management Framework which describes the processes, roles and responsibilities of both organisations.

Since the Capability Management Framework was revised in June 2014, both the Ministry and Defence Force have focused on improvements to the establishment and benefit management of the Defence Capability Change Action Plan that will deliver on the Government's investment from the 2015 Budget.

CONTRIBUTING TO A SUSTAINABLE, RESILIENT DEFENCE AND SECURITY SECTOR WORKFORCE

The Ministry works as part of a wider defence and security sector to ensure it has the workforce needed to make the sector function optimally.

Over
2014–2018

this work will involve the Ministry working as part of a wider defence and security sector to develop people and talent.



The Ministry's 2014 *Performance Improvement Framework Follow-up Review* noted the progress it had made in its focus on people and talent.⁷ All staff members are included in this, and there is a strong emphasis on support for in-role learning. The Follow-up Review also reflected that sustained progress will depend on the Ministry being engaged in sector-wide approaches to people and talent.

2014/15 was the first full year of the Ministry of Defence's new shared services arrangement with the intelligence community for Human Resource services. The focus in this period was on managing the transition and modernising some practices and systems. This work will continue in 2015/16. One of the overall goals of the arrangement is to give staff access to a career in a sector, rather than work in a single organisation only. The Ministry is working with partner agencies to achieve this.

A further priority for the Ministry has been to improve the diversity of its workforce. An early focus has been to improve the organisation's gender balance. The proportion of women who make up the Ministry's permanent staff increased from 38.3 per cent in mid-2013 to 45.6 per cent in mid-2015. The Ministry will further this progress in 2015/16.

The Ministry's Leadership Team has taken a conscious decision to provide staff with greater training and development opportunities, achieved through targeted programmes.

⁷ The Ministry's 2014 *Performance Improvement Framework Follow-up Review* is available from the Ministry's website at: <http://defence.govt.nz/reports-publications/pif-review-follow-up-2014/contents.html>.

SUMMARY FINANCIAL INFORMATION

SUMMARY OF 2014/15 APPROPRIATIONS

	Policy advice and related outputs MCA \$000	Evaluation, audit and assessment of performance \$000	Management of equipment procurement \$000	Capital expenditure: defence equipment \$000
Main estimates appropriation	5,970	1,927	3,669	464,984
Supplementary estimates change	-	-	718	(64,247)
Change by order in council under section 26A of the Public Finance Act 1989	-	-	-	-
Total amount appropriated for 2014/15	5,970	1,927	4,387	400,737
Estimated actual outturn for 2014/15 as reported in 2014/15 Estimates	5,970	1,927	4,387	400,737
Audited actual outturn for 2014/15	5,941	1,913	3,968	386,929

DEPARTMENTAL EXPENDITURE BY APPROPRIATION

	2014/15 \$000	2013/14 \$000	2012/13 \$000	2011/12 \$000	2010/11 \$000	2009/10 \$000
Revenue						
Revenue Crown	11,165	12,116	11,366	10,729	10,545	10,798
Revenue other	703	1,484	2,154	442	328	396
Total Revenue	11,868	13,600	13,520	11,171	10,873	11,194
Expenditure						
Policy advice and related outputs	5,941	6,174	5,434	5,205	4,704	4,691
Evaluation, audit and assessment of performance	1,913	2,149	2,066	1,665	1,479	1,794
Management of equipment procurement	3,968	5,255	5,787	4,249	3,880	4,526
Total expenditure under appropriations	11,822	13,578	13,287	11,119	10,063	11,011
Surplus/(deficit)	46	22	233	52	810	183

Where restructuring of the appropriation has occurred then, to the extent practicable, prior year's information is presented in a manner consistent with current year appropriations.

PAYMENTS AND RECEIPTS ON BEHALF OF THE CROWN

	2014/15	2013/14	2012/13	2011/12	2010/11	2009/10
	\$000	\$000	\$000	\$000	\$000	\$000
Capital expenditure: defence equipment						
Voted in Estimates	400,737	286,600	149,914	154,897	228,753	369,004
Actual capital expenditure	386,929	273,572	132,789	102,359	144,506	160,094
Variance	13,808	13,028	17,125	52,538	84,247	208,910
Capital receipts	386,929	273,572	176,315	154,331	135,797	174,118

ORGANISATIONAL HEALTH AND CAPABILITY

The Ministry has been transforming itself since the Performance Improvement Framework Review, published in September 2012. A follow-up review was published in August 2014. This described the Ministry's progress as "exemplary as the most successful early stage transformation [the reviewers] have seen in the New Zealand public service" while setting out challenges that would have to be met for progress to be sustained.

These challenges included addressing baseline challenges and implementing an effective defence and security sector workforce strategy. Decisions were taken in Budget 2015 to invest \$27.1 million in the Ministry over the four years from 1 July 2015, and as set out below, the Ministry is working with the agencies around it on shared approaches to workforce management and talent development.

GOOD EMPLOYER PRACTICES AND STAFF DEVELOPMENT

2014/15 was the first full year of the Ministry's new shared services arrangement with the intelligence community for Human Resource services. The focus in this period was on managing the transition and modernising some practices and systems. This work will continue in 2015/16. The Ministry has set a goal of giving staff access to a career in a sector, rather than work in a single organisation only. Work has started and is underway with partner agencies to achieve this goal.

A further priority for the Ministry has been to improve the diversity of its workforce. An early focus has been to improve the organisation's gender balance. The proportion of women making up the Ministry's permanent staff increased from 38.3 per cent in mid-2013 to 45.6 per cent in mid-2015. The Ministry will continue this priority into 2015/16.

The Ministry introduced an improved staff performance management system for 2014/15. The performance management system provides professional feedback and is connected with development opportunities. All staff have an individual development plan, and there is a focus on learning and in-role improvement.

STAFF ENGAGEMENT

The Ministry carried out a staff engagement survey in June 2015. The result was a significant increase in the organisation's overall Engagement Index from 64 (in 2013) to 80 (in 2015). This result, with 45 per cent of staff now registering as engaged (compared to 14 per cent in 2013) has moved the organisation from being at or below the State sector service benchmark, to being in the top 25 per cent.

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.

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. Relevant metrics are reported to the State Services Commission each year.

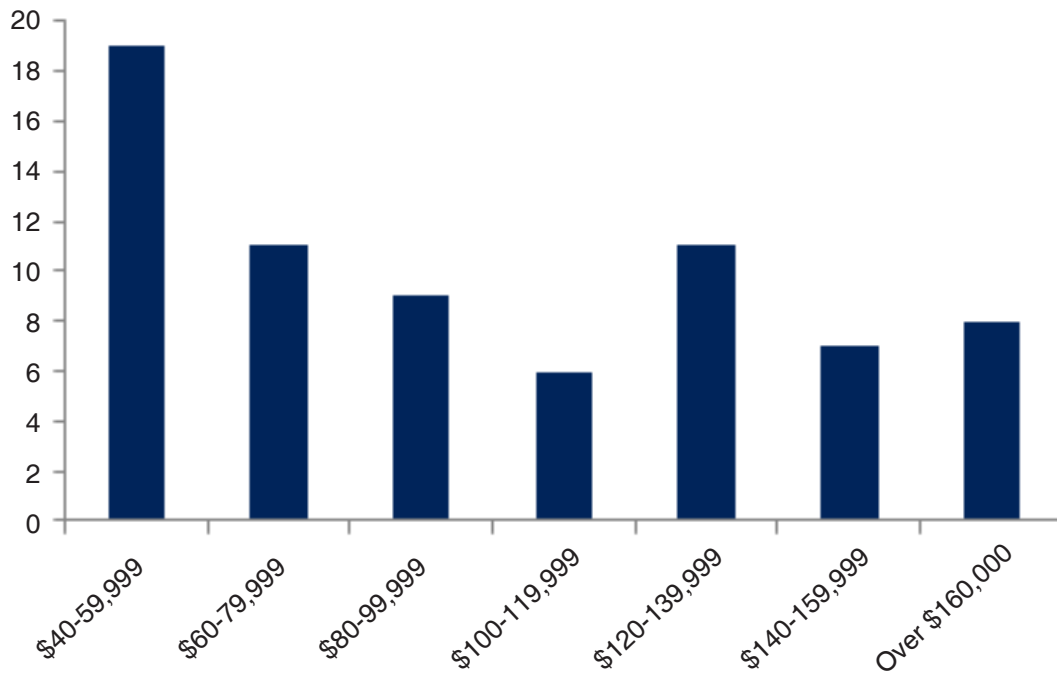
QUALITY ASSURANCE

The Ministry applied quality assurance processes to all outputs 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 the 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.

STAFF SALARY BANDS

The Ministry's remuneration policy ensures that all roles in the Ministry are evaluated using a recognised methodology and that salary bands are set accordingly, ensuring all employees, regardless of their age, gender or ethnicity, are rewarded on an appropriate salary scale.

Figure 3: Staff numbers by salary band as at 30 June 2015



THE MINISTRY'S OPERATIONS

MULTI-CATEGORY APPROPRIATION: POLICY ADVICE AND RELATED OUTPUTS

This appropriation is intended to achieve the provision of civilian advice on defence policy matters and development of international defence relations.

Under this Multi-Category Appropriation, 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 New Zealand Defence Force assets and personnel
 - the military capabilities required to meet defence policy goals, broad resource implications and the relative merits and risks associated with proposed capability options
- management and enhancement of bilateral and multilateral defence relations
- responses to Ministerial requests and Parliamentary Questions, Official Information Act enquiries and Ombudsmen correspondence.

Performance Measures	2013/14	2014/15	
	Actual	Budget	Actual
Total cost per output hour. ¹	\$159.43	< \$167	\$142.53
Total cost per output hour updated. ¹	\$109.75	N/A	\$98.12
Policy Advice			
Technical quality of policy advice, as assessed by independent review of a sample of policy papers.	72.5%	≥ 70%	76%
Minister's satisfaction with the quality of policy advice, as assessed by survey.	50% ²	≥ 70%	50% ²
Timeliness, as assessed by the percentage of papers that were submitted by the directed deadline.	100%	≥ 95%	100%
Technical quality robustness, as assessed by the Common Indicator Set tool.	100%	≥ 70%	100%

	2013/14	2014/15	
Policy Support			
Minister's satisfaction with the quality of policy support, as assessed by survey.	65% ²	≥ 70%	50% ²
Timeliness, as assessed by the percentage of papers that were submitted by the directed deadline.	100%	≥ 95%	100%
Ministerial Services			
Quality, as assessed by the percentage of first draft of all correspondence accepted by the Minister.	98.9%	≥ 70%	66% ²
Timeliness, as assessed by the percentage of papers that were submitted by the timeframe set in legislation, or otherwise agreed with the Minister.	100%	≥ 95%	96%

Notes:

1. The 'Total cost per output hour' formula has 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.
2. These scores reflect a shared rating for advice and support across both the Ministry of Defence and New Zealand Defence Force.

The Ministry continually assesses ways to improve its advice and support, in close coordination with the Minister and his office. The focus of this is to ensure 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). The Ministry has responded to feedback to satisfy Ministerial expectations, and is committed to continuous improvement in performance.

Further detail about the 2014/15 operations of this output are provided in the previous section entitled Delivering on the Ministry's Strategic Intentions, specifically work in relation to:

- assessing and providing advice on the strategic defence environment
- contributing to regional and international defence engagement
- supporting New Zealand Defence Force deployments
- defining and selecting military capability
- assessing the benefits of capability and readiness of the defence system
- administering the joint Ministry of Defence/New Zealand Defence Force Capability Management System.

Cost for the year ended 30 June 2015

	2013/14	2014/15		
	Actual	Main estimates	Supp estimates	Actual
	\$000	\$000	\$000	\$000
Total revenue	6,175	5,970	5,970	5,970
Expenses				
Policy Advice	3,716	3,593	3,593	3,576
Ministerial services	741	717	717	713
Policy support	1,717	1,660	1,660	1,652
Total expenditure	6,174	5,970	5,970	5,941
Net surplus	1	-	-	29

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

DEPARTMENTAL OUTPUT EXPENSES: EVALUATION, AUDIT AND ASSESSMENT OF PERFORMANCE

This appropriation is intended to achieve the completion of an approved schedule of evaluations, audits and assessments as required by the Minister of Defence.

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

Performance Measures	2013/14	2014/15	
	Actual	Budget	Actual
Evaluations, audits and assessments are in accordance with work priorities identified and advised by the Minister of Defence.	Standard met	Standard met	Standard met
A review of the evaluations, audits and assessment confirm that they meet acceptable standards based on pre-determined criteria.	Standard met	Standard met	Standard met

Note: The standard for these measures is based on a continuum of standard not met, standard met and standard exceeded.

Further details about the 2014/15 operations for this output are provided in the earlier section entitled Delivering on the Ministry's Strategic intentions, specifically work in relation to undertaking evaluations and assessments directed by the Minister of Defence.

Cost for the year ended 30 June 2015

	2013/14	2014/15		
	Actual \$000	Main estimates \$000	Supp estimates \$000	Actual \$000
Total revenue	2,151	1,927	1,927	1,927
Total expenditure	2,149	1,927	1,927	1,913
Net surplus	2	-	-	14

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

DEPARTMENTAL OUTPUT EXPENSES: MANAGEMENT OF EQUIPMENT PROCUREMENT

This appropriation is intended to achieve the management of procurement of major military equipment in a transparent and fair way, and in accordance with government procurement policies.

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 a \$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 receive 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, to the point when the equipment, initial training and spares are delivered to the New Zealand Defence Force
- management of any warranty provisions beyond delivery date
- management of financing commitments
- arrangement of on-sale to the New Zealand Defence Force and
- the provision of advice to industry on defence requirements.

	2013/14	2014/15	
Performance Measures	Actual	Budget	Actual
<p>Cost: Each procurement or refurbishment project will be managed within its approved budget, inclusive of approved variations to the contract price and project budget.</p> <p>The measure is the % of all project-related expenditure incurred in the year that is in excess of the approved project expenditure.</p>	0%	0%	0%
<p>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.</p> <p>The measure is the number of accepted projects that do not meet all specifications that are critical to acceptance.</p>	0%	0%	0% ¹
<p>Schedule: Each equipment procurement or refurbishment project will be managed to schedule, without avoidable schedule over-run.</p> <p>The measure is the % of all projects where, during the year, the project delivery schedule is extended by more than 10%.</p>	25% (3 of 12 projects)	0%	6% (1 of 17 projects)

Note:

1. All projects currently underway are anticipated to meet the agreed/contracted specifications and other contractual arrangements on the delivery of the capability.

Defence industry

As part of work under this appropriation, the Ministry:

- continues to facilitate effective communication between Defence and New Zealand industries to provide appropriate goods and services as required
- provides support for the New Zealand Defence Industry Advisory Council (NZDIAC)
- ensures 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
- conducts industry briefing sessions on current defence projects and activities.

Performance

The Ministry provided support for the NZDIAC in the facilitation of the Minister of Defence Awards of Excellence to Industry and at meetings held on 12 August 2014 and 5 May 2015.

The Ministry released the *Optimising New Zealand Industry Involvement in the New Zealand Defence Sector* report at the New Zealand Defence Industry Association Defence and Industry Annual Forum held in Wellington in October 2014.

Industry groups have been regularly updated on project opportunities and progress. The Ministry presented at the quarterly New Zealand Defence Industry Association Members meetings, including on:

- the status of major acquisition projects
- the implementation of the *Optimising New Zealand Industry Involvement in the New Zealand Defence Sector* report's recommendations, and
- the Ministry's programme of work to improve defence capability management, which includes a work stream to improve engagement with Defence Industry.

The Ministry issued the following Requests for Tenders, Registrations of Interest and Requests for Information to industry:

Requests for Tender (RFT), Registrations of Interest (ROI) or Requests for Information (RFI)	Published	Closed
Maritime Sustainment Capability: Provision of Support Services RFT	24 Jun 2014	27 Aug 2014
Individual Weapon Capability RFT	14 Aug 2014	12 Nov 2014
Maritime Helicopter Capability Project: Provision of Consultancy Services RFT	13 Oct 2014	7 Nov 2014
Underwater Intelligence, Surveillance and Reconnaissance ROI	24 Oct 2014	21 Nov 2014
Strategic Bearer Network – Phase Two RFI	9 Feb 2015	20 Mar 2015
P-3K Satellite Communications RFI	25 Mar 2015	29 May 2015
Maritime Sustainment Capability RFT	25 Mar 2015	24 Jun 2015
Littoral Operation Support Capability (2nd) RFI	4 Jun 2015	7 Aug 2015

The Ministry also held briefings with Industry on the Underwater Intelligence, Surveillance and Reconnaissance Capability project and the Maritime Sustainment Capability project in April 2015.

The Ministry published lists of respondents to the following Requests for Information to enable New Zealand industry to engage with potential prime contractors at an early stage in a project's life:

Request for Information	Published
Maritime Sustainment Capability	28 Nov 2014
Littoral Operation Support Capability	28 Nov 2014
Underwater Intelligence, Surveillance and Reconnaissance	5 Jan 2015
Individual Weapons Trial Selection Phase	12 Jan 2015
Strategic Bearer Network – Phase Two	4 Jun 2015

Quality measures and standards

The Ministry objective is 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.

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 for the year ended 30 June 2015

	2013/14	2014/15		
	Actual \$000	Main estimates \$000	Supp estimates \$000	Actual \$000
Total revenue	5,258	3,669	4,387	3,972
Total expenditure	5,255	3,669	4,387	3,968
Net surplus	3	-	-	4

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

New projects

Cabinet has approved the commencement of the source selection process for the following projects:

- In June 2014, Cabinet approved the Secretary of Defence calling competitive tenders for the Underwater Intelligence, Surveillance and Reconnaissance Project.
- In June 2014, Cabinet approved the Secretary of Defence calling competitive tenders for the Maritime Sustainment Capability Project.
- In May 2015, Cabinet approved the acquisition of the Network Enabled Army – Tranche 1, with a total budget of \$106.0 million.
- In June 2015, Cabinet approved the Secretary of Defence acquiring a small number of Special Operations Vehicles, equipment, infrastructure and support on a sole source basis subject to consultation prior to contract signature with the Minister of Defence and Chief of Defence Force. The total budget is \$28 million.

Current projects

A summary of each major acquisition project managed by this output is contained in the Non-Departmental Capital Expenditure: Purchase of Defence Equipment section, starting on page 35.

PERMANENT LEGISLATIVE AUTHORITY: MINISTRY OF DEFENCE – CAPITAL EXPENDITURE

This appropriation is intended to achieve the purchase and development of assets by and for the use of the Ministry in its day-to-day operations.

	2013/14	2014/15	
Performance Measures	Actual	Budget	Actual
Capital expenditure is within budget.	Within budget	Within budget	Within budget

Cost for the year ended 30 June 2015

	2013/14	2014/15		
	Actual	Main estimates	Supp estimates	Actual
	\$000	\$000	\$000	\$000
Total appropriation	560	320	608	608
Total capital expenditure	32	320	608	484

NON-DEPARTMENTAL CAPITAL EXPENDITURE: PURCHASE OF DEFENCE EQUIPMENT

This appropriation is managed by the Ministry on behalf of the Minister of Defence.

This appropriation is intended to achieve the procurement of major military equipment in a transparent and fair manner, and in accordance with government procurement policies.

	2013/14	2014/15	
Performance Measures	Actual	Budget	Actual
Performance measures are the same as used for the departmental appropriation Management of Equipment Procurement and are reported under the appropriation on page 30.	As per departmental appropriation reported on page 30.		

Cost for the year ended 30 June 2015

	2013/14	2014/15		
	Actual	Main estimates	Supp estimates	Actual
	\$000	\$000	\$000	\$000
Total appropriation	286,600	464,984	400,737	400,737
Total capital expenditure	273,573	464,984	400,737	386,929

CURRENT PROJECTS

This section summarises the background and 2014/15 performance of all major projects undertaken under this output. An explanatory note detailing the definitions used in the summaries is provided on the following page.

EXPLANATORY NOTE ON THE PROJECT COST SUMMARIES

Definitions

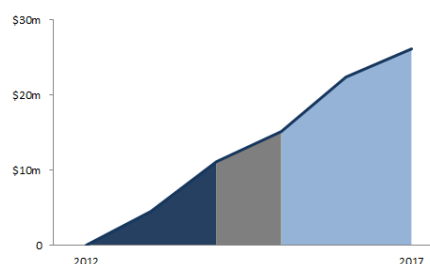
The following definitions apply to words used in the project cost summary tables:

Prime contract	Payments made by the Ministry to the contractor(s) manufacturing or supplying the major equipment.
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 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 2015 have been translated to New Zealand dollars using Treasury fiscal reporting rates at balance date. The rates were:
	AUD 0.8879 CAD 0.8462 EUR 0.6088 GBP 0.4334 JPY 83.4950 NOK 5.36905 SEK 5.6155 USD 0.68165

Project expenditure charts

The project expenditure charts show the actual to date and forecast costs from the year of Cabinet approval to expected project closure as described below:

costs to 30 June 2014
 costs incurred in 2014/15
 forecast costs to project closure



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 that Cabinet approval is sought. The subsequent recording of project expenditure uses exchange rates prevailing at the date of the transaction 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 include a line to show the total foreign exchange variance between Cabinet approval and recorded expenditure as at 30 June 2015.

ANZAC FRIGATES' PLATFORM SYSTEMS UPGRADE

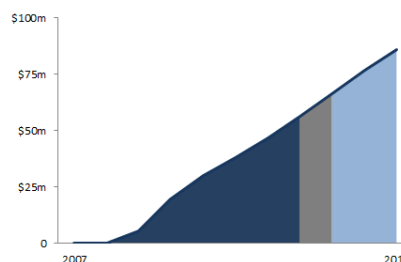
The Platform Systems Upgrade consists of four separate elements divided into two phases, each aimed at ensuring ongoing viability of the key platform systems in the ANZAC Frigates.

- Phase 1 (completed): The propulsion upgrade, stability enhancements and compartment enhancement elements were successfully integrated into HMNZS *Te Kaha* and *Te Mana*. Phase 1 was 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, and the heating, ventilation and air conditioning systems aboard HMNZS *Te Kaha* has been completed. Work is underway for these upgrades to HMNZS *Te Mana*.

During 2013/14, the project fell behind schedule and incurred a significant increase in cost. In December 2013, Cabinet approved a \$6 million increase in the appropriation to complete work on the first ship. In April 2014, Cabinet approved a further increase in appropriation to cover the work on HMNZS *Te Mana*. The adjustments to appropriation were fiscally neutral and came from under-spends in other Defence projects, bringing the total appropriation for the Platform Systems Upgrade project to \$87.6 million.

Objectives	Performance
<p>HMNZS TE KAHA</p> <ul style="list-style-type: none"> Integrate, set to work and commission the heating, ventilation and air conditioning systems. Integrate, set to work and commission the integrated platform management systems. 	<p>Completed contractor sea acceptance trials on 21 September 2014, following a period of shakedown, workup and operational readiness evaluation. The ship deployed for the Gallipoli commemoration and for operations in the Indian Ocean.</p>
<p>HMNZS TE MANA</p> <ul style="list-style-type: none"> Carry out detailed planning to ensure on-time completion of Phase 2. 	<p>Production work commenced in December 2014. The completion date of May 2016 is on schedule.</p>

Project expenditure in 2014/15	Actual \$000
Prime contract	9,381
Ancillary contracts	-
Project management	628
Total project expenditure in 2014/15	10,009



Total project cost summary As at 30 June 2015	Actual costs to 30 June 2015	Future commitments and forecasts	Estimated outturn 30 June 2015
	\$000	\$000	\$000
Prime contract	62,696	18,434	81,130
Ancillary contracts	-	-	-
Project management	3,625	124	3,749
Contingency	-	1,052	1,052
Project net expenditure	66,321	19,610	85,931
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval: favourable/ (unfavourable)			1,281
			87,212
Project costs approved by Cabinet			87,600

MARITIME SUSTAINMENT CAPABILITY

The Maritime Sustainment Capability project seeks to replace HMNZS *Endeavour* with a vessel that will maintain an afloat replenishment capacity for the New Zealand Defence Force. Cabinet approval is expected to be sought in 2015/16, following the selection of a preferred tenderer.

Objectives	Performance
<ul style="list-style-type: none"> Issue and close tenders. 	A Request for Tender was issued in March 2015 and closed on 24 June 2015.

UNDERWATER INTELLIGENCE, SURVEILLANCE AND RECONNAISSANCE

The Underwater Intelligence, Surveillance and Reconnaissance project seeks to replace the underwater intelligence, surveillance and reconnaissance capability of the existing P-3K Orion maritime patrol fleet. Cabinet approved the calling of tenders.

Objectives	Performance
<ul style="list-style-type: none"> Issue and close tenders. 	Tenders were issued in March 2015 and closed on 28 June 2015.

INDIVIDUAL WEAPONS REPLACEMENT

Cabinet approved the Secretary of Defence undertaking a competitive tender process to select a replacement individual weapon within a capital cost of \$58.4 million. It is expected that Cabinet will consider the implementation business case for this project later in 2015.

Objectives	Performance
<ul style="list-style-type: none"> Issue competitive request for tender. 	Issued in August 2014 and closed in November 2014.
<ul style="list-style-type: none"> Undertake trials of weapons. 	Completed June 2015.

ANZAC FRIGATE SYSTEMS UPGRADE

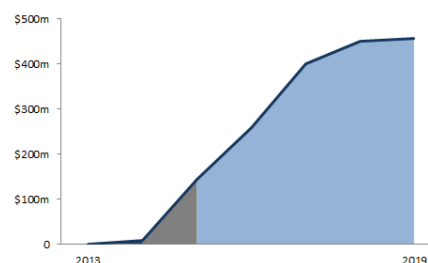
The primary objective of the Frigate Systems Upgrade project is to upgrade the ANZAC Frigates' combat capabilities to return their policy utility to the level provided on delivery. This is required to counter the combined problems of an increase in the level of sophistication of threats, coupled with obsolescence of certain systems. The project dove-tails 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 \$446.2 million of capital expenditure between the Ministry and New Zealand Defence Force. Contracts were awarded to Lockheed Martin Canada and others as required for equipment and services. Following due diligence activities, Cabinet approved Lockheed Martin Canada as the preferred Combat System Integrator.

Contract management and preliminary design work will be undertaken in the remainder of the 2015 calendar year.

Objectives	Performance
<ul style="list-style-type: none"> Complete contract negotiations and the award of contracts. Conduct scheduled Design Reviews. 	<p>A further two contracts were awarded in January and March 2015 along with three Foreign Military Sales Cases.</p> <p>The Combat Systems Preliminary Design Review was completed as scheduled in April 2015.</p> <p>The first Platform Preliminary Design Review was completed as scheduled in May 2015.</p>

Project expenditure in 2014/15	Actual \$000
Prime contract	96,616
Ancillary contracts	37,341
Project management	1,602
Total project expenditure in 2014/15	135,559



Total project cost summary As at 30 June 2015	Actual costs to 30 June 2015 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2015 \$000
Prime contract	100,371	131,852	232,223
Ancillary contracts	41,580	141,740	183,320
Project management	2,239	9,581	11,820
Contingency	-	30,156	30,156
Project net expenditure	144,190	313,329	457,519
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval: favourable/ (unfavourable)			(29,253)
Project costs approved by Cabinet			428,266
			430,785

PROTECTOR REMEDIATION

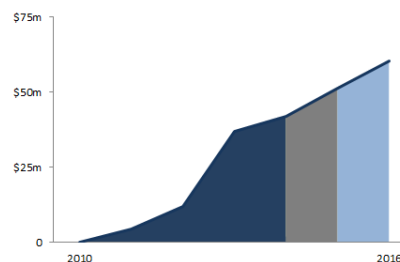
Project Protector delivered a Logistics Support Ship, two Offshore Patrol Vessels and four Inshore Patrol Vessels. These vessels were acquired to perform a range of sealift and naval patrol tasks for the New Zealand Defence Force and civilian agencies. The ships were delivered with capability shortfalls and deficiencies that were subject to a mediation claim and settlement.

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

Work has continued to plan throughout 2015/16.

Objectives	Performance
<ul style="list-style-type: none"> Complete design and implementation work. Progress installation work consistent with the vessels operational tasking. 	<p>Detailed designs completed.</p> <p>Installation work is 93% complete as at 30 June 2015. The project is scheduled to complete in June 2016 with the exception of the ballast work on HMNZS <i>Canterbury</i>, which is scheduled for September 2016 because of operational tasking.</p>

Project expenditure in 2014/15	Actual \$000
Prime work	8,879
Project management	302
Total project expenditure in 2014/15	9,181



Total project cost summary As at 30 June 2015	Actual costs to 30 June 2015 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2015 \$000
Prime work	50,939	6,823	57,762
Project management	302	618	920
Contingency	-	1,750	1,750
Project net expenditure	51,241	9,191	60,432
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval: favourable/ (unfavourable)			-
			60,432
Project costs approved by Cabinet			60,759

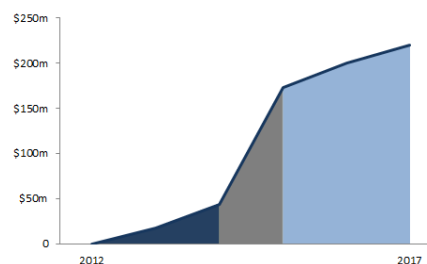
MARITIME HELICOPTER

This project is providing an upgraded fleet of naval helicopters for the Royal New Zealand Navy. Eight SH-2G(I) Super 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.

The final aircraft and the software support systems are expected to be delivered in the 2015 calendar year.

Objectives	Performance
<ul style="list-style-type: none"> Deliver all 10 helicopters and the flight training simulator. 	<p>Three helicopters were delivered in January 2015, a further three in May 2015, two in June 2015. The last two helicopters are scheduled to arrive in September 2015.</p> <p>The Flight Training Simulator is scheduled to be accepted in September 2015.</p>

Project expenditure in 2014/15	Actual \$000
Prime contract	113,271
Ancillary contracts	13,119
Project management	2,563
Total project expenditure in 2014/15	128,953



Total project cost summary As at 30 June 2015	Actual costs to 30 June 2015 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2015 \$000
Prime contract	151,507	9,094	160,601
Ancillary contracts	16,762	17,138	33,900
Project management	4,424	2,292	6,716
Contingency	-	18,692	18,692
Project net expenditure	172,693	47,216	219,909
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval: favourable/ (unfavourable)			(2,703)
			217,206
Project costs approved by Cabinet			220,342

C-130 HERCULES LIFE EXTENSION

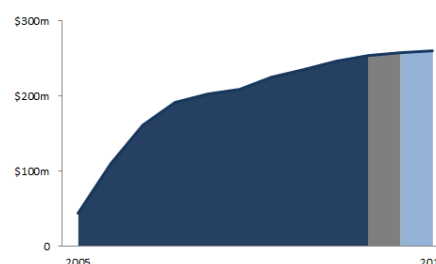
This project is extending the life of the five RNZAF C-130 Hercules aircraft by upgrading the fleet's mechanical and electrical equipment, undertaking comprehensive structural refurbishment work and extensively upgrading the communication and navigation systems.

The programme encountered 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. Four completed aircraft are delivering outputs for New Zealand Defence Force transport requirements, this has included providing support to humanitarian and disaster relief operations in the Pacific following Cyclone Pam.

The fifth and final aircraft is expected to be delivered in early 2016.

Objectives	Performance
<ul style="list-style-type: none"> Deliver the fourth (second production) aircraft in August 2014. Deliver the fifth (final production) aircraft in August 2015. 	<p>The aircraft was delivered in October 2014.</p> <p>The final aircraft is now scheduled for delivery in February 2016. Extensive corrosion has required significant additional work.</p>

Project expenditure in 2014/15	Actual \$000
Prime contract	546
Production and part task trainer	3,617
Ancillary contracts	336
Project management	33
Total project expenditure in 2014/15	4,532



Total project cost summary As at 30 June 2015	Actual costs to 30 June 2015 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2015 \$000
Prime contract	215,987	(478)	215,509
Production and part task trainer	27,268	2,174	29,442
Ancillary contracts	6,703	-	6,703
Project management	8,374	1,040	9,414
Contingency	-	-	-
Project net expenditure	258,332	2,736	261,068
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval: favourable/ (unfavourable)			3,638
			264,706
Project costs approved by Cabinet			264,789

P-3K ORION MISSIONS SYSTEMS UPGRADE

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.

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 the resolution of a relatively small number of software defects by the contractor, under warranty.

The project is expected to close out in 2015/16.

Objectives	Performance
<ul style="list-style-type: none"> Deliver the final software load in late 2015. 	Delivered in July 2015.

Project expenditure in 2014/15	Actual \$000
Prime contract	5,049
Ancillary contracts	73
Project management	365
Total project expenditure in 2014/15	5,487



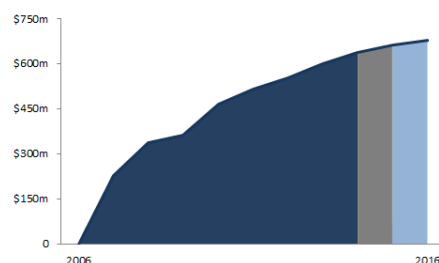
Total project cost summary As at 30 June 2015	Actual costs to 30 June 2015 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2015 \$000
Prime contract	309,434	1,065	310,499
Ancillary contracts	12,316	531	12,847
Project management	9,163	208	9,371
Contingency	-	-	-
Project net expenditure	330,913	1,804	332,717
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval: favourable/ (unfavourable)			43,460
Project costs approved by Cabinet			376,177
			377,288

REPLACEMENT HELICOPTER CAPABILITY: MEDIUM UTILITY HELICOPTER

This project covers the acquisition of eight operational NH90 helicopters. These helicopters were delivered to the New Zealand Defence Force between 2011 and 2014. Following the 2015 Exercise Talisman Sabre in Australia, the NH90 helicopters were confirmed as ready to deploy on operations in the South Pacific. The aircraft have already been used for search and rescue missions, transport for government and military personnel and lifting of equipment, while also maintaining a counter-terrorism response.

Objectives	Performance
<ul style="list-style-type: none"> Deliver helicopter 08 in final configuration. Complete the upgrade from Final Configuration to Final Configuration Plus. 	<p>Helicopter 08 was delivered in October 2014.</p> <p>The first phase of the Final Configuration Plan upgrade was completed in June 2015.</p> <p>The second phase is now scheduled for the first half of calendar year 2016.</p>

Project expenditure in 2014/15	Actual \$000
Prime contract	21,776
Ancillary contracts	3,647
Project management	730
Total project expenditure in 2014/15	26,153



Total project cost summary As at 30 June 2015	Actual costs to 30 June 2015 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2015 \$000
Prime contract	631,217	4,831	636,048
Ancillary contracts	19,108	5,000	24,108
Project management	13,280	20	13,300
Contingency	-	4,909	4,909
Project net expenditure	663,605	14,760	678,365
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval: favourable/ (unfavourable)			93,244
			771,609
Project costs approved by Cabinet			771,710

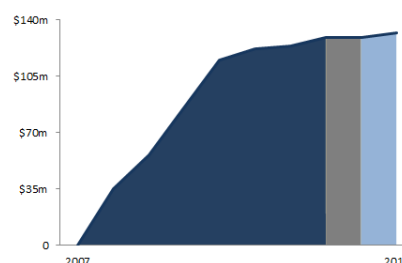
REPLACEMENT HELICOPTER CAPABILITY: TRAINING/LIGHT UTILITY HELICOPTER

This project has replaced the Sioux training helicopter with the AgustaWestland A109 Light Utility Helicopter providing a capability that meets the New Zealand Defence Force'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 2015/16.

Objectives	Performance
<ul style="list-style-type: none"> Accept the certification data for the transportation trolley. Resolve issues associated with the installation of cockpit armour. Close the project. 	<p>Certification data accepted.</p> <p>Awaiting the dates for a specialist to visit New Zealand to resolve this issue.</p> <p>Now scheduled for the second half of 2015.</p>

Project expenditure in 2014/15	Actual \$000
Prime contract	(177)
Ancillary contracts	103
Project management	19
Total project expenditure in 2014/15	(55)



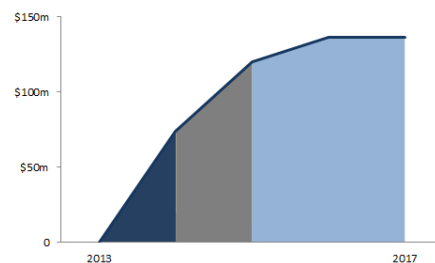
Total project cost summary As at 30 June 2015	Actual costs to 30 June 2015 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2015 \$000
Prime contract	118,809	54	118,863
Ancillary contracts	4,636	833	5,469
Project management	5,472	57	5,529
Contingency	-	2,170	2,170
Project net expenditure	128,917	3,114	132,031
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval: favourable/ (unfavourable)			5,065
			137,096
Project costs approved by Cabinet			140,529

PILOT TRAINING CAPABILITY

This project is providing an upgraded capability for Royal New Zealand Air Force pilot training. It consists of 11 T6 Texan 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. Beechcraft is the Prime contractor for both the acquisition and support contracts. The first wings (pilot training) course utilising this capability will commence in January 2016.

Objectives	Performance
<ul style="list-style-type: none"> Deliver all 11 aircraft. Complete new pilot training centre at RNZAF Base Ohakea. 	<p>Final aircraft delivered in April 2015.</p> <p>Training centre completed in May 2015.</p>

Project expenditure in 2014/15	Actual \$000
Prime contract	43,892
Ancillary contracts	1,210
Project management	1,174
Total project expenditure in 2014/15	46,276



Total project cost summary As at 30 June 2015	Actual costs to 30 June 2015 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2015 \$000
Prime contract	117,153	8,606	125,759
Ancillary contracts	1,269	4,086	5,355
Project management	1,796	1,598	3,394
Contingency	-	2,037	2,037
Project net expenditure	120,218	16,327	136,545
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval: favourable/ (unfavourable)			(2,761)
			133,784
Project costs approved by Cabinet			142,340

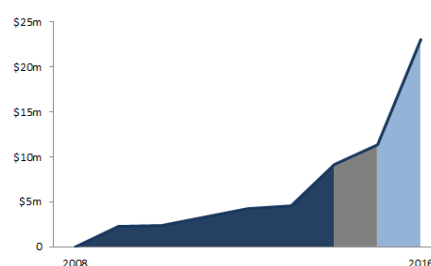
DEFENCE COMMAND AND CONTROL SYSTEM

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

The core of the system 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.

Objectives	Performance
<ul style="list-style-type: none"> Complete pilot for GCCS (Joint). 	Completed June 2015.
<ul style="list-style-type: none"> Complete implementation of GCCS (Joint) on Royal New Zealand Navy ships. 	Trials completed July 2015.

Project expenditure in 2014/15	Actual \$000
Prime contract	722
Ancillary contracts	979
Project management	529
Total project expenditure in 2014/15	2,230



Total project cost summary As at 30 June 2015	Actual costs to 30 June 2015 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2015 \$000
Prime contract	5,912	2,336	8,248
Ancillary contracts	3,948	5,478	9,426
Project management	1,490	438	1,928
Contingency	-	3,432	3,432
Project net expenditure	11,350	11,684	23,034
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval: favourable/ (unfavourable)			86
			23,120
Project costs approved by Cabinet			23,600

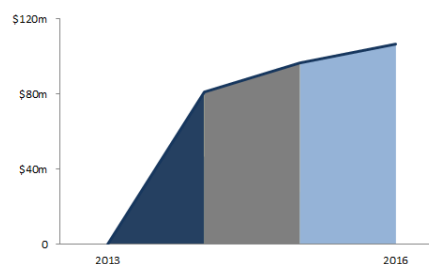
MEDIUM-HEAVY OPERATIONAL VEHICLES

The Medium-Heavy Operational Vehicles project is part of the Land Transport Capability Programme. This project will provide the New Zealand Defence Force 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 operations. Joint Ministers approved the procurement of up to 200 vehicles with Rheinmetal MAN Military Vehicles Australia in March 2013, following authorisation from Cabinet in December 2012, at a total cost of up to \$112.6 million. Apart from some minor modifications, the purchase was largely off-the-shelf and formed part of a production run for the British Army. The vehicles are now assigned to individual units and were deployed for the first time with New Zealand Defence Force personnel as part of Exercise Talisman Sabre in 2015.

The selection and acquisition of Recovery Vehicles will continue through 2015/16.

Objectives	Performance
<ul style="list-style-type: none"> Deliver vehicles in accordance with agreed schedules. 	<p>All 194 vehicles were delivered by the end of June 2015.</p> <p>Tractor trailer modifications delayed delivery of the final vehicle systems.</p>

Project expenditure in 2014/15	Actual \$000
Prime contract	15,194
Ancillary contracts	81
Project management	116
Total project expenditure in 2014/15	15,391



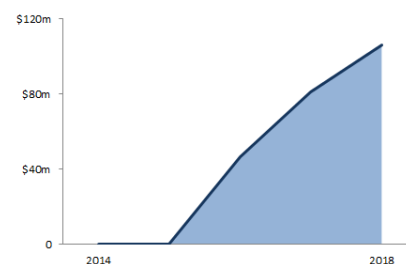
Total project cost summary As at 30 June 2015	Actual costs to 30 June 2015 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2015 \$000
Prime contract	96,036	293	96,329
Ancillary contracts	233	8,256	8,489
Project management	341	115	456
Contingency	-	1,328	1,328
Project net expenditure	96,610	9,992	106,602
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval: favourable/ (unfavourable)			4,741
			111,343
Project costs approved by Cabinet			112,637

NETWORK ENABLED ARMY – TRANCHE 1

Network Enabled Army – Tranche 1 will deliver modern communications to Special Operations Forces, and an Infantry Task Group and its Headquarters comprised of around 200 personnel.

Objectives	Performance
<ul style="list-style-type: none"> Consult with known vendors and the United States Government Foreign Military Sales system to develop an appropriate acquisition strategy. Scope the services required of a Systems Integrator. 	<p>Initial visits were conducted in May 2015.</p> <p>Scoping developed to enable a Request for Proposal to be issued in late 2015.</p>

Project expenditure in 2014/15	Actual \$000
Prime contract	-
Ancillary contracts	-
Project management	32
Total project expenditure in 2014/15	32



Total project cost summary As at 30 June 2015	Actual costs to 30 June 2015 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2015 \$000
Project costs	32	105,958	106,000
Contingency	-	-	-
Project net expenditure	32	105,958	106,000
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval: favourable/ (unfavourable)			-
			106,000
Project costs approved by Cabinet			106,000

A comprehensive budget has not been presented due to the pending finalisation of a series of workstreams.

SPECIAL OPERATIONS VEHICLES

In June 2015, Cabinet approved the Secretary of Defence acquiring a small number of Special Operations Vehicles, equipment, infrastructure and support on a sole source basis subject to consultation prior to contract signature, with the Minister of Defence and Chief of Defence Force. The total budget is \$28 million.

Objectives	Performance
<ul style="list-style-type: none"> Work through procurement options. 	Cabinet approved the initiation of this project at the end of the financial year, and work on procurement options commenced.

No project costs were incurred in 2014/15.

Total project cost summary As at 30 June 2015	Actual costs to 30 June 2015 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2015 \$000
Prime contract	-	14,400	14,400
Ancillary contracts	-	13,600	13,600
Project management	-	-	-
Contingency	-	-	-
Project net expenditure	-	28,000	28,000
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval: favourable/ (unfavourable)			-
			28,000
Project costs approved by Cabinet			28,000

STRATEGIC BEARER NETWORK – PHASE 1

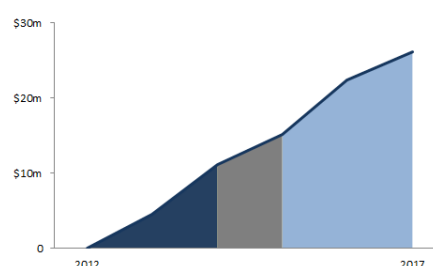
Phase 1 of this project will deliver global wide-band (high capacity) Satellite Communications (SATCOM) services to the New Zealand Defence Force. The United States Department of Defense Wideband Global SATCOM System (WGS) was identified as the preferred solution and a Memorandum of Understanding to access this constellation was signed with the Department of Defense 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 a narrow-band (less capacity but more mobile) capability is yet to begin acquisition.

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

Objectives	Performance
<ul style="list-style-type: none"> Deliver an Interim Operational Capability to the New Zealand Defence Force. Contract for Maritime Terminals. 	<p>This was achieved in September 2014.</p> <p>Supply will be through a Foreign Military Sales Case. Negotiations with the United States Government Agency have taken longer than originally envisaged.</p>

Project expenditure in 2014/15	Actual \$000
Prime contract	3,866
Ancillary contracts	-
Project management	106
Total project expenditure in 2014/15	3,972



Total project cost summary As at 30 June 2015	Actual costs to 30 June 2015 \$000	Future commitments and forecasts \$000	Estimated outturn 30 June 2015 \$000
Prime contract	14,338	10,634	24,972
Ancillary contracts	-	-	-
Project management	794	383	1,177
Contingency	-	-	-
Project net expenditure	15,132	11,017	26,149
Effect of foreign exchange movements against the foreign exchange rates used for the Cabinet approval: favourable/ (unfavourable)			-
			26,149
Project costs approved by Cabinet			26,310

PART 3: STATEMENT OF RESPONSIBILITY AND AUDIT REPORT

STATEMENT OF RESPONSIBILITY

I am responsible, as Chief Executive of the Ministry of Defence (the Ministry), for:

- the preparation of the Ministry's financial statements, and statements of expenses and capital expenditure, and for the judgements expressed in them
- having in place a system of internal control designed to provide reasonable assurance as to the integrity and reliability of financial reporting
- ensuring that end-of-year performance information on each appropriation administered by the Ministry is provided in accordance with sections 19A to 19C of the Public Finance Act 1989, whether or not that information is included in this annual report and
- the accuracy of any end-of-year performance information prepared by the Ministry, whether or not that information is included in the annual report.

In my opinion:

- the financial statements fairly reflect the financial position of the Ministry as at 30 June 2015 and its operations for the year ended on that date and
- the forecast financial statements fairly reflect the forecast financial position of the Ministry as at 30 June 2016 and its operations for the year ending on that date.

Signed by:



Helene Quilter
Secretary of Defence
30 September 2015

Countersigned by:



Bryan Westbury
**Deputy Secretary (Finance) and
Chief Financial Officer**
30 September 2015

INDEPENDENT AUDITOR'S REPORT

TO THE READERS OF THE MINISTRY OF DEFENCE'S ANNUAL REPORT FOR THE YEAR ENDED 30 JUNE 2015

AUDIT NEW ZEALAND
Mana Arotake Aotearoa

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 on her behalf of:

- the financial statements of the Ministry on pages 58 to 75, that comprise the statement of financial position, statement of commitments, statement of contingent liabilities and contingent assets as at 30 June 2015, the statement of comprehensive revenue and expense, statement of changes in equity, 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 performance information prepared by the Ministry for the year ended 30 June 2015 on pages 10 to 12 and 26 to 51;
- the statements of expenses and capital expenditure of the Ministry for the year ended 30 June 2015 on pages 56 to 57; and
- the schedules of non departmental activities of the Ministry on pages 76 to 90 that comprise:
 - the schedules of assets, liabilities, capital commitments, contingent liabilities and contingent assets as at 30 June 2015;
 - the schedules of income, expenses, capital receipts and capital expenditure for the year ended 30 June 2015; and
 - the notes to the non-departmental financial statements that include accounting policies and other explanatory information.

OPINION

In our opinion:

- the financial statements of the Ministry on pages 58 to 75:
 - present fairly, in all material respects:
 - its financial position as at 30 June 2015;
 - its financial performance and cash flows for the year ended on that date; and
 - comply with generally accepted accounting practice in New Zealand and have been prepared in accordance with Public Benefit Entity Reporting Standards.
- the performance information of the Ministry:
 - presents fairly, in all material respects, for the year ended 30 June 2015:
 - what has been achieved with each appropriation;
 - the actual expenses or capital expenditure incurred compared with the appropriated expenses or capital expenditure; and
 - complies with generally accepted accounting practice in New Zealand.
- the statements of expenses and capital expenditure of the Ministry on pages 56 to 57 are presented fairly, in all material respects, in accordance with the requirements of section 45A of the Public Finance Act 1989;

- the schedules of non departmental activities of the Ministry on pages 76 to 90 present fairly, in all material respects, in accordance with the Treasury Instructions:
 - the assets, liabilities, contingencies, and commitments as at 30 June 2015 managed by the Ministry on behalf of the Crown; and
 - the revenues, expenses, capital receipts and capital expenditure for the year ended on that date managed by the Ministry on behalf of the Crown.

Our audit was completed on 30 September 2015. 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 information we audited is 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 information we audited. 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 information we audited. The procedures selected depend on our judgement, including our assessment of risks of material misstatement of the information we audited, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Ministry’s preparation of the information we audited 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 performance information within the Ministry’s framework for reporting performance;
- the adequacy of the disclosures in the information we audited; and
- the overall presentation of the information we audited.

We did not examine every transaction, nor do we guarantee complete accuracy of the information we audited. Also, we did not evaluate the security and controls over the electronic publication of the information we audited.

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 that present fairly the Ministry’s financial position, financial performance, and its cash flows, and that comply with generally accepted accounting practice in New Zealand;
- performance information that presents fairly what has been achieved with each appropriation, the expenditure incurred as compared with expenditure expected to be incurred, and that complies with generally accepted accounting practice in New Zealand;
- statements of expenses and capital expenditure for the Ministry, that are presented fairly, in accordance with the requirements of the Public Finance Act 1989; and

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

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

The Secretary of Defence is responsible for such internal control as is determined is necessary to ensure that the Annual Report is free from material misstatement, whether due to fraud or error. The Secretary of Defence is also responsible for the publication of the Annual Report, whether in printed or electronic form.

RESPONSIBILITIES OF THE AUDITOR

We are responsible for expressing an independent opinion on the information we are required to audit, and reporting that opinion to you based on our audit. Our responsibility arises from section 15 of the Public Audit Act 2001.

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 4: APPROPRIATION STATEMENTS

STATEMENT OF EXPENSES AND CAPITAL EXPENDITURE AGAINST APPROPRIATIONS

For the year ended 30 June 2015

Actual		Forecast not audited	Main estimates	Supp estimates	Actual	Forecast not audited
2014 \$000		2015 \$000	2015 \$000	2015 \$000	2015 \$000	2016 \$000
	Vote: Defence					
	Departmental Appropriations					
	Appropriations for output expenses					
2,149	Evaluation, audit and assessment of performance	1,927	1,927	1,927	1,913	1,927
5,255	Management of equipment procurement	5,425	3,669	4,387	3,968	7,857
7,404	Total appropriations for output expenses	7,352	5,596	6,314	5,881	9,784
	Multi-category appropriations					
	Policy advice and related outputs MCA *					
3,716	Policy advice	3,593	3,593	3,593	3,576	3,984
741	Ministerial services	717	717	717	713	795
1,717	Policy support	1,660	1,660	1,660	1,652	1,841
6,174	Total multi-category appropriations *	5,970	5,970	5,970	5,941	6,620
	Capital expenditure **					
32	Capital expenditure	320	320	608	484	330
32	Total appropriations for capital expenditure	320	320	608	484	330
	Non-Departmental Appropriations					
	Capital expenditure					
273,572	Purchase of defence equipment	473,124	464,984	400,737	386,929	222,795
273,572	Total appropriations for non-departmental capital expenditure	473,124	464,984	400,737	386,929	222,795
287,182	Total appropriations administered by the Ministry of Defence	486,766	476,870	413,629	399,235	239,529

Notes: * The 2015 policy advice and related outputs multi-category appropriation (MCA) transitioned from the 2014 multi-class output appropriation (MCOA). The 2014 comparative presents the 2014 MCOA compared to the 2015 MCA as there is no change in the composition of the appropriations and they are directly analogous.

** The departmental capital expenditure appropriation is given by permanent legislative authority (PLA) under section 24(1) of the Public Finance Act 1989.

The Ministry did not have any transfers between appropriations under section 26A of the Public Finance Act 1989 during the year.

STATEMENT OF UNAPPROPRIATED EXPENDITURE AND CAPITAL EXPENDITURE

For the year ended 30 June 2015

The Ministry has no instances of departmental or non-departmental unappropriated expenditure and no breaches of projected departmental net asset schedules (2014 – Nil).

STATEMENT OF CAPITAL INJECTIONS

For the year ended 30 June 2015

The Ministry has not received any capital injections during the year (2014 – Nil).

PERFORMANCE INFORMATION

Performance information for all departmental appropriations are reported in this annual report.

Performance information for non-departmental capital expenditure is reported on page 35 in this annual report.

PART 5: DEPARTMENTAL FINANCIAL STATEMENTS

STATEMENT OF COMPREHENSIVE REVENUE AND EXPENSE

For the year ended 30 June 2015

Actual 2014 \$000		Note	Forecast not audited 2015 \$000	Main estimates 2015 \$000	Supp estimates 2015 \$000	Actual 2015 \$000	Forecast not audited 2016 \$000
	Revenue						
12,116	Revenue Crown		11,566	11,566	11,166	11,165	15,146
1,484	Revenue other	2	1,756	-	1,118	703	1,258
13,600	<i>Total revenue</i>		13,322	11,566	12,284	11,868	16,404
	Expenses						
7,984	Personnel expenses	3	8,385	8,340	8,175	7,444	9,942
5,007	Operating expenses	5	4,289	2,578	3,586	3,778	5,937
359	Depreciation and amortisation expense	7,8	375	375	250	363	252
228	Capital charge	4	273	273	273	237	273
13,578	<i>Total expenses</i>		13,322	11,566	12,284	11,822	16,404
22	Surplus/(deficit)		-	-	-	46	-
-	Other comprehensive revenue and expense		-	-	-	-	-
22	Total comprehensive revenue and expense		-	-	-	46	-

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 15.

STATEMENT OF FINANCIAL POSITION

As at 30 June 2015

Actual 2014 \$000		Note	Forecast not audited 2015 \$000	Main estimates 2015 \$000	Supp estimates 2015 \$000	Actual 2015 \$000	Forecast not audited 2016 \$000
	Assets						
	Current assets						
4,429	Cash and cash equivalents		3,489	3,489	3,829	3,575	3,751
137	Debtors and other receivables	6	160	160	-	406	-
2	Prepayments		-	-	-	-	-
4,568	<i>Total current assets</i>		3,649	3,649	3,829	3,981	3,751
	Non-current assets						
1,248	Property, plant and equipment	7	1,338	1,338	1,642	1,389	1,720
36	Intangible assets	8	267	267	-	16	0
1,284	<i>Total non-current assets</i>		1,605	1,605	1,642	1,405	1,720
5,852	Total assets		5,254	5,254	5,471	5,386	5,471
	Liabilities						
	Current liabilities						
1,505	Creditors and other payables	9	806	806	1,150	1,011	1,150
22	Repayment of surplus	10	-	-	-	46	-
639	Employee entitlements	11	650	650	605	569	605
2,166	<i>Total current liabilities</i>		1,456	1,456	1,755	1,626	1,755
	Non-current liabilities						
	Employee entitlements	11	382	382	300	344	300
270	<i>Total non-current liabilities</i>		382	382	300	344	300
270	Total liabilities		1,838	1,838	2,055	1,970	2,055
2,436	Net assets		3,416	3,416	3,416	3,416	3,416
	Equity						
3,416	General funds	12	3,416	3,416	3,416	3,416	3,416
3,416	Total equity		3,416	3,416	3,416	3,416	3,416

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 15.

STATEMENT OF CHANGES IN EQUITY

For the year ended 30 June 2015

Actual 2014 \$000		Note	Forecast not audited 2015 \$000	Main estimates 2015 \$000	Supp estimates 2015 \$000	Actual 2015 \$000	Forecast not audited 2016 \$000
3,416	Balance at 1 July		3,416	3,416	3,416	3,416	3,416
22	Total comprehensive income		-	-	-	46	-
	Owner Transactions						
(22)	Return of surplus to the Crown	10	-	-	-	(46)	-
-	Capital injection		-	-	-	-	-
-	Capital withdrawals		-	-	-	-	-
3,416	Balance at 30 June	12	3,416	3,416	3,416	3,416	3,416

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 15.

STATEMENT OF CASH FLOWS

For the year ended 30 June 2015

Actual		Forecast not audited	Main estimates	Supp estimates	Actual	Forecast not audited
2014 \$000		2015 \$000	2015 \$000	2015 \$000	2015 \$000	2016 \$000
	Cash flows from operating activities					
12,116	Receipts from revenue Crown	11,566	11,566	11,166	11,165	15,146
2,055	Receipts from revenue other	1,756	-	1,257	474	1,258
(8,062)	Payments to employees	(8,130)	(8,130)	(8,044)	(7,682)	(9,810)
(4,958)	Payments to suppliers	(5,517)	(2,788)	(4,074)	(3,966)	(6,069)
(228)	Payments for capital charge	(273)	(273)	(273)	(237)	(273)
10	Goods and services tax (net)	-	-	(2)	(102)	-
933	<i>Net cash flow from operating activities</i>	(598)	375	30	(348)	252
	Cash flows from investing activities					
-	Receipts from sale of property, plant and equipment	-	-	-	-	-
(19)	Purchase of property, plant and equipment	(142)	(142)	(608)	(482)	(330)
(15)	Purchase of intangible assets	(178)	(178)	-	(2)	-
(34)	<i>Net cash flow from investing activities</i>	(320)	(320)	(608)	(484)	(330)
	Cash flows from financing activities					
(233)	Repayment of surplus	(22)	-	(22)	(22)	-
(233)	<i>Net cash flow from financing activities</i>	(22)	-	(22)	(22)	-
666	Net increase/(decrease) in cash	(940)	55	(600)	(854)	(78)
3,763	Cash at the beginning of the year	4,429	3,434	4,429	4,429	3,829
4,429	Cash at the end of the year	3,489	3,489	3,829	3,575	3,751

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 15.

STATEMENT OF COMMITMENTS

As at 30 June 2015

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 (2014 – 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 10 years remaining.

Actual 2014 \$000		Actual 2015 \$000
	Non-cancellable operating lease commitments	
494	Not later than one year	494
494	Later than one year and not later than two years	494
1,482	Later than two years and not later than five years	1,483
2,803	Later than five years	2,307
5,273	<i>Total non-cancellable operating lease commitments</i>	4,778
5,273	Total commitments	4,778

STATEMENT OF CONTINGENT LIABILITIES AND CONTINGENT ASSETS

As at 30 June 2015

CONTINGENT LIABILITIES

The Ministry has no contingent liabilities (2014 – Nil).

CONTINGENT ASSETS

The Ministry has no contingent assets (2014 – Nil).

GUARANTEES AND INDEMNITIES

No guarantees and indemnities have been given outside the normal course of business (2014 – Nil).

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 15.

NOTES TO THE FINANCIAL STATEMENTS

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. The relevant legislation governing the Ministry's operations include the Public Finance Act 1989 and the Defence Act 1990.

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 (PBE) for financial reporting purposes.

The financial statements of the Ministry are for the year ended 30 June 2015 and were approved for issue by the Chief Executive of the Ministry on 30 September 2015.

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 Tier 2 PBE accounting standards on a going concern basis. The Ministry is eligible for Tier 2 reporting as its expenses are less than \$30 million and does not have publicly traded debt. Reporting concessions from the reduced disclosure regime have been applied where applicable.

These financial statements comply with PBE accounting standards.

Forecast financial statements have been prepared in accordance with PBE 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

These financial statements are the first financial statements presented in accordance with the new PBE accounting standards. Apart from some changes in terminology, there were no differences on transition from the NZ IFRS previously used to the PBE accounting standards.

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 2015, 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").

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 PBE FRS 42 *Prospective Financial Statements*.

The 2016 forecast financial statements are based on the Ministry's budget for 2015/16 as approved in the Estimates of Appropriations for 2015/16.

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 beyond that voted in the Estimates of Appropriations during the forecast period.

The forecast financial statements were authorised for issue by the Chief Executive of the Ministry on 10 April 2015.

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

The 2015 forecast financial statements were reported in the Ministry's 2014 *Annual Report* and were prepared on the basis presented in that *Annual Report*.

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

The Ministry's funding entitlement is established by Parliament when it passes the Appropriation Acts for the financial year. Revenue from the Crown is recognised to the level that the funding entitlement is drawn down from Treasury.

There are no conditions attached to the funding from the Crown beyond the requirement that the Ministry may only incur expenses within the scope and limits of its appropriations.

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. The Ministry is only permitted to expend its cash and cash equivalents within the scope and limits of its appropriations.

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 surplus or deficit.

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

Additions

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
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Impairment of property, plant and equipment and intangible assets

The Ministry does not hold any cash-generating assets. Assets are considered cash-generating where their primary objective is to generate a commercial return.

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 for sick leave 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, Inland Revenue is included as part of receivables or payables in the statement of financial position.

The net GST paid or received from the Inland Revenue, 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 2015, direct costs accounted for 66% of the Ministry's costs (30 June 2014 – 64%).
- 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 2015, indirect costs accounted for 34% of the Ministry's costs (30 June 2014 – 36%).

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 2015.

EVENTS AFTER BALANCE DATE

There have been no significant events after balance date.

NOTE 2: OTHER REVENUE

Actual		Forecast	Main	Actual	Forecast
2014		not audited	estimates	2015	not audited
\$000		2015	2015	\$000	2016
		\$000	\$000		\$000
1,468	Pre-acquisition project costs from Defence Force	1,756	-	703	1,258
16	Other	-	-	-	-
1,484	Total other revenue	1,756	-	703	1,258

NOTE 3: PERSONNEL EXPENSES

Actual		Forecast	Main	Actual	Forecast
2014		not audited	estimates	2015	not audited
\$000		2015	2015	\$000	2016
		\$000	\$000		\$000
7,639	Salaries and wages	7,907	7,862	7,108	9,498
319	Employer contributions to defined contribution plans	348	348	296	312
26	Increase/(decrease) in employee entitlements	130	130	40	132
7,984	Total personnel expenses	8,385	8,340	7,444	9,942

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 2015 was 8% (2014 – 8%).

NOTE 5: OPERATING EXPENSES

Actual		Forecast not audited	Main estimates	Actual	Forecast not audited
2014 \$000		2015 \$000	2015 \$000	2015 \$000	2016 \$000
98	Audit fees for financial statements	105	105	100	96
1,153	Consultancy	1,627	387	899	873
560	Professional services	318	213	228	124
771	Travel and related costs	493	429	630	590
258	Courses, conferences and exhibitions	157	69	208	156
599	Rental of premises	587	510	532	588
397	Legal	260	22	126	206
67	Grants and contributions	60	90	128	60
1,104	Other operating costs	682	753	927	3,244
5,007	Total operating expenses	4,289	2,578	3,778	5,937

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

NOTE 6: DEBTORS AND OTHER RECEIVABLES

Actual		Main estimates	Actual
2014 \$000		2015 \$000	2015 \$000
137	Debtors	160	406
-	Less provision for impairment	-	-
137	<i>Net debtors</i>	160	406
-	GST receivable	-	-
137	Total debtors and other receivables	160	406

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

NOTE 7: PROPERTY, PLANT AND EQUIPMENT

	Main estimates	Actual			
	Total	Leasehold improvements	Office furniture	Office and computer equipment	Total
	\$000	\$000	\$000	\$000	\$000
Cost or valuation					
Balance at 1 July 2013	3,841	2,574	123	1,144	3,841
Additions	153	-	-	18	18
Disposals	-	-	-	(390)	(390)
Transfers	-	6	(6)	-	-
Balance at 30 June 2014	3,994	2,580	117	772	3,469
Balance at 1 July 2014	3,994	2,580	117	772	3,469
Additions	142	194	225	63	482
Disposals	-	-	-	-	-
Transfers	-	-	-	-	-
Balance at 30 June 2015	4,136	2,774	342	835	3,951
Accumulated depreciation					
Balance at 1 July 2013	2,245	1,139	53	1,053	2,245
Depreciation expense	278	271	9	42	322
Eliminate on disposal	-	-	-	(346)	(346)
Transfers	-	-	-	-	-
Balance at 30 June 2014	2,523	1,410	62	749	2,221
Balance at 1 July 2014	2,523	1,410	62	749	2,221
Depreciation expense	275	312	19	10	341
Eliminate on disposal	-	-	-	-	-
Balance at 30 June 2015	2,798	1,722	81	759	2,562
Carrying amounts					
At 30 June and 1 July 2014	1,471	1,170	55	23	1,248
At 30 June 2015	1,338	1,052	261	76	1,389

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	Actual	
	Total	Acquired software	Total
	\$000	\$000	\$000
Cost or valuation			
Balance at 1 July 2013	969	969	969
Additions	201	14	14
Disposals	-	(27)	(27)
Balance at 30 June 2014	1,170	956	956
Balance at 1 July 2014	1,170	956	956
Additions	178	2	2
Disposals	-	-	-
Balance at 30 June 2015	1,348	958	958
Accumulated amortisation			
Balance at 1 July 2013	883	883	883
Amortisation expense	98	37	37
Disposals	-	-	-
Balance at 30 June 2014	981	920	920
Balance at 1 July 2014	981	920	920
Amortisation expense	100	22	22
Disposals	-	-	-
Balance at 30 June 2015	1,081	942	942
Carrying amounts			
At 30 June and 1 July 2014	189	36	36
At 30 June 2015	267	16	16

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 2014 \$000		Main estimates 2015 \$000	Actual 2015 \$000
496	Creditors	756	390
805	Accrued expenses	-	472
204	GST payable	50	149
1,505	Total creditors and other payables	806	1,011

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 2014 \$000		Actual 2015 \$000
22	Net surplus/(deficit)	46
22	Total repayment of surplus	46

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

NOTE 11: EMPLOYEE ENTITLEMENTS

Actual 2014 \$000		Main estimates 2015 \$000	Actual 2015 \$000
	Current provisions are represented by:		
610	Annual leave	646	542
3	Sick leave	4	1
26	Retirement and long service leave	-	26
639	<i>Total current provision</i>	650	569
	Non-current employee entitlements are represented by:		
270	Retirement and long service leave	382	344
909	Total employee entitlements	1,032	913

NOTE 12: EQUITY

Actual 2014 \$000		Actual 2015 \$000
	Taxpayers' funds	
3,416	Balance at 1 July	3,416
22	Net surplus/(deficit)	46
-	Capital contribution from the Crown	-
(22)	Provision for repayment of surplus to the Crown	(46)
3,416	Taxpayers' funds at 30 June	3,416

NOTE 13: RELATED PARTY TRANSACTIONS AND KEY MANAGEMENT PERSONNEL

Related party transactions

The Ministry is a wholly-owned entity of the Crown.

All transactions with related parties have been undertaken either:

- within a supplier/client relationship on terms and conditions no more or less favourable than those it is reasonable to expect of the Ministry would have adopted in dealing with the party on an arm's length basis; and/or
- with other government agencies consistent with the usual operating arrangements between the Ministry and those agencies.

Key management personnel compensation

Actual 2014 \$000		Actual 2015 \$000
	Leadership team, including the Chief Executive	
1,840	Remuneration	1,618
6	Full-time equivalent staff	6

Key management personnel include the Chief Executive and the five members (2014 – five) of the Leadership Team.

The above key management personnel compensation excludes the remuneration and other benefits received by the Minister of Defence. 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 14: FINANCIAL INSTRUMENTS

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

Actual 2014 \$000		Actual 2015 \$000
	Loans and receivables	
4,429	Cash and cash equivalents	3,575
137	Debtors and other receivables	406
2	Prepayments	-
4,568	<i>Total loans and receivables</i>	3,981
	Financial liabilities measured at amortised cost	
1,505	Creditors and other payables	1,011

NOTE 15: EXPLANATION OF MAJOR VARIANCES AGAINST BUDGET

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

Revenue Crown

Revenue Crown decreased during the year as the costs relating to project management on the Protector Remediation project were transferred from departmental funding to non-departmental capital expenditure.

Revenue other

Subsequent to the approval of the Main Estimates the pre-acquisition stages of three new acquisition projects were approved by Cabinet. The full amount approved for 2014/15 of \$1.8 million was included in revenue and expenses in the Forecast financial statements. This was reduced to \$1.1 million in the Supplementary Estimates as funding was transferred to 2015/16 to match the expected timing of costs. Actual costs were lower than the Supplementary Estimates as cost efficiencies were identified from the original budgets.

Personnel expenses

Personnel expenses are lower than Forecast and both Estimates due to delays in recruiting staff to fill vacancies.

Operating expenses

The increase in operating expenses from the Main Estimates to Forecast and the subsequent reduction in the Supplementary Estimates reflects the timing of pre-acquisition costs as described above in Revenue other.

The increase in actual operating expenses from the Supplementary Estimates arose from the utilisation of the above personnel variance to fund increased international defence relations activity and other Ministry priorities.

Cashflow

Variances in cashflows largely reflect the above reasons. Further variances arise from the timing of payment following invoicing as reflected by variances in the debtors and creditors balances.

PART 6: NON-DEPARTMENTAL STATEMENTS AND SCHEDULES

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

SCHEDULE OF NON-DEPARTMENTAL REVENUE

For the year ended 30 June 2015

Actual 2014 \$000		Note	Forecast not audited 2015 \$000	Main estimates 2015 \$000	Supp estimates 2015 \$000	Actual 2015 \$000
1,195	Realised foreign exchange gains		-	-	23,965	40,512
943	Realised gains on derivatives		-	-	3,246	7,185
565	Unrealised gains on derivatives		-	-	5,180	20,956
89	Unrealised foreign exchange gains		-	-	-	-
362	Interest		-	-	297	495
3,154	Total non-departmental revenue	4	-	-	32,688	69,148

SCHEDULE OF NON-DEPARTMENTAL EXPENSES

For the year ended 30 June 2015

Actual 2014 \$000		Forecast not audited 2015 \$000	Main estimates 2015 \$000	Supp estimates 2015 \$000	Actual 2015 \$000
18,231	Realised foreign exchange losses	-	-	910	1,180
12,378	Realised losses on derivatives	-	-	(828)	126
10,447	Unrealised losses on derivatives	-	-	1,669	131
-	Unrealised foreign exchange losses	-	-	94	156
51,994	GST input expense	23,839	23,839	63,877	53,174
93,050	Total non-departmental expenditure	23,839	23,839	65,722	54,767

The accompanying notes form part of these financial statements. 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 2015.

SCHEDULE OF NON-DEPARTMENTAL ASSETS

As at 30 June 2015

Actual 2014 \$000		Note	Forecast not audited 2015 \$000	Main estimates 2015 \$000	Supp estimates 2015 \$000	Actual 2015 \$000
	Assets					
	Current assets					
368,898	Cash and cash equivalents	4	16,992	16,992	130,237	201,300
210,943	Debtors and other receivables	2,4	132,544	132,544	216,238	201,723
416	Derivatives in gain		440	440	2,705	17,175
580,257	<i>Total current assets</i>		149,976	149,976	349,180	420,198
	Non-current assets					
298	Derivatives in gain		-	-	-	1,421
298	<i>Total non-current assets</i>		-	-	-	1,421
580,555	Total non-departmental assets		149,976	149,976	349,180	421,619

SCHEDULE OF NON-DEPARTMENTAL LIABILITIES

As at 30 June 2015

Actual 2014 \$000		Note	Forecast not audited 2015 \$000	Main estimates 2015 \$000	Supp estimates 2015 \$000	Actual 2015 \$000
	Liabilities					
	Current Liabilities					
52,273	Creditors and other payables	3	52,273	-	28,205	66,024
3,165	Derivatives in loss		3,165	394	4,189	1,953
55,438	<i>Total current liabilities</i>		55,438	394	32,394	67,977
	Non-current liabilities					
4,481	Derivatives in loss		4,481	-	-	-
4,481	<i>Total non-current liabilities</i>		4,481	-	-	-
59,919	Total non-departmental liabilities		59,919	394	32,394	67,977

The accompanying notes form part of these financial statements. 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 2015.

SCHEDULE OF NON-DEPARTMENTAL CAPITAL RECEIPTS

For the year ended 30 June 2015

Actual 2014 \$000		Note	Forecast not audited 2015 \$000	Main estimates 2015 \$000	Supp estimates 2015 \$000	Actual 2015 \$000
4,546	Defence command and control system		14,118	14,118	6,045	2,230
6,574	Strategic bearer network		13,177	5,177	3,877	3,972
8,719	P-3K Orion systems upgrade		6,418	6,418	5,750	5,487
(41)	Boeing 757 modification		-	-	-	(14)
7,350	C-130 Hercules life extension		5,839	5,839	6,411	4,532
36,619	Medium utility helicopter		36,184	36,184	35,376	26,153
5,379	Training/light utility helicopter		-	-	3,045	(55)
26,285	Maritime helicopter		124,074	124,074	131,464	128,953
73,942	Pilot training capability		49,353	49,353	47,473	46,276
10	Project Protector vessels		13	13	11	7
3	Close-in weapons system		-	-	65	-
9,276	Platform systems upgrade		12,463	12,463	12,990	10,095
5,013	Remediation Protector		5,309	5,309	9,844	9,181
8,630	Frigate systems upgrade		158,000	158,000	135,317	135,559
-	Medium range anti-armour weapon		-	-	(870)	(870)
47	Army engineering gap crossing system		-	-	-	-
81,220	Medium-heavy operational vehicles		28,036	28,036	19,739	15,391
-	Individual weapons replacement		140	-	140	-
-	Network enabled army		-	-	1,200	32
-	Underwater intelligence, surveillance and reconnaissance		-	-	200	-
-	Portfolio adjustment		20,000	20,000	(17,340)	-
273,572	Total non-departmental capital receipts	4	473,124	464,984	400,737	386,929

The accompanying notes form part of these financial statements. 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 2015.

SCHEDULE OF NON-DEPARTMENTAL CAPITAL EXPENDITURE

For the year ended 30 June 2015

Actual 2014 \$000		Note	Forecast not audited 2015 \$000	Main estimates 2015 \$000	Supp estimates 2015 \$000	Actual 2015 \$000
4,546	Defence command and control system		14,118	14,118	6,045	2,230
6,574	Strategic bearer network		13,177	5,177	3,877	3,972
8,719	P-3K Orion systems upgrade		6,418	6,418	5,750	5,487
(41)	Boeing 757 modification		-	-	-	(14)
7,350	C-130 Hercules life extension		5,839	5,839	6,411	4,532
36,619	Medium utility helicopter		36,184	36,184	35,376	26,153
5,379	Training/light utility helicopter		-	-	3,045	(55)
26,285	Maritime helicopter		124,074	124,074	131,464	128,953
73,942	Pilot training capability		49,353	49,353	47,473	46,276
10	Project Protector vessels		13	13	11	7
3	Close-in weapons system		-	-	65	-
9,276	Platform systems upgrade		12,463	12,463	12,990	10,095
5,013	Remediation Protector		5,309	5,309	9,844	9,181
8,630	Frigate systems upgrade		158,000	158,000	135,317	135,559
-	Medium range anti-armour weapon		-	-	(870)	(870)
47	Army engineering gap crossing system		-	-	-	-
81,220	Medium-heavy operational vehicles		28,036	28,036	19,739	15,391
-	Individual weapons replacement		140	-	140	-
-	Network enabled army		-	-	1,200	32
-	Underwater intelligence, surveillance and reconnaissance		-	-	200	-
-	Portfolio adjustment		20,000	20,000	(17,340)	-
273,572	Total non-departmental capital expenditure	4	473,124	464,984	400,737	386,929

The accompanying notes form part of these financial statements. 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 2015.

SCHEDULE OF NON-DEPARTMENTAL CAPITAL COMMITMENTS

As at 30 June 2015

Actual 2014 \$000		Actual 2015 \$000
	Non-cancellable capital commitments	
381,755	Not later than one year	212,585
146,341	Later than one year and not later than two years	155,788
143,928	Later than two years and not later than five years	32,468
-	Later than five years	-
672,024	Total non-cancellable capital commitments	400,841

SCHEDULE OF NON-DEPARTMENTAL CONTINGENT LIABILITIES AND CONTINGENT ASSETS

As at 30 June 2015

CONTINGENT LIABILITIES

The Ministry on behalf of the Crown has no contingent liabilities (2014 – Nil).

CONTINGENT ASSETS

The Ministry on behalf of the Crown has no contingent assets (2014 – Nil).

The accompanying notes form part of these financial statements. 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 2015.

NOTES TO THE NON-DEPARTMENTAL FINANCIAL STATEMENTS

NOTE 1: STATEMENT OF ACCOUNTING POLICIES

Reporting entity

These non-departmental statements and schedules 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 2015. 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 statements and schedules 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 statements and schedules are consistent with New Zealand generally accepted accounting practice (Tier 1 Public Sector Public Benefit Entity Accounting Standards) as appropriate for public benefit entities.

Changes in accounting policies

These non-departmental statements and schedules are the first prepared in accordance with the new PBE accounting standards. Apart from some changes in terminology, there were no differences on transition from the NZ IFRS previously used to the PBE accounting standards.

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 2015, 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"). Where applicable, this includes transfers made under section 26A of the Public Finance Act 1989.

The budget figures have been prepared in accordance with New Zealand Generally Accepted Accounting Practices, using accounting policies that are consistent with those adopted in preparing these financial statements.

Forecast

The 2015 forecast financial statements were reported in the Ministry's 2014 *Annual Report* and were prepared on the basis presented in that *Annual Report*.

SIGNIFICANT ACCOUNTING POLICIES

Revenue

Interest income is recognised using the effective interest method.

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 re-measured 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.

Comparative information

Comparatives have been restated where necessary to maintain consistency with current year amounts.

NOTE 2: DEBTORS AND OTHER RECEIVABLES

Actual 2014 \$000		Actual 2015 \$000
210,943	Debtors	201,723
-	Less provision for impairment	-
210,943	<i>Net debtors</i>	201,723
-	Receivables written off during period	-
210,943	Balance at 30 June	201,723

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

	2014			2015		
	Gross \$000	Impairment \$000	Net \$000	Gross \$000	Impairment \$000	Net \$000
Not past due	210,943	-	210,943	201,723	-	201,723
Past due 1–30 days	-	-	-	-	-	-
Past due 31–60 days	-	-	-	-	-	-
Past due 61–90 days	-	-	-	-	-	-
Past due > 91 days	-	-	-	-	-	-
Total	210,943	-	210,943	201,723	-	201,723

NOTE 3: CREDITORS AND OTHER PAYABLES

Actual 2014 \$000		Actual 2015 \$000
52,273	Creditors	65,729
-	Monies received in advance	295
52,273	Total creditors and other payables	66,024

NOTE 4: EXPLANATION OF MAJOR VARIANCES AGAINST BUDGET

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

Non-departmental revenue 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 the Forecast and Main Estimates due changes in the timing, and assessed value, of the importation of military equipment into New Zealand.

Non-departmental assets

- **Cash and cash equivalents**
The cash holdings are higher than the Forecast and both Estimates due to the requirement to purchase foreign currency for capital expenditure contracted in 2015/16.
- **Debtors**
The Ministry invoices New Zealand Defence Force on a six-monthly basis for non-departmental capital expenditure. The variance in the year-end debtors balance reflects the timing of project expenditure across the year and the resultant timing of invoicing to the Defence Force.

Non-departmental liabilities

- **Creditors**
The increased creditors balance at 30 June 2015 from that presented in both Estimates reflects the effect of accrued work in progress by suppliers at year-end plus an increased GST liability resulting from invoicing of capital expenditure to New Zealand Defence Force as described in the debtors section above.

NOTE 5: FINANCIAL INSTRUMENTS

Financial instrument categories

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

Actual 2014 \$000		Actual 2015 \$000
	Loans and receivables	
368,898	Cash and cash equivalents	201,300
210,943	Debtors and other receivables	201,723
579,841	<i>Total loans and receivables</i>	403,023
	Fair value through surplus / (deficit) – designated as such upon initial recognition	
714	Derivative financial instrument assets	18,596
7,646	Derivative financial instrument liabilities	1,953
	Financial liabilities measured at amortised cost	
52,273	Creditors and other payables	66,024

The notional principal amount of outstanding forward exchange contract derivatives at 30 June 2015 is NZD 207.0 million (2014 – NZD 322.8 million). The contracts consist of the purchase of (amounts in foreign currency):

Actual 2014 \$000		Actual 2015 \$000
14,670	Australian dollars	8,100
37,500	British pounds	27,500
89,300	Canadian dollars	62,300
23,600	Euros	13,500
87,990	Norwegian krone	22,350
41,500	Swedish krona	25,400
50,080	United States dollars	27,780

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:

- level 1: Quoted market price – Financial instruments with quoted prices for identical instruments in active markets.
- level 2: Valuation technique using observable inputs – 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.
- level 3: Valuation techniques with significant non-observable inputs – 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.

	Total	Valuation technique		
		Quoted market price	Observable inputs	Significant non-observable inputs
	\$000	\$000	\$000	\$000
2014				
Financial assets				
Foreign exchange derivatives	714	-	714	-
Financial liabilities				
Foreign exchange derivatives	7,646	-	7,646	-
2015				
Financial assets				
Foreign exchange derivatives	18,596	-	18,596	-
Financial liabilities				
Foreign exchange derivatives	1,953	-	1,953	-

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

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.

As at 30 June 2015	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	201,300	-	-	-	201,300
Debtors and other receivables	201,723	-	-	-	201,723
Derivative financial instruments	6,746	8,266	-	-	15,012
<i>Total current assets</i>	409,769	8,266	-	-	418,035
Non-current assets					
Derivative financial instruments	-	-	565	(22)	543
<i>Total non-current assets</i>	-	-	565	(22)	543
Total assets	409,769	8,266	565	(22)	418,578
Liabilities					
Current liabilities					
Creditors and other payables	52,273	-	-	-	52,273
Derivative financial instruments	870	1,856	-	-	2,726
<i>Total current liabilities</i>	53,143	1,856	-	-	54,999
Non-current liabilities					
Derivative financial instruments	-	-	-	-	-
<i>Total non-current liabilities</i>	-	-	-	-	-
Total liabilities	53,143	1,856	-	-	54,999
Net liquidity of continuing operations	356,626	6,410	565	(22)	363,579

As 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	152	(216)	-	-	(64)
<i>Total current assets</i>	579,993	(216)	-	-	579,777
Non-current assets					
Derivative financial instruments	-	-	(3,159)	-	(3,159)
<i>Total non-current assets</i>	-	-	(3,159)	-	(3,159)
Total assets	579,993	(216)	(3,159)	-	576,618
Liabilities					
Current liabilities					
Creditors and other payables	52,273	-	-	-	52,273
Derivative financial instruments	3,163	1,178	-	-	4,341
<i>Total current liabilities</i>	55,436	1,178	-	-	56,614
Non-current liabilities					
Derivative financial instruments	-	-	11,820	-	11,820
<i>Total non-current liabilities</i>	-	-	11,820	-	11,820
Total liabilities	55,436	1,178	11,820	-	68,434
Net liquidity of continuing operations	524,557	(1,394)	(14,979)	-	508,184

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 NZ\$000	Asset carrying amount NZ\$000	Contractual cash flows NZ\$000	Less than 6 months NZ\$000	6–12 months NZ\$000	1–2 months NZ\$000	2–5 years NZ\$000
Gross settled forward foreign exchange contracts:							
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
2015	1,953	18,596					
- outflow			206,922	67,494	117,601	18,496	3,331
- inflow			219,749	73,369	124,011	19,060	3,309

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.

	2014			2015		
	Cash and cash equivalents \$000	Derivatives \$000	Net gain/(loss) \$000	Cash and cash equivalents \$000	Derivatives \$000	Net gain/(loss) \$000
Effect on surplus if NZ dollar strengthened by 5%						
AUD	(561)	(728)	(1,289)	(254)	(429)	(683)
CAD	(1,801)	(4,442)	(6,243)	(1,649)	(3,469)	(5,118)
EUR	(2,827)	(1,744)	(4,571)	(1,008)	(1,055)	(2,063)
GBP	(1,310)	(3,406)	(4,716)	(660)	(3,000)	(3,660)
NOK	(31)	(863)	(894)	(58)	(198)	(256)
SEK	(218)	(332)	(550)	(1)	(216)	(217)
USD	(8,042)	(2,710)	(10,752)	(2,035)	(1,937)	(3,972)
Total	(14,790)	(14,225)	(29,015)	(5,665)	(10,304)	(15,969)
Effect on surplus if NZ dollar weakened by 5%						
AUD	620	804	1,424	281	474	755
CAD	1,991	4,909	6,900	1,822	3,835	5,657
EUR	3,125	1,927	5,052	1,114	1,167	2,281
GBP	1,448	3,765	5,213	729	3,316	4,045
NOK	34	954	988	64	219	283
SEK	241	367	608	1	238	239
USD	8,889	2,995	11,884	2,249	2,141	4,390
Total	16,348	15,721	32,069	6,260	11,390	17,650

