VALUE FOR MONEY

REVIEW OF NEW ZEALAND DEFENCE FORCE

Pacific Road Group

MINISTRY OF DEFENCE
Manatū Kaupapa Waonga

New Zealand DEFENCE FORCE
Te Ope Kātua O Aotearoa
NAVY | NZ ARMY | AIR FORCE

LEAD EXTERNAL REVIEWER | DR RODERICK DEANE

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- This Review, and the Executive Summary, must be read subject to the qualifications and assumptions set out above and in the body of the Review.

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Section A: Part 1

Executive Summary

VfM Background

1.1 On 23 March 2010, the Minister of Defence, the Hon Dr Wayne Mapp, announced that an external Value for Money (VfM) review (the Review) was to be undertaken of the New Zealand Defence Force (NZDF).

1.2 Dr Roderick Deane, as External Reviewer, with the assistance of Pacific Road Corporate Finance New Zealand Limited (Dr Deane is the Chairman of the Pacific Road Group) was appointed in April 2010 to undertake the Review and a reporting date of 30 June 2010 was agreed. This date was subsequently changed to 30 July 2010.

1.3 The objectives of the Review were: to help identify efficiencies; to seek to identify shifting resources to front line activities; and to provide assurances and options around the cost effectiveness and sustainability of the NZDF.

1.4 Excluded from the Review was the strategic context, including defence priorities, which was to be taken as having been established by the Ministry of Defence through the Defence Assessment. The number and application of military platforms and capability and operational deployments were specifically excluded from the Review's Terms of Reference.

VfM Report

1.5 The VfM Report is in four sections:

- This Executive Summary, including our recommendations, is outlined in Section A of the report;
- Section B detailing the critical VfM issues and opportunities, including constraints on delivering the opportunities;
- Section C containing work stream by work stream VfM analysis and conclusions; and

- Section D comprising a series of Appendices including spreadsheets setting out our projected savings including capital inflows (from asset sales) and outflows from essential additional capital and operating expenditure to deliver the VfM opportunities.

VfM Challenge

1.6 In the financial year to 30 June 2010, the NZDF spent $2.2 billion (including depreciation and a set capital charge) on its operations and $326 million on capital items.

1.7 Using a measure adopted by NATO, New Zealand's expenditure on defence is approximately 1.2% of GDP which places it slightly below similar countries such as the Scandinavian ones but, in relative terms, well below other countries such as Australia at 1.8% and the NATO average of 2.6%.

1.8 Defence absorbs a significant proportion of core Crown Government capital expenditure, averaging 30% over the three years to 2008-09, or an average annual total amount of $450 million. This is projected to increase as new and replacement capability comes on stream.

1.9 The Parliamentary Vote – Defence Force comprises 16 outputs that are managed as a whole by the NZDF or by the relevant Service: Army, the Navy or the Air Force.

1.10 By international standards the NZDF is small but "in the field" it is ably led, well trained, in the main well equipped, highly professional, able readily to work closely with our military partners, and respected by them.

1.11 Furthermore, at the front of the organisation (i.e. deployments and related operations and support functions), the NZDF is clearly delivering VfM and has a culture of excellence, speedy decision making and a focus on being world class.

1.12 This is not the case in the middle and back of the NZDF.

1.13 Close to 55% of the NZDF's operating costs are incurred in the back and middle of the organisation and 45% in the front line. The front line includes both military and non-military tasking.

1.14 Most defence forces have as a core objective spending more on front line activities including capability than in the support areas, and the NZDF should be no exception. There would have to be a $200 million reduction in middle and back expenditure and a $200 million increase in front line expenditure to reverse the NZDF's current back and middle versus front line expenditure pattern.

1.15 Perhaps even more important than the ratio between the middle and back of the NZDF and the front line, however, is the growing gap between the current and projected Defence Appropriation and the NZDF's likely operating and capital expenditure requirements under the three scenarios specified in the Defence Assessment.

1.16 The Defence Assessment described a low, middle and high pathway, with an expressed preference for the middle pathway. By way of example, if further savings and efficiencies cannot be found by the NZDF, the funding gap relative to the middle pathway would be more than $300 million in FY 2014/2015.

1.17 This is at the heart of the VfM challenge.

VfM Methodology and Process

1.18 The VfM Team was briefed on all major areas of the NZDF's operations and support functions. The team met a large number of people both within and outside the NZDF.

1.19

s9(2)(b)(ii)

1.21 The Review Team was fortunate to be able to meet with, and obtain guidance from, the leader of the 2009 Australian Defence Force Audit, George Pappas. The Audit was similar to this VfM Review covering much of the same territory. As a consequence of the ADF Audit, the Australian Government and the Department of Defence have publicly committed to over A$20 billion of savings over the next 10 years, or between 7% and 8% of Australia's current annual Defence Appropriation.

1.22 The Review Team noted that similar VfM exercises are also well advanced in the United Kingdom and Canada and, in light of severe budget constraints; the level of savings sought by the new UK Government is expected to be considerably higher in relative terms than the Pappas Audit has delivered in Australia.

1.23 Over 100 work streams were established and each work stream was analysed for existing VfM and for future VfM opportunities. Section C of this report contains work stream by work stream VfM analysis and conclusions. A summary of these conclusions is contained in this Executive Summary together with the associated recommendations.

1.24 Collection of data was sometimes a challenge because it was, at times, subject to disconcerting changes as it was reworked and because the same question could at times attract different answers. In some cases the information sought was either not available or not available in a form that was useable. There is often no "one source of the truth" within the NZDF.

Governance, Management and Organisation

1.25 The higher the level of savings sought or, indeed required, the more demanding are the management and policy choices required of the Government and the NZDF.

1.26 While the savings identified in this Review are achievable, there has to be an appropriate level of commitment to them within and throughout the NZDF. Getting the right people in the right jobs is overwhelmingly important. Military people may be good at military tasks but they rarely make good managers of corporate-like functions.

1.27 Under the State Sector Act and for most Government Agencies, the State Services Commissioner appoints and employs the Chief Executive (CEO) after consulting the Government. It is not like this in the NZDF.

1.28 For primarily constitutional reasons, but also historical ones the CDF and the Chiefs of the three Services are appointed under warrant by the Governor-General on recommendation from the Government. This gives the Service Chiefs an air of independence which can make life complicated for the CDF, particularly if the appointees are not the CDF's preferred choice for the job.

1.29 While the model of three Services and a Joint Forces Command remains appropriate, the reality is that the independence of the three Services, real or perceived, too often inhibits changes which would benefit the organisation as a whole. As a result, changes within the NZDF are subject to excessive analysis, are dominated by committees rather than individual line managers, take too long to decide and implement, are too often compromises, and can too easily get sidetracked.

1.30 It is our view that only the CDF needs to be or indeed should be warranted and that the CDF should appoint the Service Chiefs. They work for the CDF and they should be accountable to him.

1.31 Such changes would require amendments to the Defence Act. This is our preferred option.

1.32 It is further recommended that the Vice Chief of Defence Force (VCDF) role be preserved for someone who could manage the middle to back functions such as finance, procurement, logistics, IT and human resources. In corporate terms this person would be the Chief Operating Officer (COO) of the NZDF. If that person was not a military person, and we think it should be a civilian, then the job could be termed COO rather than VCDF and the VCDF position could be disestablished.

1.33 Consequent on a COO appointment, the Operational Support Group (OSG) would be disbanded and its activities re-allocated where appropriate to relevant line managers.

1.34 Other senior (civilian) roles within the NZDF need to be strengthened beyond the COO appointment. For example, there should be a redefinition of the Chief Financial Officer (CFO) role to ensure that his authority is pan-NZDF and with full management control of an integrated NZDF-wide finance function.

1.35 The Chief Information Officer (CIO) should be restructured with similarly NZDF-wide authority over non-military information technology systems and hardware. As with the CFO and the COO, the CIO should report to the CDF.

1.36 If real authority is not vested in these positions the VfM reforms are likely to fail.

1.37 There are two final recommendations that will be critical to the new organisational structure and culture proposed above.

1.38 The Minister of Defence should craft a performance agreement with the CDF who in turn should have performance agreements with all his direct reports both military and civilian. If the VfM changes we suggest are to be achieved, there must be specific agreement on their delivery by the CDF and each of his top team, military and civilian.

1.39 There should also be a significant shift in non-front line staff from military to civilian status and this should be used as a means to enable access to greater expertise on the specific support functions, both at a senior and technical level. It will also save money.

The Ministry of Defence, NZDF and Procurement

1.40 The MoD and NZDF undertake a range of procurement activities that are spread across both organisations, often with duplication of personnel and systems and an inability to leverage their combined buying power and skills.

1.41 In the case of the acquisition of military platforms, the current separation of responsibilities between the MoD and the NZDF creates conflicts and inefficiencies and is leading to sub-optimal outcomes.

1.42 The MoD should be primarily responsible for the development and specification of military capability requirements. Once the Government, through Cabinet, has decided on large scale military acquisitions, on advice from the Secretary of Defence and in consultation with the CDF, the actual purchase process should then be the responsibility of the CDF.

1.43 A single, integrated procurement group should be formed within the NZDF which would comprise the functions currently carried out by the existing MoD Acquisitions Division and other procurement elements within the NZDF.

1.44 We agree with the Defence Assessment that a structure along these lines would benefit from the establishment of a Board capable of providing external input and advice to the Secretary of Defence and the CDF on procurement, implementation of this VfM Review, and other matters.

1.45 We propose the formation of a Defence Advisory Board (DAB) ideally comprising the Secretary of Defence, the CDF and two or three independent, high quality commercially experienced members. The Secretary to the Treasury could be a member as well.

1.46 The DAB would not be a decision making body but rather an advisory, coordination and communications vehicle. The DAB would advise the Secretary and the CDF on matters of substance which would be determined from time to time in consultation with the Minister of Defence.

Some NZDF Personnel Issues

1.47 If the NZDF is to aspire to the middle pathway in the Defence Assessment it is self evident that substantial savings must be achieved.

1.48 While large savings will need to come from other operating costs, it is clear that significant savings must also be made in personnel costs. The severity of this challenge is stark given the 18% increase in remuneration implemented in 2008-09.

1.49 The average annual remuneration for military personnel is more than 30% greater than the NZDF's civilian workforce and the public service generally. In addition the NZDF still has over 300 different allowance types, which amount to part of remuneration but which were meant to be, or should have been, abolished in 2008/2009 when the significant increase in remuneration was implemented.

1.50 The State Services Commission should have exercised a much closer oversight of this position and it should also have been a matter of concern to the Treasury.

1.51 With regard to personnel, as at 30 June 2010, NZDF employed 9,673 military staff and 2,590 civilians, a total of 12,260, along with 2,314 part time reserves, an all-up total of 14,577 people.

1.52 Notably, over the last eight years, NZDF Headquarters (HQ) personnel numbers have grown by 130%. Half of this has resulted from the establishment of a shared services function. In the same period, Air Force has grown by 21%, NZ Army by 2% and the Navy by 5%.

1.53 The growth in Air Force, Army and Navy numbers has largely been in uniformed personnel who, as noted above, attract a premium over civilians, yet a significant component of the positions filled by military personnel could be filled at a lower cost, and in many cases with more relevant skills and experience, by civilians. This theme is repeated throughout our report.

1.54 The ability to deliver significant savings and efficiencies in these and other areas is made more difficult by the fact that 30% of NZDF's outputs relate to non military activities undertaken in support of other New Zealand Government agencies.

1.55 From a Whole-of-Government perspective this makes sense. However, the Government needs to be aware that, as the NZDF's non-military outputs have increased so too have its deployment outputs. The risk is that NZDF's ability to deliver on its priority military outputs will start to degrade.

NZDF Business Model

1.56 In the "business" part of the NZDF, principally the support and corporate functions, there is a need for greater data integrity and improved business modelling, supported by activity based accounting.

1.57 Existing performance metrics are inadequate and are not used frequently enough to drive better performance. The performance metrics considered by the NZDF's Executive Leadership Team on a monthly basis have a military or operational bias. They need to be augmented by financial and support function indicators that measure how the NZDF is progressing from a financial perspective and in delivering VfM gains.

1.58 Support services are often treated as "free goods" and there is no transfer pricing. The Information Technology and Defence Technology (DTA) areas are classic illustrations of this dilemma.

1.59 With respect to NZDF output classes, we recommend that a review of these be undertaken after the White Paper has been released to ensure that the present set of outputs matches what the NZDF is expected to achieve in today's world.

1.60 At the very least, future outputs should much more transparently identify the Government's expectations, the cost of delivering on those expectations, key metrics to determine that the NZDF is delivering on the expectations, and the annual operating and capital budget allocated to each output class.

The Size of the Prize

1.61 If fully implemented, the VfM Review would result over time in annual savings well in excess of $200 million. Indeed, the savings could reach a peak of $271 million in FY 2014/15 (or $349 million if the savings already identified by the NZDF are included for that year) if all our recommendations are adopted.

1.62 As a result, if the total savings are realised, the middle pathway in the Defence Assessment is achievable without the need for the Government to increase Defence Operating Appropriations. The high pathway is also a possibility although, in the outer years, additional Government funding may be required.

1.63 This is the "size of the prize". The greater the level of savings and efficiencies achieved by the NZDF, the greater the prize in terms of increased front line capability and the NZDF achieving its vision of a modern, well equipped Defence Force for the 21st Century.

1.64 Many of the identified savings will require substantial changes to current processes and practices. This will take time and will involve additional capital and operating expenditure particularly in the IT area. This report identifies the level of additional operating and capital expenditure required to deliver the savings

1.65 A critical point, apart from the macro level of savings, is setting realistic timetables for the savings targets. It would appear that the timetables identified for some of the savings programmes already in train within the NZDF and analysed by the VfM Team (particularly Logistics and HR) are optimistic.

1.66 An integral part of delivering the targeted savings and the VfM opportunities is ensuring that the NZDF has the right incentives. This would involve an agreement between the NZDF and the New Zealand Treasury to facilitate the NZDF retaining the proceeds of an agreed proportion of particular asset sales and being entitled to retain the savings achieved from the VfM programmes.

VfM Categories

1.67 The VfM Team identified and analysed over 100 work streams across the NZDF's operations. Not all the work streams resulted in identified savings. In some cases, savings were identified but fell outside the next five-year period which the prime focus of the VfM Review.

1.68 In other cases, we concluded that savings existed but we were unable to get comfortable with an appropriate savings target.

1.69 In the accompanying set of recommendations, a summary of the key conclusions from the work streams is provided. Full details on a work stream by work stream basis are provided in Section C.

1.70 We summarise below some of our key findings.

Support Functions

1.71 Primarily, this involves what is generally described as the "Back Office": human resources (HR), finance, procurement, corporate and administration and shared services.

1.72 Over and above the savings already identified by the NZDF, the VfM Team concluded that, by FY 2014/2015, the NZDF should be able to deliver incremental savings of over $39 million per annum. Support functions make up 16% of the VfM incremental savings.

1.73 The largest contribution to these savings will come from the HR function where, by any measure, the NZDF is delivering poor VfM. The projected savings as measured by the number of HR full time equivalents (FTE) to total NZDF FTE will require considerable expenditure on IT systems and upgraded HR processes but are unquestionably achievable when compared against best practice in Government and the commercial world.

1.74 Significant savings are also identified for the Finance and Procurement functions. Primarily, this results from the NZDF establishing a single, integrated function and moving away from the Tri Services model with its triplicate functions.

Work Force

1.75 By far the largest area for savings is the NZDF work force with peak annual savings of $140 million or over 50% of total annual savings identified by the VfM Team.

1.76 While the savings are significant, they do involve sometimes difficult policy choices. The workforce savings from different areas including: remuneration; the conversion of a large number of positions currently filled by military personnel to civilian positions or uniformed positions on civilian rates; reserves, health services and recruitment.

1.77 In the remuneration category, the focus of the VfM Team has been on the withdrawal of the proposed military remuneration increase of $25 million scheduled for in FY 2011/2012, a rationalisation of non-operational allowances, a gradual change from the current superannuation arrangements to Kiwi Saver, and applying the work already started by NZDF on matching

Warrant Officer rank and skills (the R5 project). There is an opportunity to apply the findings of this across NZDF with further scope for significant savings.

1.78 Military personnel are remunerated 30% more (an average of $23,000) per annum than civilians, primarily due to the universal accommodation allowance (UAC) and a military factor allowance. Quite apart from the merit of these two allowances and their universality, a core question is whether all positions currently filled by military personnel need to be.

1.79 This is a complex issue and is inextricably linked with the number of personnel the NZDF need to have in uniform (known by the acronym PRU) to meet its Government-endorsed deployment and sustainment ratios.

1.80 The VfM Team undertook its own analysis and shared its conclusions with the Services. As a result of this analysis, we concluded that there was a significantly reduced requirement for PRU relative to either the status quo or the Defence Assessment projections. There is thus an opportunity to increase the number of civilian (and lower paid) positions. The VfM Review concluded that there were up to 2,000 positions (many in Logistics) in this category which, if converted, would deliver $46 million in annual savings.

1.81 A key component of the work force area is Reserves at an annual cost of $33 million per annum and with some $26 million of real estate "allocated" to the Reserves. The VfM Review concluded that, as presently configured, the Reserves were not delivering VfM.

1.82 It is proposed that part time military personnel replace the Reserves and that these part timers be integrated into Regular Force units as and when necessary to enable the NZDF to deliver its outputs in the most efficient way possible.

1.83 It is further proposed that the focus for part timers should be on key capabilities that it would not be economical for the NZDF to seek to retain on a full time basis. Examples are medical specialists, linguists, certain critical trades and engineers.

1.84 The VfM Team acknowledges that the Reserves do provide some Whole-of-Government benefits. Should the Government wish to continue with this or even expand these programmes, then there should be an explicit output class so the NZDF's responsibilities and funding are clear.

1.85 In Health Services and Military Recruitment, there are also savings opportunities (in the case of the latter, already identified by the NZDF). In both categories, the largest savings are likely to come from outsourcing most of the function. The

Australians have already contracted out recruitment where recruitment agencies are paid once the recruits successfully achieve basic training.

Education and Training

1.86 By their very nature Defence Forces are training organisations. It is no surprise, therefore, that they spend considerable sums on training and education. What surprised the VfM Team was the amount of money spent in this area by the NZDF.

1.87 While accurate data were, as ever, somewhat elusive, we concluded that the NZDF spends up to 10% of its operating expenditure (excluding the capital charge) on this expenditure category.

1.88 The NZDF will always spend a large amount in this area but benchmarking informs us that there is considerable scope for efficiency gains. The VfM Team has estimated this as up to 10% of current annual expenditure.

Non-Military or Non-Specialised Military Equipment (SME) Procurement

1.89 The NZDF spends approximately $620 million a year on commodity goods and services and strategic items (parts, munitions, rotables, military-specific inventory). This increases to $1 billion when military capital items are included.

1.90 The Pappas review of the ADF identified over 15% savings per annum and recent procurement transformation programmes among leading New Zealand commercial organisations have delivered savings of between 10% and 15%.

1.91 Together with the work already carried out by the NZDF, the VfM Team considers that the NZDF can deliver annual savings of at least $40 million per annum, or around 6% of total expenditure.

Logistics

1.92 The NZDF has already moved to follow international Defence Force trends by establishing a single Logistics command structure (the Defence Logistics Command - DLC). This new organisation commenced on 1 July 2010. As part of this organisational change, the NZDF identified potential savings over 10 years of $334 million with peak annual savings of $41 million.

s9(2)(b)(ii)

Platforms and Capability

s9(2)(b)(ii)

1.99 The one exception is in strategic air transport where the 757s are expensive to run, are not well utilised and spend too much time being repaired. On a purely financial basis, the Government is not receiving VfM from these aircraft and we have concluded that most of the capability provided by the 757s could be delivered by third parties such as Air New Zealand at a lower cost.

s9(2)(b)(ii)

1.102 Related to this, of course, is the likely significant (non cash) loss the NZDF would make on the sale of the 757s.

The Defence Estate

1.103 In the main, the Defence Estate is run down and in need of significant operating and capital expenditure. We refer to this specifically in our report and recommend considerable additional funding.

1.104 Setting aside the general condition of the Defence Estate, there are opportunities for base consolidation and for an accelerated Defence housing sale programme, both of which would deliver significant VfM.

1.105 As part of the VfM Review, we worked with key NZDF people, the New Zealand Treasury and KPMG to assess the opportunity for base consolidation concentrated on the Ohakea Base to proceed via a Public Private Partnerships (PPPs). The initial results are very promising and the NZDF should proceed to a full business case as soon as possible.

1.106 An integral part of the Ohakea opportunity would be the closure of Linton and Woodbourne and the transfer of certain personnel and functions from Trentham and Waiouru.

1.107 Base closures are always difficult decisions for Governments and Defence Forces but the VfM opportunities are clear.

1.108 The NZDF owns well over 2,000 houses and spends some $70 million a year providing accommodation and accommodation benefits to many of its personnel. It has moved, albeit too slowly in our view, to exit from housing and to put in place financial incentives to facilitate this but the costs of these incentives are overly generous and they are yet to produce meaningful results.

1.109 The prize in value terms is very significant, over $200 million indicatively in Defence housing sale proceeds and over $20 million in reduced annual operating costs if our recommendations are adopted.

1.110 As part of our review we considered Whenuapai against the background of the Government's retention decision. While the optimal VfM outcome is likely to be to close the Base and to relocate to the planned northern runway at Mangere, there are still real savings to be secured from managing Whenuapai in a more efficient manner, most likely with greater private sector involvement.

The Private Sector

s9(2)(b)(ii)

1.114 Finally, the NZDF should seek to promote strategic alliances with key private sector providers. Air New Zealand is an obvious example and the NZDF has been slow to leverage this relationship. Global players such as Lockheed Martin are well placed to bring best practice techniques to the NZDF.

s9(2)(b)(ii)

1.118 The NZDF spends approximately $20 million per annum on military diplomacy. While many Defence Attachés are performing a useful function, it is difficult to justify this expenditure on VfM grounds when there are so many competing demands for this funding. We consider that there is scope for the NZDF to reduce expenditure in this area.

1.119 Some $16 million is spent each year on the Defence Technology Agency (DTA). We do not doubt that the DTA has the capacity to make a real difference to the NZDF, but we do question the way it is structured.

1.120 It is proposed that DTA be set up along the lines of a Crown Research Institute (CRI) with the NZDF committing a declining annual fixed amount (starting with $10 million in the next financial year) and the Services being required to bid and commit funding for work over and above the initially funded amount. The DTA should also be encouraged to secure revenue from external parties, subject to appropriate security protections.

Information, Communications and Technology (ICT)

1.121 ICT has been left to last because it was the area that concerned the VfM Team the most yet it is so critical to achieving the VfM gains.

1.122 Put simply, without a major investment in corporate IT systems, many of the VfM savings we have identified will not happen.

1.123 The most obvious areas are Logistics, HR and Finance but there are a myriad of other areas where outdated systems and infrastructure require upgrading.

s9(2)(b)(ii)

1.125 The report contains an extensive set of ICT recommendations informed by input from a leading IT practitioner. The NZDF is facing the need to spend well over $100 million over the next few years and it must proceed to do so with urgency.

Conclusions

1.126 What the VfM Review has demonstrated is that it will be possible to close the gap between the NZDF's projected operating expenditure (including depreciation) and expected Defence Appropriations and at least to meet the Defence Assessment's middle pathway.

1.127 Generating the savings and the efficiency gains to enable this to happen will not be easy. But with a culture change within the NZDF, organisational and personnel changes and determined leadership, it is achievable. Other organisations have clearly demonstrated this.

1.128 The NZDF has shown repeatedly at the front line that in VfM terms it can foot it with the best. It needs to transfer these same skills and determination to the back and middle of the organisation.

1.129 When this happens, the NZDF will be able to say that it is as good at the business of Defence as it is at the operational and military elements of Defence.

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Section A: Part 2

Recommendations

Management and Organisational Matters

2.1 The Service Chiefs to be appointed by the CDF and not to be warranted. This would require a change in legislation.

2.2 The VCDF position, which should be a civilian and renamed Chief Operating Officer, should manage the middle and back functions of NZDF.

2.3 Reporting to the COO would be the Heads of Logistics (including procurement), Personnel and other support functions except Finance and IT.

2.4 With the appointment of a COO, the position of VCDF should be disestablished and the present Organisational Support Group (OSG) disbanded. OSG functions to be distributed to relevant line managers

2.5 There is no requirement for a formal Deputy to CDF; the CDF should delegate to the Commander Joint Force New Zealand.

2.6 Introduce a further top level position, CIO, and upgrade the role of the CFO, all (including the COO) to be direct reports to CDF.

2.7 The State Services Commissioner on behalf of the Minister to have an annual performance agreement with the CDF and this should be monitored to ensure delivery. VFM savings should be part of this. The agreement should be short and sharp, concentrating on a small number of high priority areas for the CDF's attention.

2.8 In turn, the CDF should have performance agreements with each of his direct reports. These agreements should include progressing VfM initiatives.

2.9 Decision processes on areas needing change should be sped up and the layers of bureaucracy reduced. One option used elsewhere would be to cancel all committees and start again.

2.10 Form an Executive Management Board (EMB) replacing the existing ELT comprising 8 permanent members – CDF, COO, CIO, CFO, three Service Chiefs and the Joint Commander.

2.11 The State Services Commissioner on behalf of the Minister to have an annual performance agreement with the CDF and this should be monitored to ensure delivery. VFM savings should be part of this. Agreement to be short and sharp, concentrating on a small number of high priority areas for the CDF's attention.

2.12 Decision processes on areas needing change should be speeded up and the layers of bureaucracy reduced. One option used elsewhere would be to cancel all committees and start again.

Defence Advisory Board

2.13 A Defence Advisory Board (DAB) should be established comprising the CDF, Secretary of Defence, Secretary of Treasury, and two or three external independent members, one of whom should be Chairman.

2.14 The external members of the DAB would be appointed by the CDF and the Secretary of Defence after consultation with the Minister. The Chairman of the DAB would have direct access to the Minister if required. The Minister could consult the DAB from time to time as needed.

Approval of Remuneration

2.15 The State Services Commissioner should have a much stronger role in overseeing remuneration changes within NZDF.

2.16 A change in the State Services Act is required to enable the Commissioner to exercise a power of veto over remuneration changes (a principle which we think should apply to all public service departments and not solely the

NZDF). This should relate to the overall framework and scale of increments rather than the detail.

Commitment to VFM and Savings Retention

2.17 The government and the NZDF should commit fully to the VFM savings identified in this report and implement them vigorously.

2.18 Objectives and time frames for VFM savings should be clear, concise and adhered to.

2.19 Line managers should have full accountability for delivering the VFM savings in their areas. There should be less committee decision making across the NZDF.

2.20 Retain the VFM savings within NZDF for reinvestment in agreed front line activities, subject to the savings being clearly identifiable and removed from Budget line items for transfer to other Budget lines as agreed.

Other Finance and Administration Policies

2.21 Improve the incentives for NZDF to dispose of surplus assets and to rationalise asset holdings by an agreement between Treasury and NZDF on retention of an agreed proportion of asset sales providing the proceeds are directed to VFM propositions such as upgrading IT systems, capability and base consolidation and maintenance.

2.22 Upgrade substantially corporate IT systems to underpin improvements in NZDF Management and delivery of VFM savings.

2.23 Data integrity within the NZDF to be given high priority so that all data are reliable and readily accessible.

2.24 Activity accounting to be introduced to track readily all major activities and functions.

2.25 Recoding items to under spent budget areas to be forbidden.

Procurement Policies

2.26 The Secretary of Defence to be responsible for the development and specification of large scale military capabilities, up to the point of Government decision, with the NZDF development function being moved to the MoD. Material variations would be the responsibility of the MoD.

2.27 The CDF to be responsible for the actual purchase process once the Government had made the acquisition decision, with a single Procurement Group being formed within the NZDF including the present DLC, JLSO, the MoD acquisitions function, which would be transferred to NZDF, and other acquisition functions within the NZDF.

2.28 Alignment and prioritisation against an agreed strategic plan should be compulsory for all capital projects.

2.29 The Capability Management Framework, which sets out the process for obtaining capital project approvals within the NZDF, should be reviewed, shortened, and strictly adhered to throughout the organisation.

2.30 Full specification of through-life and whole-of-life capital costs should be part of the approval and budgeting process for all capability and capital expenditure.

2.31 Introduce transfer pricing for all IT development and servicing work and for Research & Development work being carried out by DTA. Capital for IT to be bid for and then provided by that part of the NZDF seeking IT changes or upgrades. DTA resources should also be bid for.

Support Services - Human Resources

2.32 Expedite the replacement of ATLAS with SAP HR.

2.33 Establish modern HR processes based on the software: do not customise SAP to match current practices.

2.34 Consolidate and simplify HR functions to achieve 1:100 ratio of HR FTE to NZDF FTE.

2.35 Transfer payroll function to HR.

2.36 Establish web kiosk facilities to facilitate personal management of own HR information.

Support Services - Finance

2.37 Consolidate all finance functions into a single, integrated Finance Branch under the CFO.

2.38 Target the ratio of Finance staff to NZDF of 1:90.

2.39 Implement activity-based accounting.

2.40 Upgrade financial processes to SAP military version, if acquired.

2.41 Retain some of the VFM savings within Finance to improve the quality of finance business support services and to establish both business analysts and a forensic accounting function.

2.42 Transfer accounts payable function back to Finance.

Support Services – Procurement

2.43 Consolidate all procurement activities into a single Centre of Excellence within DLC incorporating JLSO, Services procurement arms, CIS procurement activities and MoD capital procurement.

2.44 Target ratio of 1:100 for procurement FTE to NZDF FTE.

2.45 Business cases for minor capital investment should be the responsibility of the business unit owner or benefits owner.

2.46 Capability development work and business cases for major capability to be the responsibility of the Secretary of Defence.

Support Services - Development and Capital Procurement

2.47 Ensure that staff working on development and procurement tasks have appropriate professional training, experience, and tools.

2.48 Ensure project teams are fully staffed and reduce staff rotation.

2.49 Seek opportunities for a higher proportion of civilian staffing (including former military personnel).

2.50 Apply a rigorous prioritisation and firm discipline to capital minor project proposals so that only high priority projects receive funding. This prioritisation should be the responsibility of the CFO.

Support Services – Other

2.51 Target further reductions in consultants and contractor expenditure and restructure DTP (with reduced expenditure).

2.52 Consolidate civilian and military payroll services into a shared service function located within HR.

2.53 Bring strategy and planning FTE and operating expenditure into line with other comparable agencies.

Defence Transformation Programme (DTP)

2.54 DTP to shift from a set of separately managed programmes to the appropriate line management responsibility.

2.55 DTP annual costs to be reduced by 50% and kept under constant review by ELT (or the new EMB). Savings of 50% and the other 50% re-allocated to relevant line management.

Remuneration, Civilianisation, and Non-deployable military

2.56 Remove the $25 million provision for remuneration increment in FY 11/12 and thereafter.

2.57 Accelerate R5 Project and implement Warrant Officer findings.

2.58 Rationalise Non-Operational Allowances – which for a wide range of allowances would mean removal.

2.59 Restructure military remuneration. Staff in positions not within deployable force elements to be remunerated at civilian rates.

2.60 Restructure superannuation to move staff to Kiwi-Saver over time.

2.61 Civilianise / reclassify as non-deployable military 2,000 positions which should be paid at civilian rates.

Control of Establishments

2.62 CDF to be the approval authority for establishment numbers.

2.63 Existing arrangements for approval of establishments to be withdrawn.

2.64 Establishments to be reviewed in accordance with 2010 Defence White Paper.

2.65 Establishment numbers to be capped at the minimum number of staff required to meet outputs.

2.66 Personnel under Training (PUTs) and Manpower Not Effective (MNE) to be held over establishment.

Reserves

2.67 That the descriptor part time uniformed member of the NZDF be used in place of Reserve / Reservist.

2.68 The term Reserve to be applied solely to those people serving out a reserve obligation post Regular Force service.

2.69 That the NZDF continues to use part-time uniformed members where it represents good value to do so, and that these members are directly integrated into the units that employ them.

2.70 That the NZDF cease undertaking NVR, TF and Air TF activities where it is more cost effective to produce those outputs through the Regular Force.

2.71 That where there are properties and infrastructure that are no longer needed to support part time uniformed members of the NZDF, that those properties and infrastructure be sold.

2.72 That if it is decided that there are non-military social, community, or workforce training imperatives for activities to be undertaken by part-time uniformed members of the NZDF, then that should be made explicit within the Statement of Intent and Annual Output Plan with separate funding and a separate Output Expense Class.

Military Recruitment

2.73 Develop a pan NZDF recruitment strategy and reorganise the Recruitment function to support this strategy.

2.74 Introduce online applications, candidate management system and skills database. This will require IT investment and should be part of the HR IT Project.

2.75 Reduce advertising expenditure through an online and digital strategy.

2.76 Develop a strategy to involve a broader number of NZDF personnel in recruitment activities – recruitment should not just be the responsibility of the recruiters.

2.77 Rationalise recruitment research and remove duplication and triplication across the three Services.

2.78 Consider the ADF outsource model and pay an external service provider a fixed fee once recruit successfully passes initial recruit training.

Health Services

2.79 Establish a single, integrated command for health services.

2.80 Outsource all domestic health services conditional on the service providers engaging under secondment NZDF health personnel to facilitate training and maintenance of skills.

2.81 Domestic health to exceed average public provision only when there is an operational imperative.

2.82 Close uneconomic health facilities including the Navy Hospital and Hyperbaric Unit and strategic AME.

2.83 Review the health facilities and personnel requirements at Linton.

Training and Education

2.84 Establish a 2010/2011 Education and Training baseline.

2.85 Deliver a 10% cost reduction against that baseline.

2.86 Reduce duplication and triplication in training design and delivery.

2.87 Explore and execute more cost efficient training delivery methods and identify where NZDF is over-training (i.e. more than is required to deliver outputs).

2.88 Greater use of simulation, in-sourcing and outsourcing.

2.89 NZDF should benchmark itself against other Industry Training Providers, Wananga and Universities.

Non-Military Procurement

2.90 Execute non-military procurement savings of up to $15.4 million per annum additional to the savings identified via NIKE process.

2.91 Impose savings through top-down constraints via Budget process.

2.92 Achieve savings through aggressive demand and supply side management.

Logistics

2.93 Expand NZDF's logistics initiative by including most of forward logistics and maintenance within DLC.

2.94 Adopt a more ambitious programme of cost reduction with primary focus on headcount reduction, increased inventory savings, civilianisation of certain uniformed positions and strategic sourcing.

2.95 Ensure DLC has access to necessary operating and capital expenditure to support more ambitious cost saving programme.

2.96 Actively pursue contracting out of Logistics and MRO.

2.97 Implement alternative ownership structures for warehouses and distribution centres.

2.98 DLC to be the Centre of Excellence for NZDF procurement functions.

Capability and Specialist Military Equipment

s9(2)(b)(ii)

2.104 Consider divestment of B757s once five C130 Hercules have been returned to operational service. Commence discussions with Air New Zealand on strategic and VIP transport.

s9(2)(b)(ii)

2.108 Measure fleet utilisation and operating costs, identifying variances.

2.109 Once utilisation is determined, consider opportunities for a further 10% reduction in fleet size if warranted (10% shown indicatively).

2.110 Test the market to determine VFM opportunities from sale and lease back and outsourcing.

Operational Tempo and Preparedness

2.111 Savings from adjusting operational tempo can only be achieved if the Government accepted a greater Response Time (measured in months) for the deployment of forces.

2.112 The potential savings unlikely to be material and increased future expenditure would likely be incurred later as forces are deployed.

Capital Programme Minor

2.113 Ensure central management and oversight of the Capital Program Minor with CDF to review monthly.

Non-Military Tasking

2.114 Review Output Classes to reflect fully and to identify separately the non-military (MAOT) activities conducted by the NZDF.

2.115 The use of the NZDF as a service provider for other Government Departments represents VFM from a Whole of Government perspective.

2.116 The Government to note that too much MAOT risks erosion of readiness, deployments and operational capability.

2.117 Comprising 30% of NZDF's operating expenditure, MAOT activities have grown significantly and are placing significant pressure on NZDF.

Property and Real Estate – Bases

2.118 Optimise the Base configuration for NZDF comprising:

- Devonport Naval Base;
- Single Auckland location for the RNZAF;
- Auckland location for the SAS;
- Limited NZ Army Training Facility at Waiouru;
- Manawatu consolidation centred on Ohakea;
- Closure of Linton;
- Closure of Woodbourne;
- Retention of Burnham and Tekapo - reduced scale; and
- NZDF in Wellington CBD limited to Defence House

2.119 Prepare full business case for the redevelopment of and consolidation at Ohakea as a PPP.

2.120 Undertake an ownership review of facilities, buildings and infrastructure at Whenuapai and assess the merits of a PPP.

2.121 Consider a PPP for the new SAS battle training facility at Papakura.

2.122 Advance discussions between RNZAF and Auckland International Airport Limited (AIAL) regarding the sharing of expertise, resources and facilities with respect to Whenuapai and Mangere Airport.

2.123 Keep under review financial and operational merits of closing Whenuapai and relocating to proposed AIAL northern runway at Mangere.

2.124 Increase property maintenance capital and operating expenditure at those Bases that will not be part of the Ohakea Project.

Property and Real Estate - Defence Housing

2.125 Complete Defence housing sale programme by 30 June 2014.

2.126 Give tenants formal notice to vacate within an agreed period.

2.127 Introduce a one-off payment (not an ongoing payment) to facilitate movement of staff out of NZDF houses in Auckland.

2.128 Accelerate discussions with Iwi and develop further opportunities with Housing New Zealand.

2.129 Remove the UAC from those living in barracks accommodation.

Information and Communications Technology

2.130 The CIO should develop and agree with the CDF an ICT strategic plan which should include an ICT remediation and upgrade programme. This should be reported to and discussed fully at the EMB. A skilled independent facilitator should be used to ensure that all parties sign off to this plan.

2.131 Develop an implementation strategy for the strategic plan, with timing, milestones, priorities, costs and resources.

2.132 Hold individual managers responsible for ICT projects and benefit delivery.

2.133 Rationalise ICT personnel by consolidating into a single, integrated CIS branch under a CIO who will be a direct report to CDF.

2.134 Establish a shared services model with customer relationship managers embedded with major ICT users.

2.135 Increase the annual ICT budget from $70 million to between $100 and $125 million, including annual capital investment of between $25 million and $50 million.

2.136 Match the capital investment to the NZDF's ability to undertake projects and to deliver benefits.

2.137 Mandate SAP as the sole ERP solution. Negotiate an enterprise licence for the military modules and ensure all future ERP applications and business cases are based on SAP.

2.138 Require all ICT proposals to be fully costed, including the internal resources required to implement and operate. All project costs, including labour, to be capitalised.

Military Diplomacy

2.139 Reduce direct costs to $15 million over 3 years, closing up to 6 posts to achieve.

2.140 Review the number and location of overseas posts, in consultation with MFAT.

2.141 Establish specific outputs and KPIs for each post.

2.142 Appoint people on merit.

2.143 Establish regional service hubs.

Defence Technology Agency

2.144 Establish as a crown-owned commercial entity, analogous to a CRI.

2.145 DTA services and expertise to be bid for and purchased by NZDF in accordance with ELT (or new EMB) – agreed priorities.

2.146 DTA to look to deliver services and expertise more efficiently pursuant to a funder-purchaser model.

2.147 Consider relocation of DTA to Wellington.

Other Services – Libraries

2.148 Put in place a single, central NZDF library with online access and resources.

2.149 Base libraries to contain essential and Service relevant books and journals only.

2.150 Reduce subscriptions to printed journals.

2.151 Consider opportunity to close all libraries and merge collection with National Library.

Other services - Museums and Bands

2.152 Improve efficiencies of Museums by bringing operating costs per visitor in line with benchmark organisations.

2.153 As a more demanding alternative, transfer the Museums to the Ministry of Culture & Heritage to operate with budget appropriation to transfer with ownership.

2.154 Reduce expenditure on Bands by 50% by consolidating the number of Bands and considering appropriateness of paying full military allowances to Band personnel.

2.155 Where required for ceremonial purposes, establish separate Output class and a maximum level of expenditure.

Private Sector Relationships – Contracting Out

2.156 Pursue aggressively opportunities to outsource to the private sector non core services and/or those that do not have a direct association with military operations and force elements.

2.157 Extend the coverage of existing and new outsourcing contracts, where appropriate, to national contacts.

2.158 Seek national contracts in: property and infrastructure maintenance; canteen and mess management; health services; vehicle fleet management; warehouse management, logistics and distribution services; ICT services and certain HR services.

s9(2)(b)(ii)

2.160 National outsourcing contracts to proceed only where there is a fully functioning competitive market for the service being procured.

Private Sector Relationships – Ownership Structures

2.161 Change from a "should own all assets" approach to one where alternative ownership structures are considered for all existing and new assets other than those assets that could operate in hostile environments.

2.162 Consider alternative ownership and contracting structures for appropriate assets and capabilities as they come up for acquisition, replacement or renewal.

2.163 Consider alternative ownership structures for: the replacement Air Trainer fleet (currently leased); certain B, C and CL vehicles; Short Range Maritime Surveillance Aircraft; existing, replacement and new IT systems and infrastructure, and the proposed Logistics hubs in Auckland and Manawatu.

Private Sector Relationships - Air New Zealand

2.164 Accelerate and finalise by an agreed date, discussions with Air New Zealand on a range of matters including:

s9(2)(b)(ii)

- Pilot training;
- Fleet optimisation with respect to Air Trainers and the proposed Short Range Maritime Surveillance Aircraft;
- The provision of certain strategic and VIP transport services; and
- Opportunities for joint procurement and shared services and infrastructure.

s9(2)(b)(ii)

systems; military doctrine; communication protocols and training and development.

2.169 ADF and NZDF to undertake annual joint benchmarking on key functions, activities and capabilities.

Revenue Generation Opportunities

2.170 Optimise third party revenues.

2.171 Following the reorganisation of DTA, pursue opportunities to secure third party research revenue and, where appropriate, to sell intellectual property rights.

2.172 Participate in the whole of government carbon credits scheme.

Section B

VfM Report

Introduction

3.1 On 23 March 2010, the Minister of Defence, the Hon Dr Wayne Mapp, announced that a Value for Money (VfM) external review was to be undertaken of the New Zealand Defence Force (NZDF). This followed the announced delay in the completion of the Defence White Paper which is now due later this year. The objectives of the VfM Review were: to help identify efficiencies; to seek options for shifting resources to front line activities; and to provide assurances and options around the cost effectiveness and sustainability of the NZDF. The Minister indicated that the Government was seeking savings of over $50 million per year.

3.2 The Terms of Reference for the VfM Review are at Appendix I to our Report. In essence, the objectives comprised: a review of the NZDF's business model and cost structures; an identification of any changes required to improve the NZDF's performance; the quantification of any gains which may be possible; and a plan to assist in realising those gains.

3.3 The scope of the review was defined as including whether improved VfM could be achieved by resource shifts from support functions to military capabilities; changes in organisational structures; exploring alternative models of asset ownership; reassessing policy requirements; improving capital management; platform numbers and capability; service interface and duplication issues; tasking and training; interface with civilian agencies and whole of government activities; use of personnel, both military and civilian; and technology.

3.4 Excluded from the VfM Review was the strategic context, including defence priorities, which was to be taken as already established by the Government, the Ministry of Defence (MOD) and the NZDF. The number and application of military platforms and operational deployments were also excluded.

3.5 The strategic context for this VfM Review is set out in the Defence Assessment prepared by the Secretary of Defence and which will be elaborated further by the Government in the Defence White Paper. In summary, we have assumed the strategic context to be the overarching national security strategy directed to protecting New Zealand, its people, and its interests. Within this context, the principal roles and tasks of the NZDF are protection of New Zealand and the EEZ; honouring New Zealand's alliance obligations to Australia; contributing to peace and stability in the South Pacific; making an appropriate contribution in support of peace and security in the Asia-Pacific region; and protecting New Zealand's global interests.

3.6 The original VfM reporting date was to be 30 June 2010 but this was extended by mutual agreement to 31 July.

3.7 The review was conducted by Dr Roderick Deane as lead reviewer assisted by Mr Greg Kay, Executive Director of Pacific Road New Zealand. Dr Deane is Chairman of the Sydney based Pacific Road Group. The MOD and the NZDF each provided invaluable staff resources to assist the reviewers. The team members are listed in Appendix II. We would like to express our warmest appreciation to those who helped us. They take no responsibility for the judgement calls we have made but they assisted us hugely and with great professionalism in collecting and analysing the information and in understanding the complexities and challenges of the military.

3.8 The VfM study has been informed by a wide range of interviews (see Appendices III & IV), both within the NZDF and external to it, both within New Zealand and in London and Canberra; by a range of military base and site visits; by many outside public sector and commercial organisations which provided valuable advice and benchmark data; by considerable help from the NZ Treasury; by a huge array of information now collated in a resource library to help underpin our findings and to make our source material readily accessible to the NZDF; by an audit process conducted by internal experts who were independent of the VfM team; and by the openness and positive assistance received from all quarters of the NZDF and the MoD. We are most appreciative of all the help and guidance we received from many individuals, organisations and the reports of others.

Context and Themes

3.9 In the financial year to 30 June 2010, the NZDF spent $2.2 billion (including depreciation and capital charge) on its operations and $326 million on capital items. It employed 9,673 military personnel and 2,590 civilians, a total of 12,263, along with 2,314 part time reserves, an all-up total of 14,557 people.

Service	Regular Force	Reserve Force	Civilians	Total
HQ NZDF	370	19	477	866
NZDF Support Services	71	1	612	684
HQ JFNZ	165		39	204
Navy	2161	339	370	2870
Army	4905	1789	690	7384
Air Force	2607	186	402	3195
TOTAL	9673	2314	2590	14577

Table 1.1: Personnel Numbers for the NZDF as at 30 June 2010. Source: NZDF Draft Annual Report for FY 2009/2010.

3.10 While the NZDF is not large by international Defence Force standards nor compared with significant commercial organisations, it is the largest core Public Sector organisation in New Zealand by employee number and represents a sizeable proportion of the Government's annual budget.

3.11 The Parliamentary Vote - Defence Force comprises 16 outputs that are managed as a whole by NZDF or by the relevant Service, whether Navy, Army or Air Force. Other than with respect to its military equipment procurement function where there is considerable interfacing with the NZDF, this review does not cover the small but important separate policy agency, the MoD. The chart below (Figure 1.1) sets out the current structure, including the principal outputs of the NZDF and its three Services, Navy, Army and Air Force.

Pan NZDF	Navy	Army	Air Force
Military Policy Miscellaneous Support Activities Service Museums Mutual Assistance Programme New Zealand Cadet Forces Support to Youth Development Limited Service Volunteer Scheme Operationally Deployed Forces	Naval Combat Force (Frigates) Naval Patrol Force (Patrol Boats) Naval Support Force (Tanker and Multi-role	Land Combat Forces Land Combat Support Forces Land Combat Service Support Forces Special Operations Forces	Rotary Wing Transport Forces (Iroquois) Fixed Wing Transport Forces (C-130 & 757) Maritime Patrol Forces (P3 Orions)

Figure 1.1: NZDF Departmental Outputs on a Service by Service basis.

3.12 The NZDF is a large organisation carrying out highly important and sometimes dangerous tasks where a high level of professionalism and skill is critical. The NZDF must be appropriately funded to do its multitude of jobs to a high standard but equally, as a taxpayer funded organisation, it is expected to deliver good VfM. It is clear to us that the NZDF itself wants to do this, and to be seen to be doing this, as witnessed by the number of change and improvement projects it currently has in train.

3.13 In assessing the way in which the NZDF delivers VfM we explored all the areas of its operations which we were charged with doing under the terms of reference. We identified and analysed over 100 work streams. Our reporting time frame was four months. We studied the areas where the NZDF currently delivers world class VfM; the areas where it is already pursuing programmes of its own to achieve better VfM; and areas where we came to the view that there is scope for further VfM opportunities. In some cases these opportunities are substantial.

3.14 Some common themes arose from our work. First, in both the military and non-military operational arenas, in what one would describe as the front end of the organisation, the evidence is consistently one of a defence force which delivers considerable VfM within constant financial constraints.

3.15 By international standards the NZDF is small but “in the field” it is ably led, well trained, in the main well equipped, highly professional, able readily to work closely with our military partners, and respected by them. It makes significant contributions with our partners to military activities in a wide range of arenas and geographies, to international peacekeeping and constabulary roles, and to many domestic and Pacific non-military activities, as diverse as customs and fisheries patrols to disaster relief operations.

3.16 Secondly, the NZDF is keen to perform better in those areas where it is clear that there is room for improvements, which are basically in what are termed the middle and back end of the NZDF, essentially the support functions. The Defence Transformation Programme (DTP) and its associated components, an initiative of the NZDF, confirm this.

3.17 Thirdly, there is substantial remaining scope for improvements in these support areas. This report sets those out. The review summarises where the NZDF is today; what its own change programmes are planned to deliver; and what further gains can be made. As with other organisations, some people within the NZDF are already aware of where most of these potential gains lie but have not yet been able or willing to deliver on them.

3.18 Fourthly, if the further changes we suggest are implemented, there is scope for transferring significant resources from the middle and back end support areas to the front end military and military support activities, thereby enhancing the NZDF's ability to continue to meet the Government's requirements. Without these changes, the NZDF's capabilities will continue to be degraded.

3.19 Fifthly, additional capital expenditure, especially on IT systems, base facilities and capability, will be required to facilitate these improvements.

3.20 Sixthly, we support the retention of the three Services and the Joint Force Headquarters model for the NZDF but improved ways around the complexity of this arrangement must be found. Improvements are occurring but much remains to be done.

3.21 Finally, the VfM gains will only be realised if there is a change in processes, culture and leadership style throughout the organisation. The can-do, let's get on with it, decisiveness and vigour, which is a feature of the front line operations, needs to be translated to all other areas of the NZDF. This will not be without its challenges, but it is eminently possible, as other organisations have proven.

3.22 The Chief of Defence Force (CDF) has made it clear to us that he sees this review as providing a set of new opportunities and acting as a catalyst for the NZDF to achieve long overdue changes. We agree. The NZDF in its key front line roles knows how to deliver VfM. It simply has to translate that culture across all of its activities.

Methodology and Process

3.23 The VfM team initially sought briefings on all major areas of NZDF operations and support functions. We met a large number of people within and outside the NZDF (see Appendix III & IV) who without fail were helpful to us. We asked people what they thought the NZDF did well and where things could be done better. A comprehensive request for information was widely distributed and the responses were often fulsome. Over 100 work streams were established and assigned to individual members of the team. The information obtained at interviews and by other means was analysed and common presentation formats were designed. We read many internal and external documents including a significant number of other NZDF reviews (Appendix V).

3.24 A range of public and private sector organisations were asked for benchmark comparative data to assess alongside the NZDF information. Our information was shared with others within the NZDF to obtain further feedback. Many of the senior people met with us on more than one occasion. Some of the meetings were lengthy. We shared our questions and our emerging views as we proceeded and did not seek confidentiality within the NZDF for any of our work.

3.25 Some of our discussions were lively and many of them illuminating. The NZDF and MOD people were open and straightforward with us. This attitude permeated from the CDF and the Secretary of Defence and they made their expectations clear to their staff. As our primary liaison people at a senior level, the CDF's Chief of Staff and the Deputy Secretary of Defence, Policy and Planning, were exceptionally helpful to us.

3.26 In assessing the additional opportunities for savings we took account of benchmark comparisons where such information was available and relevant. Of more importance was what people within the organisation thought was achievable and our own judgement from our combined comprehensive public and private sector experience. That experience is described in Appendix VII.

s9(2)(b)(ii)

3.28 We are particularly grateful for the help provided to us by George Pappas who chaired the 2009 ADF Audit and who, following the completion of that Audit, is Chairing an independent Advisory Board set up to monitor over A$20 billion of savings targeted for achievement over a 10-year period.

3.29 Many days were spent assessing what "demanding but achievable" targets for savings across the various work streams would amount to. We feel we have answered the question of what can be delivered. Of equal or perhaps more importance, however, is how to deliver it, and who will be responsible for making it happen. These are questions for the CDF who is also the NZDF's Chief Executive.

3.30 Some of the target savings rely on policy choices, a number of which will challenge the way the NZDF has carried out its business for many years and in some cases since the end of the Second World War.

3.31 We have endeavoured to build in assessments and judgements which minimise the risk of double counting savings but inevitably there will be some overlap between categories of expenditure.

3.32 On the other hand, we have not been able to take full account of the follow on, or indirect savings, which will emerge from our first round recommendations, so there will be an offset here. In many cases more time and more detailed work would reveal more of these matters but there is a need to be careful about avoiding excessive analysis which inhibits actually getting on with the job. This warning is important given the NZDF's present penchant for the most detailed analysis and numerous meetings but in our view extremely time consuming processes around any changes in administrative and support areas.

3.33 Of the benchmark data, some of this is commercially sensitive so the organisations' names are protected in the charts. The same applies to some of the material supplied to us by other Defence Forces. However, appropriate people within the NZDF and Central Agencies can access these sources from our library of files on each work stream.

3.34 Collection of data was sometimes a challenge. This was not because of any unwillingness to supply it to us but rather because it was, at times, subject to disconcerting changes as it was reworked and because the same question could at times attract different answers. In some cases the information we sought was either not available or not available in a form that was useable. In short, there is often no "one source of the truth" within the NZDF.

3.35 Other reviewers have experienced the same dilemma. Improving data integrity is a critical objective for the NZDF if VfM gains are to be achieved. Being able to measure accurately the costs and effectiveness of an organisation's operations is fundamental to good management. Moreover, activity based accounting should be introduced to enable proper oversight and monitoring of the costs of all significant functions and activities. Coding errors must be reduced. Recoding items to budget areas which have unutilised budgets should be forbidden.

3.36 The analysis emerging from the wide range of work streams was always written up and typically shared with relevant sector experts within the NZDF and the MOD. We actively sought feedback and comments on both the data and the analysis to ensure accuracy and to assist sound judgements. The process of interaction was open and straightforward. We had no hidden agendas.

3.37 In addition, a person with considerable expertise but independent from the VfM team, having been nominated by the NZDF, went through all our work sheets and the data which underlies the report to check them for both accuracy and reasonableness. He provided detailed written and oral commentary. Members of the team and ourselves met with him. His comments were taken fully into account. This was effectively an audit process.

3.38 The report has four components: an Executive Summary including our recommendations; these introductory sections setting out the rationale for the VfM Review and covering key issues and conclusions; an activity by activity analysis of the VfM opportunities, covering areas where the NZDF performs well and areas where improvements and savings can be made, and some appendices.

Overview

3.39 In an international context, using the NATO measure, New Zealand's expenditure on defence is about 1.1% of GDP which places it slightly below similar countries such as the Scandinavian ones but, in relative terms, well below other countries such as Australia at 1.8% and the NATO average of 2.6%. The US is at 4.3% and the UK at 2.5%. The chart below (Table 1.2) sets out these figures for a selected number of countries for 2008-09.

Country	Percentage (2008)
United States	4.3%
Singapore	4.1%
NATO average	2.6%
United Kingdom	2.5%
Malaysia	2.0%
Australia	1.8%
Denmark	1.4%
Netherlands	1.4%
Norway	1.3%
Sweden	1.3%
Finland	1.3%
Germany	1.3%
New Zealand	**1.1%**
Ireland	0.6%

Table 1.2: Defence Expenditure as a percentage of GDP for selected nations. Source: Stockholm International Peace Research Institute.

3.40 Figure 1.2 below which shows the way in which the NZDF has grown more slowly than other core Crown activities in terms of both personnel numbers and operating expenses over the period 2002-03 to 2008-09 but with some recovery in the relative position over more recent years. Despite this, Defence absorbs a significant proportion of core Crown Government capital expenditure, averaging 30% over the three years to 2008-09, or an average annual total amount of $450 million. This is projected to increase as new and replacement capability comes on stream.

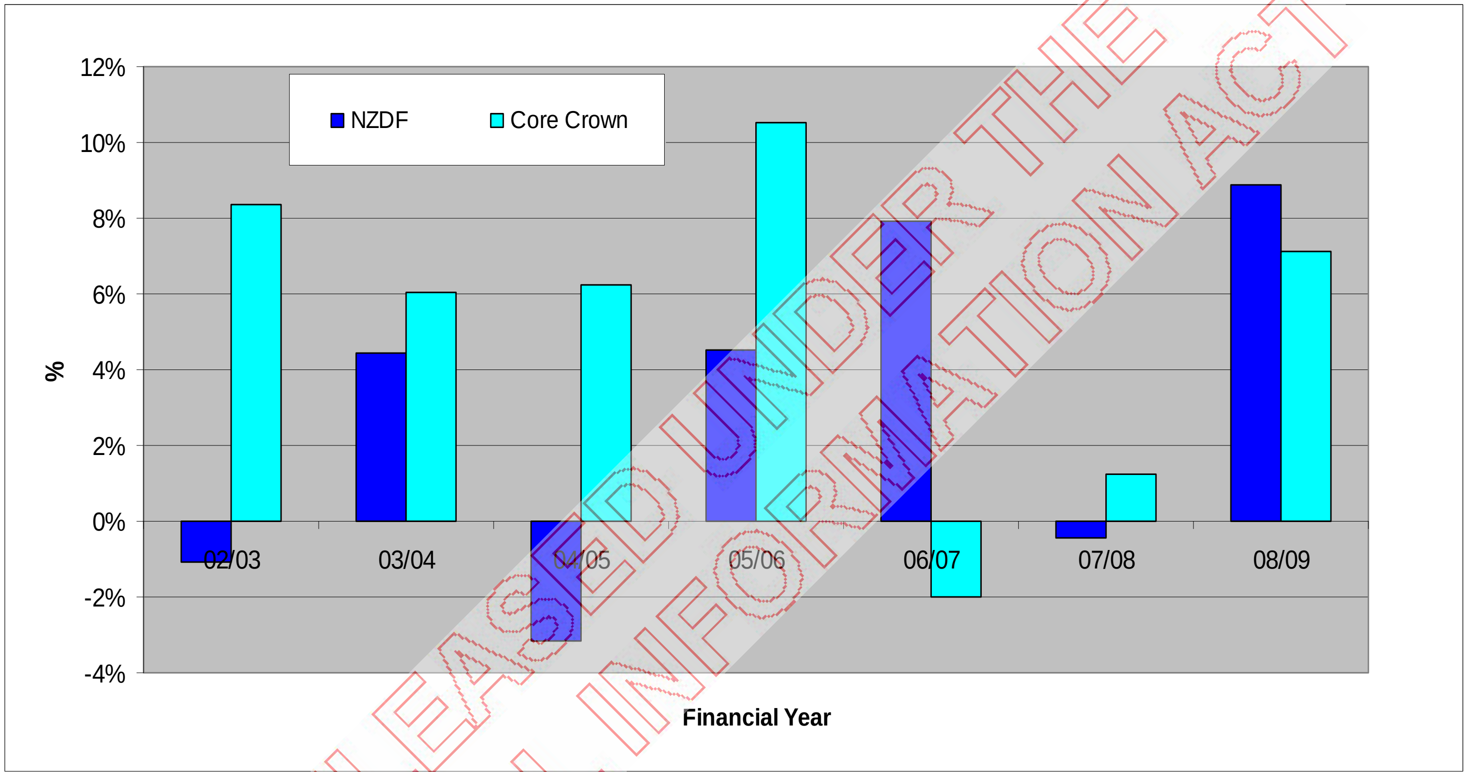


Figure 1.2: Change in Operating Expenses (2002/2003 – 2008/09) Core Crown and NZDF.
Source: The Treasury

3.41 The driver for the increase in capital expenditure is set out in the Defence Assessment. The essence was the redevelopment programme agreed by Government for the ten years up to 2011-12. This involved capital injections of around $1 billion and included the acquisition of seven new vessels and upgrades for the two frigates; two 757 aircraft, eight NH 90 and five light utility helicopters, along with upgrades for the C130 Hercules and the P3 Orions; and the purchase of 105 LAVs and 321 Pinzgauer vehicles (LOVs).

3.42 Apart from the NATO figures, another recent international benchmark study of defence forces was undertaken by McKinsey, some results of which are illustrated in Table 1.3.

Measure	McKinsey Range	McKinsey Average	Estimate for NZDF
Personnel Measures			
"Tooth to Tail" (Combat personnel as a % of total personnel)	16-54%	26%	17%
Number of deployed as a percentage of total active troops	1-18%	5.3%	12.8%
Personnel costs per active and other personnel	US$800 - $146,000	US $44,800	NZ $88,097
Equipment Procurement Measures			
Procurement spending over active troops	US$1,000- $536,000	US $60,000	NZ $3,163
Maintenance Measures			
Cost of maintenance over cost of equipment procurement	8.2% - 446%	13%	747%
Maintenance Costs over total budget costs	1-22%	10.4%	10.1%

Table 1.3: Recent international military benchmarking and NZDF estimates for comparison.
Source: "McKinsey on Government", Issue 5, Spring 2010 and NZDF data.

3.43 The McKinsey exercise in military benchmarking was reported in the "McKinsey on Government" issue number 5, Spring 2010 in an article entitled, "Lessons from around the world: Benchmarking performance in Defence." The study covered 12 nations.

3.44 The NZDF was not part of this study but the NZDF carried out some estimates of its numbers for comparative purposes. It is difficult to draw very meaningful conclusions from this work in terms of the VfM Review other than to suggest, importantly, that the NZDF has a relatively high proportion of personnel deployed, at 12.8% versus an average of 5.3% across the sample of 12 countries used by McKinsey, and has a relatively low "tooth to tail" ratio at 17% versus a range of 16 to 54% and an average of 26%. This latter measure relates to the number of deployed or deployable personnel as a proportion of total NZDF personnel. In other words, NZ has a relatively low proportion of NZDF personnel capable of being deployed but, of those, we have a relatively high proportion deployed on active duty.

3.45 This in turn raises the question of whether the NZDF has too high a proportion of its personnel in support functions, or in what the military term the back and middle areas, and too low a proportion available to be deployed at the front end. An associated issue is whether the NZDF has too high a proportion of its personnel in uniform but carrying out tasks which could be performed, certainly at lower cost and possibly with greater expertise, by civilians. This would be consistent with the position we believe exists from our examination of the NZDF.

3.46 Of equal significance is that, over the last 10 years, the proportion of NZDF expenditure on non military "whole of Government" operational activities (disaster relief, customs and fisheries surveillance, ceremonial activities and the like) has increased markedly to over 30%. What this means is that the NZDF has less money to spend on military operations, a situation exacerbated by the growth in the back and middle of the organisation.

3.47 The following graphs confirm this on the basis of both expenditure and personnel numbers, showing how, over time, there has been a strong growth in non military and support activities relative to front line/military ones and how a seemingly high proportion of both personnel and spending is devoted to non-front line activities.

3.48 The charts also show that close to 55% of the NZDF's operating costs are incurred in the back and middle offices and 45% in the front line.

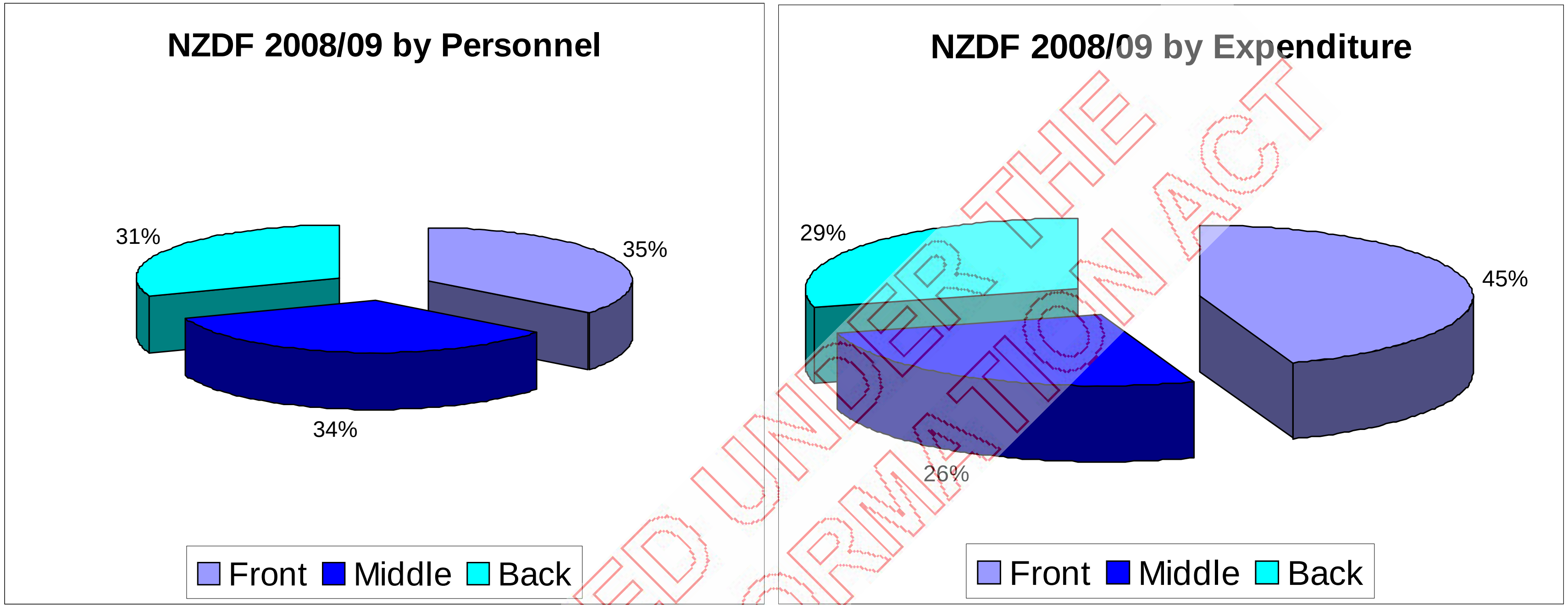
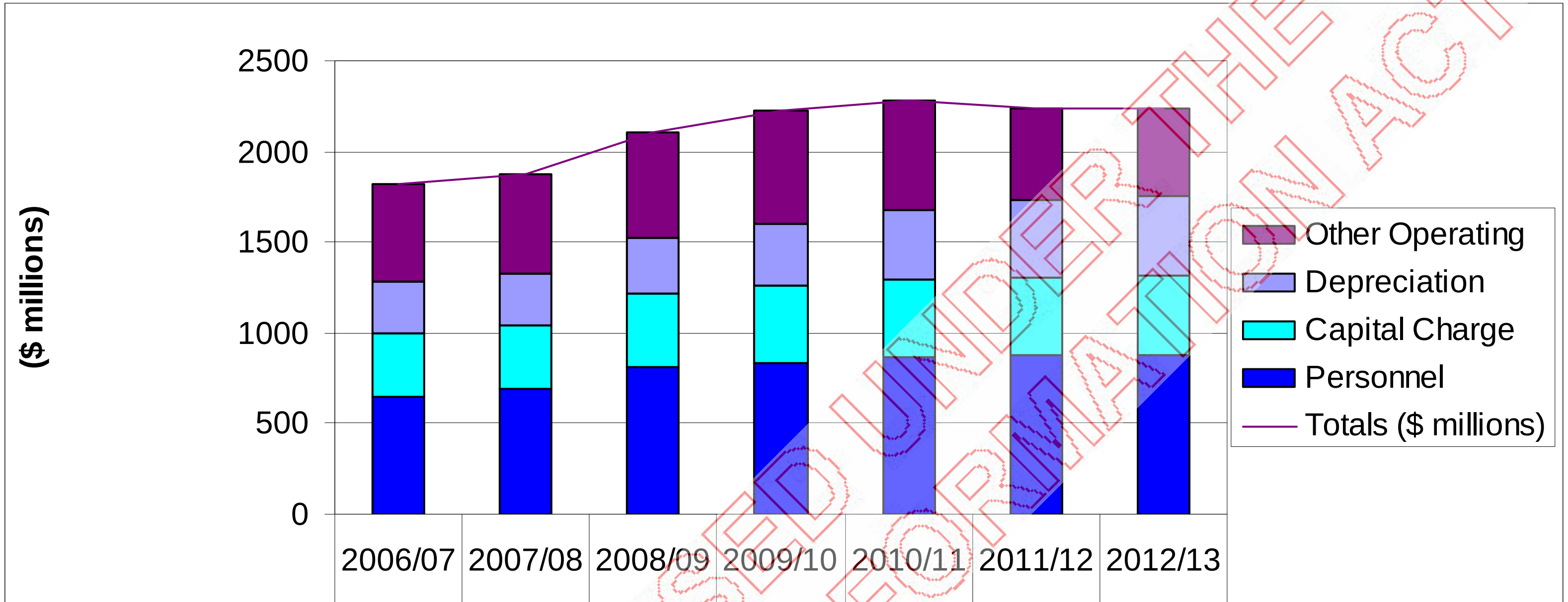


Figure 1.3: FY 2008/2009 Operating expenditure and personnel for the "Front", "Middle" and "Back" of NZDF.
Source: NZDF

3.49 Most defence forces have as a core objective spending more on front line activities including capability than in the support areas and the NZDF should be no exception. There would have to be a $200 million reduction in middle and back expenditure and a $200 million increase in front line expenditure to reverse the current back and middle versus front line expenditure pattern. This is at the heart of the VfM challenge.

3.50 This report addresses these matters and suggests the need for a substantial shift in resources from the back and the middle to the front. The resulting savings could be large and the underlying VfM proposition is compelling.

3.51 The pressing need to address these matters is illustrated in Figure 1.4 and Table 1.4 below which set out the actual and forecast Defence Appropriations by expense type. Given the pressures from projected rises in personnel costs and depreciation charges, the forecast percentage of the total NZDF budget available for other operating expenses declines from 28% in 2009-10 to 21% in 2012-13. In dollar terms, this is a decline from $623 million to $480 million, or $140 million.



	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
Other Operating	529	554	582	623	604	505	480
Depreciation	291	280	306	335	378	429	444
Capital Charge	347	357	400	429	436	436	436
Personnel	648	689	812	836	861	872	877
Totals ($ millions)	1,815	1,879	2,101	2,223	2,279	2,242	2,237

Figure 1.4: Vote Defence Force departmental operating appropriations by expense type. Source: NZDF.

Expense Category	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
Personnel	36%	37%	39%	38%	38%	39%	39%
Capital Charge	19%	19%	19%	19%	19%	19%	19%
Depreciation	16%	15%	15%	15%	17%	19%	20%
Other Operating	29%	29%	28%	28%	27%	23%	21%

Table 1.4: Vote Defence Force departmental operating appropriations by expense category in % terms. Source: NZDF

3.52 The Defence Assessment suggests that, while the NZDF may be able to remain within its appropriations for the 2010-11 year, aided by an additional $35 million for depreciation, it faces an operating deficit of $90 million in 2011-12 and larger compounding gaps in outer years. The Assessment refers to the reductions in funding implied for personnel and other operating costs combined of $45 million in 2010-11 and $133 million in 2011-12, compared with 2009-10. Figure 1.5 and Table 1.5 below illustrates this dilemma.

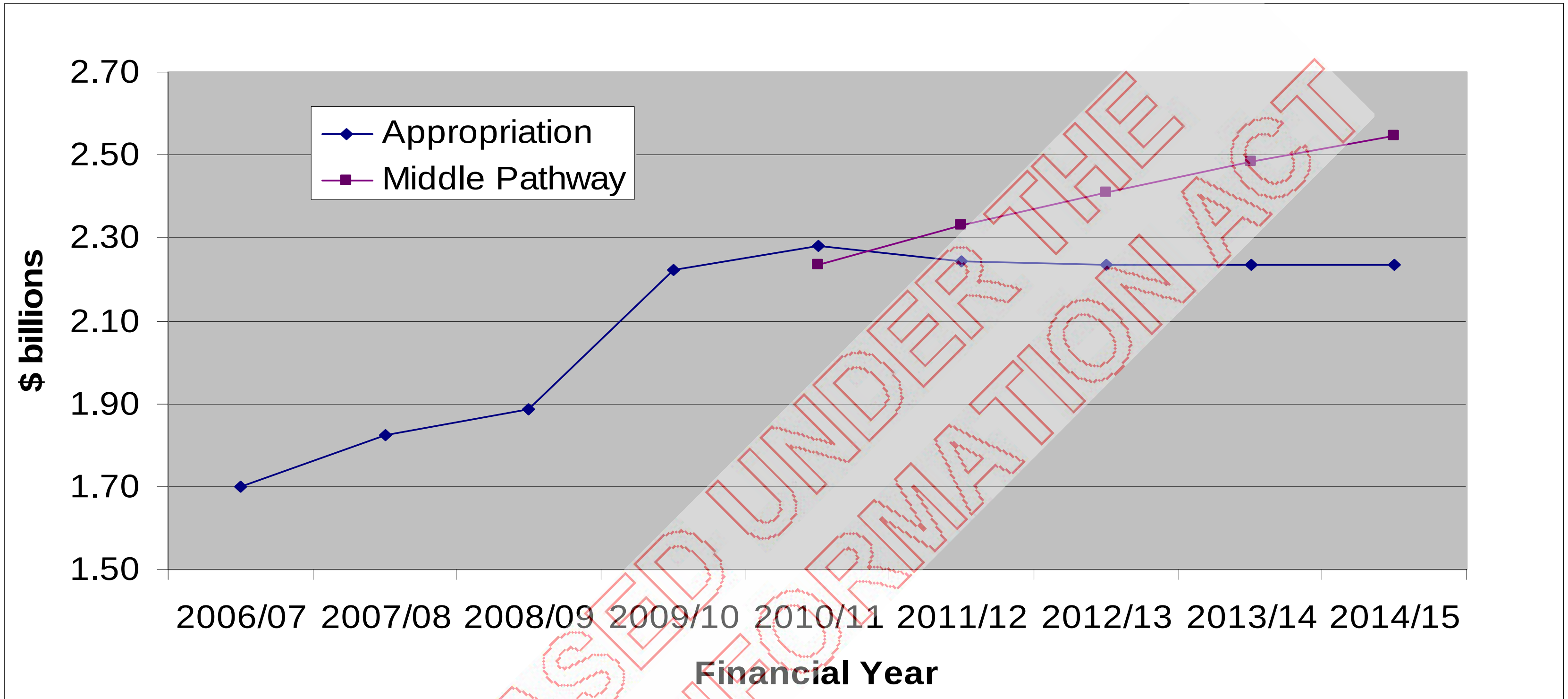


Figure 1.5: Forecast Defence Appropriation compared with Defence Assessment middle path option (Real Estate excluded). Source: Defence Assessment 2010.

Expense Category	Budget 2010/11	Forecast 2011/12	Forecast 2012/13	Forecast 2013/14	Forecast 2014/15
Appropriation/Forecast	$2,279,461	$2,241,763	$2,236,671	$2,236,671	$2,236,671
Low Pathway	$2,231,890	$2,303,325	$2,355,009	$2,371,671	$2,376,124
Middle Pathway	$2,236,864	$2,328,601	$2,408,706	$2,485,034	$2,545,170
High Pathway	$2,298,000	$2,373,000	$2,457,000	$2,562,000	$2,646,000

Table 1.5: Forecast Appropriation compared with costs of all Defence Assessment pathway options (Real Estate excluded). Source: Defence Assessment 2010.

3.53 This is a demanding situation. The reasons for this VfM study are thus clear.

3.54 While some savings in other operating costs must be achieved, savings must also be made in personnel costs. The acuteness of this challenge is the result of a combination of factors but particularly stark is the large increase in remuneration implemented in 2008-09, a startling 18%, and which is the subject of a major part of our report, along with steady increases in personnel numbers. On the depreciation side, the replacement of military platforms and the acquisition of new ones has been the major factor.

3.55 Compounding these problems has been the disconcerting impact of NZDF Headquarters (HQ) appearing to grow much faster than the three Services due in part to the centralisation of some support functions but, beyond that, for reasons which do not appear easy to justify. Furthermore, Air Force personnel numbers have grown at a rate vastly in excess of Army and Navy which is also difficult to explain. The graphs and tables on personnel numbers provided below and in other sections of our Report demonstrate these points starkly (Table 1.6).

3.56 Later sections will delve into these matters further in exploring VfM issues. HQ is up 130% over the eight years to 2009-10, or perhaps by half when personnel transferring from the three Services to HQ shared services are excluded, Air Force is up by 21%, Army by 2% and Navy by 5%. It is not at all clear that these differential growth rates were part of a deliberate strategic decision (which presumably they should have been) or were driven by other factors.

	FY 01/02	FY 02/03	FY 03/04	FY 04/05	FY 05/06	FY 06/07	FY 07/08	FY 08/09	FY 09/10
Army	7227	7053	7019	7032	7220	7035	7133	7434	7384
Navy	2735	2773	2706	2646	2676	2699	2726	2838	2870
Air Force	2644	2674	2683	2670	2821	3007	3090	3215	3194
HQ NZDF & HQ JFNZ	764	791	867	975	1050	1227	1389	1585	1754
Percentage Change Over Time									
Army	0%	-2%	-3%	-3%	0%	-3%	-1%	3%	2%
Navy	0%	1%	-1%	-3%	-2%	-1%	0%	4%	5%
Air Force	0%	1%	1%	1%	7%	14%	17%	22%	21%
HQ NZDF & HQ JFNZ	0%	4%	13%	28%	37%	61%	82%	107%	130%

Table 1.6: Personnel break down by Services and HQ and % changes over time.
Source: NZDF Draft Annual Report for FY 2009/2010.

3.57 Despite the much lower cost of civilian staff and the growth in total personnel numbers being concentrated in jobs other than in the front line, that is in jobs for which civilian personnel may be better suited, the growth in uniformed personnel has been much greater at 723 over the five years to 2009-10 than in civilian staff at 397.

3.58 These trends run counter to what one would expect from an organisation ostensibly concentrating on shifting more resources to the front line or from an organisation which has several major change programmes in place to address this resource shift and cost saving challenge.

3.59 The programmes in train include principally the umbrella DTP and its component parts comprising a number of projects including a single, integrated Defence logistics organisation, a single Human Resources operation including an integrated Training and Education Directorate, and a restructuring of HQ with a particular focus on the Finance and Administration functions.

3.60 $84 million of “quick wins” are recorded as having been achieved by the DTP although it is not clear to us that these wins have been included in the NZDF FY 2010/2011 Budget and the two-year Resources Plan. Future annual “tactical” savings are forecast at an average of $34 million for the next four years, based on a continuation of savings programmes already in place. The operating costs for the DTP in 2010-11 are forecast as $13.4 million, with net operating “transformational” savings at $2.4 million. For the three years 2011-12 to 2013-14, the average net savings of this type are forecast at $53 million. As far as capital is concerned, the DTP savings for the next four years are significantly more than offset by the associated additional capital costs.

3.61 These programmes have proven costly to manage and time consuming to deliver. The NZDF needs to change its culture such that change is more readily accepted and more easily and quickly implemented. We think the management of DTP would agree with this view. An attitude that is positively responsive to change should be imbedded in the whole organisation and should not be concentrated in a single change agent such as the existing Organisational Support Group (OSG).

3.62 Given the work of this group, whose programmes we commend despite some reservations, we have endeavoured to frame our findings in a manner which recognises the changes underway by setting out where the NZDF is at on each issue we examined; what gains are accruing from the DTP and other initiatives; and what further savings may be possible by stretching the targets to a “demanding but achievable” level.

3.63 The following report elaborates, through the charts and tables, a number of examples of where the NZDF has improved its performance over time, in some cases substantially, in order to provide a sense of balance when assessing the many areas where it is suggested that further gains are possible. Organisations are dynamic. Although we recommend a wide range of savings, progress is already being made in many of these areas and people within the NZDF were often the ones to suggest additional savings opportunities to us. The trick is how to move on these matters more rapidly and effectively, with increased speed of decision making and reduced bureaucratic impediments.

3.64 At the front end, in the wide range of fields of front line operations, the NZDF appears to deliver very good VfM. Many illustrations of this were provided to us and these were confirmed by our conversations with the Ministries of Defence in Canberra and London. Numerous conversations and anecdotes indicate that the NZDF operates in the field in an economical way and certainly compares well with its military partners in terms of VfM.

3.65 This review includes some illustrations of the regard in which the NZDF is held by other countries such as the commendation of the Director General of the Multinational Force and Observers (MFO) in 2006, the US Presidential Citation for Service in Afghanistan in 2004, the NATO medal award to a NZ Officer in 2009, the Australian Government Meritorious Unit Citation to the RNZAF for its operations in East Timor in 2002, the observations in the Australian Defence White Paper in 2000 which stated inter alia, “The high quality of New Zealand’s Forces is beyond question”, and the major contribution of the NZDF to the relief efforts after the 2009 tsunami in Samoa (Appendix VII).

3.66 As the 2010 NZ Defence Assessment states:

- "The greatest asset of our Armed Forces is, and will remain, the quality of our people. The NZDF is a valued partner in New Zealand and throughout the world because its personnel are honest, impartial, culturally respectful, and accountable to the civil authorities. They are also disciplined, well-trained, and understand their constitutional and legal obligations. These attributes are more rare than one might think."

3.67 These points confirm the importance of preserving the values of the NZDF, which we see as consistent with improving the efficiency and effectiveness, or the VfM, of the middle and back end support services in order to concentrate a higher proportion of resources in the front end operations.

Non-Military Tasking

3.68 It is not always appreciated that the NZDF undertakes or coordinates a wide range of activities in support of other New Zealand government agencies, including maritime surveillance, search and rescue (SAR), Department of Conservation support to the outer islands, HM Customs support/constabulary tasks, fisheries surveillance operations, Police support (land SAR and anti-drug activities), support to the Antarctic programme, coordination of improvised explosive device disposal and explosive ordnance disposal, counter-terrorism, rugby World Cup (RWC2011) assistance, civil defence systems in New Zealand, fire fighting support within New Zealand and Australia, and ceremonial, protocol and representational support.

3.69 The expansion of the Limited Service Volunteer scheme and the introduction of the Youth Life Skills programme are tangible examples of the NZDF supporting the social structure within New Zealand not only as a partner of the Ministry of Social Development but also as part of the community itself.

3.70 The graphs in the Non Military Tasking section of this review make clear the importance of these activities which are estimated today to occupy about 30% of NZDF outputs, a proportion that has increased strongly over the past 20 years. In the same way, the operations and deployment outputs have also increased, meaning that the readiness and contingent force component has declined sharply over time, perhaps now being half the proportion that it was some years ago.

Governance, Management and Organisation

Background and Issues

3.71 While this review identifies substantial potential savings, the higher the level of savings sought or, indeed required, given the future budgetary constraints, the more demanding are the management choices required of the NZDF. However, we are strongly of the view that the savings we have suggested are achievable provided there is an appropriate level of commitment to them within and throughout the NZDF.

3.72 The challenge is to provide a more explicit determination of priorities; to set clearer objectives, time lines and accountabilities; to create a culture more conducive to change and one focused on delivering VfM in the back and the middle of the organisation; to achieve goals which benefit the NZDF as a whole; and to ensure there is an organisational and management structure which facilitates change. Getting the right people in the right jobs is overwhelmingly important. Military people may be good at military tasks but they rarely make good managers of corporate-like functions. Moreover they are too often cycled through the jobs for only short time periods. They are much more expensive than civilian employees (by 35 % on average).

3.73 The NZDF Headquarters (HQ) is a substantial organisation in its own right, much more so than was envisaged when it was first established, and the three Services still operate at times with too many degrees of separation particularly in areas which if integrated would yield efficiencies. The independence of the three Services, real or perceived, too often unnecessarily inhibits changes which would benefit the organisation as a whole. We were given numerous examples of this in the areas of acquisitions, training, personnel, finance, information technology (IT) and logistics.

3.74 As a result, changes are subject to excessive analysis, are dominated by committees rather than individual line managers, take too long to decide and implement, are too often compromises and can too easily get sidetracked. We are not alone in thinking this. Previous reports have found the same. For example the Defence Assessment quotes the Aurecon report at length in an analogous manner.

3.75 The solution is to bring the front line culture of clear objectives and accountabilities, decisiveness and action orientation, to the back and the middle. But in this case, it will almost certainly have to be done by high quality civilian executives rather than military ones. The trick is to give such executives the power and authority to run the support services much more efficiently than at present, without the need to resort to a uniform and a senior military rank to give them the clout.

3.76 This will require a change in culture of substance. Strong leadership and commitment to change is thus the key and these matters are for the CDF to resolve.

3.77 The State Sector Act makes these matters clear for normal government departments. The State Services Commissioner appoints and employs the Chief Executive (CEO) after consulting the Government in the manner set out in the State Sector Act. In turn, the CEO is the employer and has the power of appointment of direct reports. It is analogous to the corporate model where the board, elected by shareholders, appoints the CEO who in turn appoints his or her direct reports. In each case, the ultimate authority, be it the State Services Commissioner or the company board of directors, or beyond them, the Government or shareholders, has the power to set policies around matters of relevance, such as remuneration.

3.78 It is not like this in the NZDF. For reasons related to constitutional considerations and historical precedent, the CDF and the Chiefs of the three Services, Army, Navy and Air Force, are appointed under warrant by the Governor General on recommendation from the Government. This gives the Service Chiefs an air of independence which can make life complicated for the CDF, particularly if the appointees are not the CDF's preferred choice for the job.

3.79 The Vice Chief of Defence Force (VCDF) and the Commander Joint Forces New Zealand (COMJFNZ) are not warranted even though it could perhaps be argued that if warranting was required for other than the CDF, these positions would be more appropriate than having the three Service Chiefs warranted. This is because the VCDF would be expected to fill in for the CDF if the CDF were absent and because the COMJFNZ has primary responsibility for field operations and placing military people in positions of high risk. The warranting of the three Service Chiefs but not the other two star officers appears to be an historical legacy and a matter which should have been addressed when the Joint Forces arrangement was put in place but was not.

3.80 In any event, it is our view that only the CDF needs to be or indeed should be warranted. The fact that the VCDF and COMJFNZ are not warranted indicates that there is equally no need for the Service Chiefs to be warranted.

3.81 A further major complication is the role of the MoD relative to the NZDF. For sound reasons, partly constitutional, the MoD is charged with providing policy advice to the Government, for overseeing large scale acquisitions, and for evaluating the NZDF. The relative roles of the MoD and the NZDF are addressed in full in the Defence Assessment which endeavours to bring more clarity to the nature of their joint and separate roles.

Current Organisational Model

3.82 The dual Chief Executive model (i.e. the Secretary of Defence and the CDF as Head of the NZDF) employed to oversee New Zealand's Defence establishment is different from a number of other Western countries. For example, in Australia, the Secretary of Defence is the civilian manager in charge of the MoD, which includes the ADF, and has control of the money. The CDF has control of the military. This is sometimes referred to as a diarchy and we comment on this further below.

Legislative Change

3.83 It is likely that the management and organisational changes we are proposing below would require amendments to the Defence Act and, quite possibly, the State Services Act as well. Legislative change would be our preferred option.

3.84 Legislation would facilitate a change to the employment status of the Service Chiefs, a move which, for the reasons cited earlier, we consider to be of critical importance if the transformation (including achieving the VfM benefits) of the NZDF is to be a success.

3.85 It is our strong view that the CDF should appoint the Service Chiefs. They work for the CDF and they are accountable to the CDF. The CDF should, of course, consult the State Services Commissioner in appointing them but the final decision should rest with the CDF as CEO of the NZDF. The Service Chiefs should not be warranted.

3.86 It is further recommended that the VCDF role be preserved for someone who could manage the middle to back functions such as finance, procurement, logistics, IT and human resources. In corporate terms this person would be the Chief Operating Officer (COO) of the NZDF. If that person was not a military person, and we think it should be a civilian, then the job could be termed COO rather than VCDF. There does not seem to us to be a need for a VCDF as the Deputy role could effectively be delegated to the COMJFNZ with other current VCDF functions being allocated to the COO and others as appropriate.

Full Diarchy

3.87 If the Government was willing to consider legislative changes, a case could be made for going further still and considering the diarchy type of model.

3.88 There is much to commend the Australian approach in the way financial matters are separated from military operational matters and if New Zealand was starting from scratch, this would probably be the way to go.

3.89 However, this would require a major change in the manner in which the MoD operates and in the skill requirements of its senior officers. Donald Hunn told us that he would favour this model today although he did not recommend it in his 2002 report because of concerns at the time about preserving the principles of the State Sector Act.

3.90 On balance, however, we feel the required NZDF organisational and cultural changes can be achieved without turning the MoD and the NZDF on their heads as the full diarchy approach would surely do.

Partial Diarchy

3.91 The Defence Assessment has recommended the establishment of a new decision making Joint Management Board (JMB) which would be constituted under an amended Defence Act for the purpose of exercising joint management over a specified range of tasks that need to be undertaken jointly by personnel from both the Ministry and the NZDF. These joint tasks are mainly the formulation of policy advice, the procurement of military equipment and the development and management of major defence capabilities. The JMB would comprise the Secretary and the CDF acting together as a single body with joint legal authority over particular matters. At least two external advisers would be appointed to the JMB.

3.92 If the Defence Act were to be changed to facilitate this arrangement, essentially a partial diarchy, then it would also be possible, at the same time, to address the warranting issue discussed in the Legislative Change section above.

3.93 Moreover, it would be possible for the JMB to be a forum for monitoring the implementation of the VfM savings suggested in this report. However, it would not be intended that such monitoring would in any way detract from the individual accountabilities of the Secretary and the CDF in this respect.

3.94 While the JMB arrangement has merit, it also has some weaknesses. For example, our preference would be for a clearer cut management model to avoid the JMB diluting the authority and the accountability of the Secretary and the CDF. The proposed JMB arrangement would, in our view, lead to the creation of yet another separate agency which in time would develop a life and cost structure of its own (which an analogous organisation has done in Australia).

Organisation Structure and Procurement

3.95 The MoD and NZDF undertake a range of procurement activities including:

- the acquisition of military capability and platforms;
- other capital expenditure;
- the acquisition of products and services from the private sector;
- the acquisition of munitions; and
- the contracting out of certain services (i.e. maintenance and property management) to the private sector.

3.96 These activities are spread across both organisations, often with duplication of personnel and systems and an inability to leverage their combined buying power and skills.

3.97 In the case of the acquisition of military platforms, the current separation of responsibilities between the MoD and the NZDF, as pointed out in the Wintringham and Aurecon Reports, is leading to sub-optimal outcomes in terms of delays, cost overruns, fitness for purpose and so on.

3.98 To address these procurement challenges we would recommend several steps:

- First, the MoD should be primarily responsible for the development and specification of military capability requirements, consistent with its overall defence policy advisory role and with the principle that this process should be led by the civilian arm. The functions currently undertaken by the NZDF Development Branch should be moved to the MoD and renamed the Military Capability group.
- Secondly, once the Government, through Cabinet, has decided on large scale military acquisitions, on advice from the Secretary of Defence and in consultation with the CDF, the actual purchase process should be the responsibility of the CDF. A single procurement group should be formed within the NZDF which would comprise the functions currently being carried out by the existing MoD Acquisitions Division and other procurement elements within the NZDF which

can be currently found in the DLC, the JLSO, the Development Branch (with respect to the Capital Minors Programme), CIS Branch and the Services. In our view the procurement group should be consolidated within the DLC and be under the leadership of COMLOG.

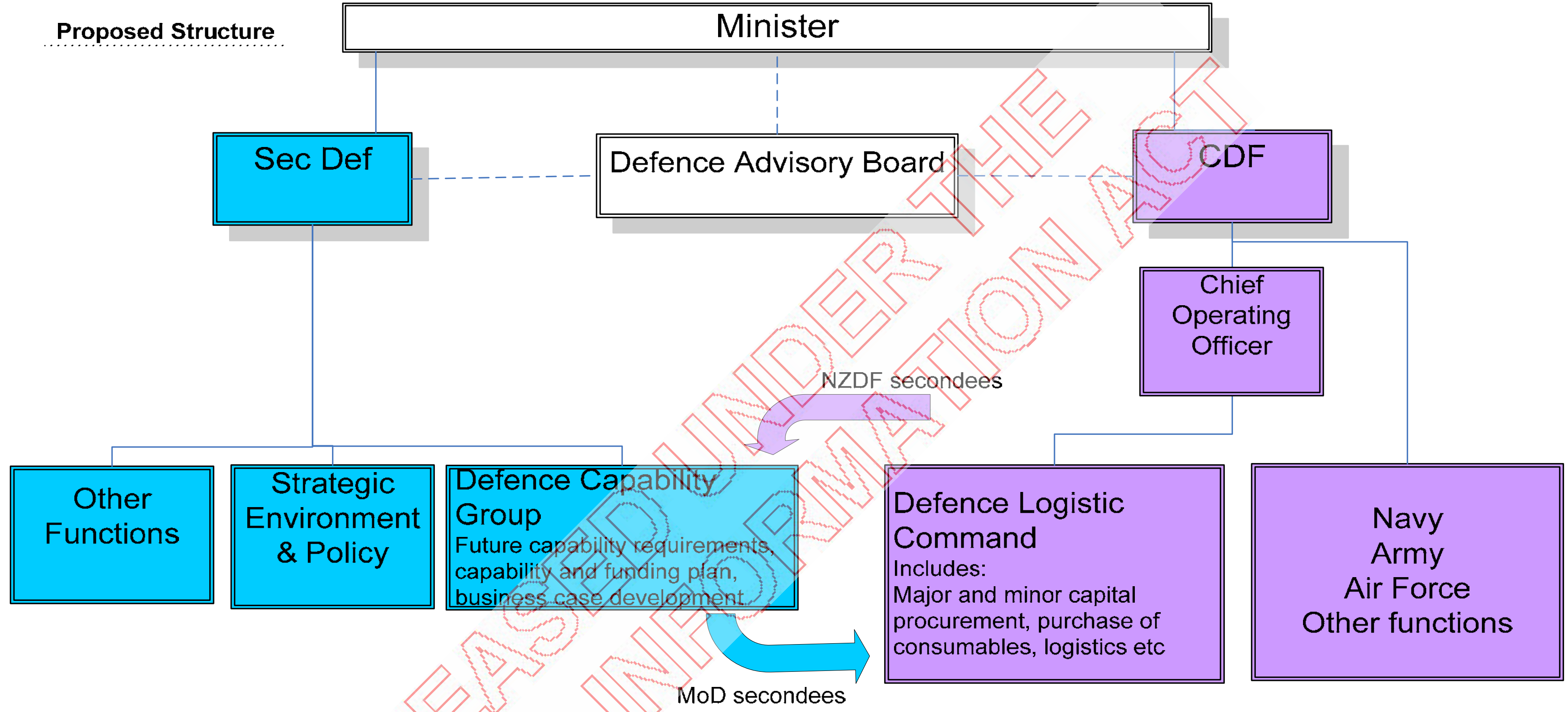
- Thirdly, a Defence Advisory Board rather than a JMB would be formed. This would not necessarily require legislative change.

Defence Advisory Board ("DAB")

3.99 The DAB would, ideally, comprise the Secretary of Defence, the CDF and two or three independent, high quality commercially experienced members. The Secretary to the Treasury could be a member providing he personally had time to attend the meetings.

3.100 In order to avoid any prospect of detracting from the individual accountabilities of the two CEOs, this DAB would not be a decision making body but rather an advisory, coordination and communications vehicle. The DAB would advise the Secretary and the CDF on matters of substance which would be determined from time to time in consultation with the Minister of Defence. It is envisaged that the agenda would include such matters as large scale military capability acquisitions and significant other procurement initiatives (for example PPP projects). The DAB agenda would also include implementation of this VfM Review.

3.101 As the chart below shows (Figure 1.6), the DAB would sit between the Secretary of Defence and the CDF. Its members would be appointed by them in consultation with the Minister. Its Chair would be one of the independent members. The Minister could meet with the DAB from time to time and the independent Chair would have the right of access to the Minister.



Defence Advisory Board – established by Cabinet direction, ensures communication & coordination between NZDF and MoD, and enables external scrutiny. Sec Def and CDF select independent advisers and appoint one as Chair. Terms of Reference: Capability Development, Capital Procurement, VFM Implementation, Other matters by agreement.

Defence Capability Group – sits within the MoD as an extension of policy advice. Mostly civilian staffing with military secondees.

Defence Logistic Command – sits within the NZDF as the organisation that acquires, operates and maintains capability. Includes ComLog, JLSO, and the functions currently performed by MoD Acquisitions.

Figure 1.6: Proposed Organisational and Procurement Structure.

3.102 The DAB as we envision it would not necessarily require a change in legislation; would importantly leave individual accountabilities with the two CEOs; be consistent with the underlying principles of the State Sector Act and good management practice; be consistent also with the primary areas of responsibility of the Secretary and the CDF; create a clear pass over of responsibilities with respect to the two major stages of large scale acquisitions, being development and implementation; and inject some outside guidance to ensure that the MoD and the NZDF work well together and implement good management practices such as those advocated in this VfM report.

No Legislative Change

3.103 If legislative change is not considered to be appropriate, then we would suggest the following arrangements with respect to senior appointments.

3.104 First, the Government could agree to an ongoing process which ensured that the CDF has the primary role in appointing the three Service Chiefs. The CDF and the State Services Commissioner could form a committee to make recommendations to the Minister on these appointments. The Chair of the DAB could be a member of this panel. In turn, the Minister could agree to recommend to the Governor General the appointment of the recommended person.

3.105 This would be designed to ensure that the Service Chiefs were aware that the CDF had the principal role in their appointment and that they were clearly accountable to the CDF. This applies already to the VCDF and the COMJFNZ as they are not warranted.

Other Organisational and Management Changes

3.106 The CDF will also need to strengthen the top management arrangements of the NZDF most likely by appointing the equivalent of a COO. This person would be responsible for all middle and back shared support services and functions and for the change programmes within the NZDF.

3.107 The CDF would need to provide the COO with the authority to have management oversight of these functions across the whole of the NZDF including across the three Services.

3.108 We would also envisage the need for additional strengthening of the top management team in the non-military space.

3.109 This should include a redefinition of the Chief Financial Officer (CFO) role to ensure that the CFO's authority spans the complete NZDF including the three Services with full management control of an integrated NZDF-wide finance function. This function should encompass the usual roles of a corporate-like CFO including being a principal adviser to the CDF on all matters pertaining to the finance function and the efficiency and effectiveness of the whole organisation in a financial sense. The CFO would oversee the budget process and reporting against the budget.

3.110 There should be a new appointment of a Chief Information Officer (CIO) with similarly NZDF-wide authority over non-military information technology systems and hardware. We commissioned a separate report on the IT part of the NZDF by one of Australasia's leading experts in this area, Mr Stephen Bradley, former CIO of Woolworths Limited, a company recognised as being a leader in matters IT. His recommendations are reflected in the review. Both the CFO and the CIO should report to the CDF. The IT area needs a major upgrade if the VfM savings are to be delivered.

3.111 This would mean that, under our proposed organisational structure, set out in Figure 1.7 below, the CDF would have the COO, CFO and CIO reporting to him as well as the senior military officers.

NZDF Organisation

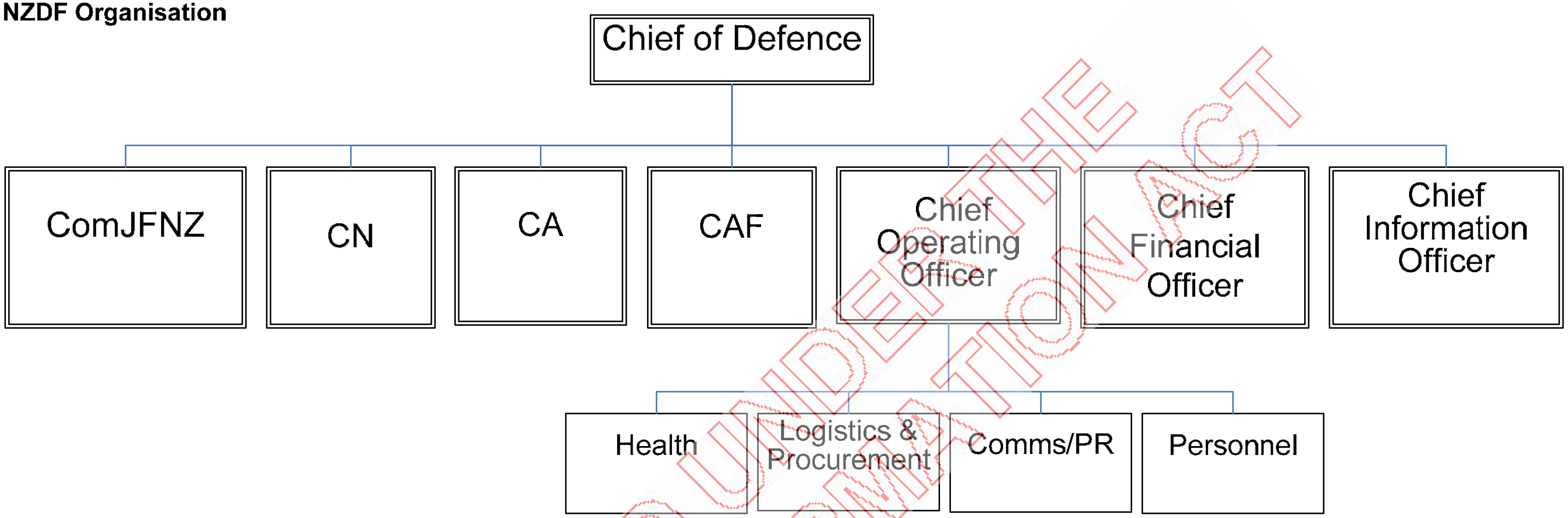


Figure 1.7: Revised NZDF Organisation Structure.

3.112 We recommend that an Executive Management Board (EMB), largely based on the existing Executive Leadership Team (ELT) structure, be established. It would comprise the five senior military officers and the three support executives. At eight members, this is a manageable number which should facilitate good debate and be the group which the CDF uses to commit to the change programme. The number of people we observed attending the ELT meetings would make effective discussions and decision making very difficult.

3.113 Reporting to the COO would be the heads of the Logistics (which would include procurement) and Personnel Groups as well as other support functions not under the purview of the CFO or the CIO.

3.114 It is our view that the present OSG would be disbanded and its activities re-allocated where appropriate to the relevant line managers. Line managers should be responsible for implementing and delivering change; not a separate change group which does not have direct line authority. Allocating change to a separate group confuses responsibility and accountability and makes change harder to implement.

3.115 The principles underlying this recommended arrangement are that the CFO must have strong authority on financial matters across the whole NZDF; the CIO should also be pan NZDF and all other groups should be customers of the IT Group with appropriate transfer pricing to remove the present dilemma of IT being treated as a free good; this would also lift the profile of IT which is essential to delivering improvements in VfM; and the COO would oversee management changes and VfM improvements in the other major areas warranting reform which are principally logistics (including procurement), personnel and training and education.

3.116 If additional and substantial authority is not vested in positions such as a COO, CFO and CIO, the reforms we propose are likely to fail or be only partially and unevenly delivered. This would be an extremely disappointing outcome given the scale of the opportunity. The people selected for these upgraded jobs must be of the highest calibre and in our view will be civilians.

3.117 It should also be noted that realisation of the VfM benefits is heavily dependent on significant but not untoward amounts of capital being devoted to upgrading IT systems. This capital need not necessarily all be supplied by Government as outsourcing possibilities are available, as outlined later in the review. The real challenge is committing to the upgrading and making it work well.

3.118 In order to ensure that the VfM changes are implemented, the Minister should craft a performance agreement with the CDF who in turn should have performance agreements with all his direct reports, both military and civilian. Such agreements should be short and sharp, not lengthy "all things to all people" types of agreements such as the current annual Terms of Reference agreement between the Minister and the CDF, and should encompass no more than four of five top priority items which are to be delivered and would add real value.

3.119 These agreements are of particular importance when new appointments are made given the present warranting arrangements. If the VfM changes we suggest are to be achieved, there must be specific agreement on their delivery by the CDF and each of his top team, military and civilian. On any new appointment, the performance agreement should be signed off coincident with the time of appointment.

3.120 Elsewhere we recommend a significant shift in non-front line personnel from military to civilian status and this should be used as a means to enable access to greater expertise on the specific support functions, both at a senior level and at a technical level. Although we do not support uniform or across the board remuneration increases, some individual remuneration levels may need to be adjusted and geared to particular markets and particular jobs in areas where there is a shortage of top management expertise. IT is almost certainly an example of this.

The Ministry of Defence

3.121 For the MoD, its functions are defence policy advice (the CDF is responsible for military advice), acquisition of major military platforms, and evaluation and assessment of the NZDF. Apart from some change in procurement arrangements as outlined above, we do not envisage the need for any other changes for the MoD and indeed the MoD was not part of our brief other than where it overlapped with the NZDF (procurement) and we felt some change was in order.

3.122 However, we would observe that the evaluation, assessment and audit functions of the MoD should be enhanced and strengthened to ensure, among other things, that the implementation of the changes envisaged in this report are monitored in whatever manner is agreed. Recommendations proposed by the Evaluation Division should be decided upon and actioned. At present they too often appear to languish.

Reserves

3.123 On the separate matter of Reserves, it is important to be clear about the VfM proposition.

3.124 Reserves are expensive. The later work in this review makes that clear. The review recommends a move away from the current Reserves model towards one which utilises part time people wherever necessary but within the normal military framework.

3.125 In keeping with current terminology this review uses the term *Reserve* to describe a member of the Naval Volunteer Reserve (RNZNVR), the Army Territorial Force (TF), or the Territorial Air Force (TAF).[1]

3.126 To understand the conclusions and recommendations of this review, it is useful to first establish the context from where Reserves have come, and where they are today. This review also focuses predominantly on the TF as it comprises over 80% of the Reserve.

[1] It is noted that the Strategic Reserve is provided by ex Regular Force members who are serving a Reserve Service obligation upon departure from the Regular Force under the provisions of the Defence Act.

3.127 Prior to, and in the years immediately following World War II, the TF was the major component of the New Zealand Army. During this period the Regular Force (RF) was a small cadre to provide support to the TF. In response to the changing circumstances in South East Asia in the 1950s and 1960s, the RF components of the Army were strengthened and better equipped. In subsequent years this direction continued and the Army evolved into a professional standing force able to deliver Outputs agreed with Government on an annual basis.

3.128 Over the same period, the Reserves declined in numbers as the technical skills required for operations increased and in the main became unable to be delivered by reservists without a substantive period of RF service. Over recent years, the TF has provided individuals for operations, but deployable reserve units have not been maintained for many years. In the last 12 months (April 2009 to April 2010), for example, 88 TF have deployed on operations, 58 to OP RATA in the Solomon Islands, which is now a benign operation.

3.129 Reserves also undertake a number of non-military social, community, or workforce training activities, although none of these are separately designated Outputs for NZDF.

3.130 The VfM Review has concluded that:

- The current organisational arrangements for Reserves do not match the requirements of the NZDF and are expensive.
- Many of the activities undertaken by Reserves focus on military capabilities more cost effectively provided by the RF.
- The areas where Reserves offer better VfM are in specialised non-military areas such as medical specialists, linguists and trades people.
- Reserves undertake a number of non-military, social and community activities such as ceremonial parades and support to Civil Defence that are not specified in the NZDF Output Plan.
- The term Reserve and Reservist do not describe the functions that these people perform. They are not a ‘Reserve’, but active contributors to the NZDF on a part time basis.

3.131 Based on these conclusions, we recommend a move away from the Reserves model towards one which utilises part time personnel wherever necessary but within the normal NZDF organisational framework. We cannot conclude, given the objectives of the NZDF, that Reserves as they are presently configured and cost (over $30 million per annum) represent VfM.

3.132 But that is not to say the NZDF does not have to tap into the community and the non-military workforce to supplement its resources and skill base. It has to do this; it must do this where appropriate; and indeed this is what it does now. People with the requisite skills should be engaged on contract or part time directly by the unit that would employ them. This approach would ensure greater VfM.

3.133 If the Government decides that, for broader social, community or workforce training reasons, it wishes to have an arrangement analogous to the present Reserves model, then that should be a separate and transparently funded NZDF output class. The objectives of these schemes would need to be made clear and funding provided to match those aims. The NZDF could then, in effect, be contracted to undertake such work.

3.134 The above findings and recommendations on Reserves have been discussed with, and endorsed by, the Director General of Reserve Forces and Youth Development.

Personnel Reductions

3.135 If the VfM recommendations are implemented there will be some redundancies. In part the changes will be facilitated by natural attrition and for the rest we have assumed that any payments can be absorbed within existing budgets given that the timing of any departures will be spread through time and some savings in annual budgets will thus be recorded to meet such redundancy costs.

3.136 We recommend the disbandonment of the OSG. This is neither because we do not support the work they have been doing nor the quality of the people. Some of the programmes are very good but they have been difficult in a number of cases to execute. This is not surprising. A separate change department without direct control and accountability is always going to find execution a challenge.

3.137 We are strongly of the view that the DTP work should be allocated to individual line managers and some of the funding should accompany the transfer of responsibility. But there should be savings here too, as is set out later. Each of the shared services functions (payroll, accounts payable, procurement and property services) should be allocated to the appropriate line management groups within the NZDF.

Business Model & Financial Matters

Business Model

3.138 As far as the business model used by the NZDF, many improvements are suggested throughout our report. Overall, in the "business" part of the NZDF, principally the support and corporate functions, there is a need for greater data integrity, improved modelling supported by activity based accounting and more readiness to make decisions based on evidence rather than prejudice or preconceived ideas or simply doing things the way they have always been done. We encountered different empirical answers to the same question on many occasions, depending on who was asked and when. Errors were discovered by us or others advising us. Some of the coding errors were large.

3.139 Consistent performance metrics are inadequate and are not used frequently enough to drive better performance. Too much rework occurs. Too many matters are decided by committee. Rotation through back office jobs is too frequent and too often regarded as part of "training" or "experience" when the jobs should be filled by professionals or experts (who will often be civilians) and for periods long enough to achieve real improvements.

3.140 The performance metrics considered by the ELT on a monthly basis in the main have a military or operational bias. They need to be augmented by a series of financial and support function indicators that, among other things, will measure how the NZDF is progressing in delivering the VfM gains.

3.141 Support services are often treated as "free goods" and there is no transfer pricing. The IT and Defence Technology (DTA) areas are classic illustrations of this dilemma. Support area priorities are not well resolved or clearly decided or strongly linked to military and non-military tasking. Insufficient thought is given to how to structure peoples' incentives to deliver better performance. There is an absence of a performance culture in the middle and back office parts of the organisation. This is in marked contrast to the operational front end.

3.142 These are all matters which have faced other organisations and many have proven that they can be addressed. It is not easy but the rewards are large.

3.143 It is partly about good organisational and governance arrangements but it is even more importantly about quality of management.

3.144 This means the adoption of a culture embracing the need for change and a determination to do things better. It also means a culture where the NZDF is honest with itself and encourages alternative views. The recent report from the Office of the Auditor General (OAG) on misuse of accommodation and other allowances is an unfortunate illustration of a culture that clearly needs to change.

3.145 Finally, the NZDF culture needs to be based on a commitment to doing things that benefit the NZDF as a whole and not simply a concentration on things which benefit one's own Service.

Remuneration

3.146 On remuneration, we are troubled by the position the NZDF is now in. The average annual pay for military personnel is more than 30% greater than for the public service generally. This is not justified. This has not always been the case but changes in recent years have facilitated this disparity. The State Services Commission should have exercised a much closer oversight of this position and it should also have been a matter of concern to the Treasury.

3.147 We note that this gap comes on top of the unfortunate fact that public service average pay rates are now also substantially in excess of those of the private sector, again a situation which is unwarranted and a mystery to us as to why this has been allowed to occur. The State Services Commissioner should be given the power to oversee and where necessary control remuneration to ensure that an appropriate framework is established and adhered to by the public sector and, with respect to our review, the NZDF.

3.148 It has been this large margin of higher payments in the NZDF that has in part resulted in the recommendation that up to 2000 jobs in the NZDF should be civilianised (or carried out by personnel in uniform but at civilian pay rates).

3.149 We also do not favour ongoing allowances, of which there are over 300 different types, which amount to part of remuneration but which were meant to be, or should have been, abolished some years ago when a significant increase in remuneration was granted.

3.150 An example in our view of an unsatisfactory remuneration arrangement is the universal accommodation component or allowance (UAC) which is paid to all uniformed personnel who do not live in NZDF houses. This allowance was meant to act as an incentive for military personnel to move out of military houses into their own homes. However, it was paid as a component of remuneration rather than as a one-off transition payment which is the arrangement we would think preferable. It included even those not actually living in NZDF houses at the time of its introduction as well as younger people living in barracks. In our view, there is no justification for this allowance being paid to people in barracks.

3.151 There is also a proposed variable additional accommodation component within the UAC for people living in more expensive areas such as Auckland. We do not agree with permanent ongoing allowances of this form. If an additional payment is to be made in places such as Auckland it should be of a one-off character to minimise the cost to the taxpayer.

Output Classes

3.152 With respect to NZDF output classes more generally, we recommend that a review of these be undertaken after the White Paper has been released to ensure that the present set of outputs matches what the NZDF is expected to achieve in today's world. We have noted throughout our report where this does not appear to be the case.

3.153 At the very least, future outputs should much more transparently identify the Government's expectations, the cost of delivering on those expectations, key metrics to determine that the NZDF is delivering on the expectations and the annual operating and capital budget allocated to each output class.

Capital Expenditure Approval Processes

3.154 It is clear that improvements are needed to get a stronger alignment and prioritisation of capital projects against an agreed strategic plan. This should be compulsory for all capital expenditure. The present Capability Management Framework, which is a lengthy document, sets out the process for obtaining capital project approvals within the NZDF. It should be reviewed, shortened, and strictly adhered to throughout the organisation.

3.155 Full specification of through-life and whole-of-life capital costs should be part of the approval and budgeting process for all capability and capital expenditure. This is not always the case at present and this has resulted in budgeting problems after acquisitions have been put in place. As mentioned above, transfer pricing should be introduced in areas such as IT and for the DTA to help clarify decision making and accountability.

Other Operating Expenditure Matters

3.156 Many areas of operating expenditure are covered in the review and savings in particular areas are identified. By way of background comment, we would observe that the NZDF uses too many consultants in areas where the organisation should be able to do the work itself. Expenditure on consultants is substantial. In many cases, if managers cannot do the work the consultants do, there is a need to review the suitability of the managers for the functions they lead. For example, much of the work we have performed was done with the assistance of a team from within the NZDF and MoD who knew or was able rapidly to discover where large savings were possible. Many of the people we spoke to also knew the same for their areas.

Capital Charge and Depreciation

3.157 New Zealand's total defence expenditure of $2.2 billion in 2009-10 comprised two large non-cash items: a capital charge of $429 million and depreciation of $335 million, or a combined 34% of total expenditure. Any opportunities for better VfM in these areas for the NZDF come principally from holding less assets or having alternative asset ownership structures, thus reducing the capital charge and depreciation.

3.158 We have been informed that the capital charge was originally designed with the intention that it would provide an incentive to rationalise assets but that it now effectively involves a capital charge and an offsetting contra transaction. NZDF says that it is thus not a major consideration in its investment and divestment decision making. The cost is based on the organisation's net assets, or taxpayer investment, multiplied by a set interest rate. Any major movements in either direction are in the main compensated for by the Crown, making the charge neutral.

3.159 The NZDF does not have an external revenue stream of any significance so better use of assets to generate more revenue, which is the way a commercial organisation would think, is not really an option. Better utilisation of some assets, such as inventory and cash management, has limited potential to reduce the capital charge as the asset base is dominated by large scale, expensive military equipment such as ships and planes.

3.160 The depreciation regime we understand may change in the near future such that depreciation will be ring-fenced and this too will be more neutral in its impact. In terms of the other option here, that of moving assets off the balance sheet to reduce these charges, such as by means of operating leases, a technique employed by some other government entities such as TransPower, previous investigations of these possibilities have not been progressed where they would have involved benefits accruing from other tax jurisdictions. This was a policy decision taken after consultation with other government agencies.

3.161 Depreciation is based on the replacement cost of an asset over its set life. The replacement cost is reviewed annually (or biannually) as part of a revaluation exercise in compliance with International Financial Reporting Standards. Over 80% of asset valuation and resulting depreciation is attributable to major specialised military equipment.

3.162 Depreciation is increasing due to the replacement of existing assets with more expensive new assets, for example NH90s versus Iroquois, and through revaluations as replacement costs increase. The impact is significant. Over the next three years the increase is forecast to be $43 million, $94 million and $109 million. This excludes changes due to revaluations as they are dependent on future inflation and exchange rates.

3.163 The NZDF is not automatically funded for increases in depreciation unlike their Australian counterparts. Where the higher costs are not funded the increases are, in the first instance, managed by producing equivalent reductions in personnel and operating costs. The NZDF states that this helps to explain some of the lack of maintenance and support in areas such as the Defence Estate. If sufficient savings cannot be made in operational areas to meet the deprecation charges, the NZDF would argue that this risks leading to a reduction in capability.

3.164 The lack of certainty with respect to future funding presents major challenges for the NZDF when trying to produce meaningful future strategic plans in an organisation that needs to make extremely large capability replacement decisions a long way out from effective delivery. This includes personnel issues, such as numbers and skills, as well as the new asset acquisitions and their introduction into service.

3.165 Depreciation can only be reduced by reducing assets or when their value changes. If this can be achieved then the retention of both the proceeds of sale and the depreciation stream need to be negotiated with Treasury officials.

3.166 Replacing owned assets with finance leases at the same cost has two impacts on the financial statements: first, the addition to the balance sheet of the debt to the lessor and, secondly, the cost of finance appears in the operating statement.

3.167 There may be limited opportunities for the NZDF to enter into operating leases or to acquire a service from a potential service provider, the cost of which would go to the operating statement rather than the balance sheet. We expand further on these opportunities elsewhere in the report.

3.168 In summary, current direct incentives for divestment by the NZDF are minimal with all profit on asset sales being returned to the Crown unless otherwise negotiated. The only indirect incentive for the NZDF is any savings in operating or personnel through no longer operating the asset.

3.169 We understand that the issues surrounding funding and the financial management of the NZDF are being addressed as one of the work streams being incorporated into a paper being prepared for the Cabinet Strategy Committee. It is hoped that any new regime will be such as to give greater clarity and certainty to the NZDF going forward.

3.170 It would be our view that clarification of these issues would be very helpful to the management of the NZDF.

3.171 Beyond this, we would recommend that if the VfM savings we suggest are to be implemented then it would be wise for the Government to consider improving the incentives for the NZDF both to dispose of surplus assets and to rationalise assets where opportunities exist for this. This could be done by reaching an agreement between the NZDF and the NZ Treasury to facilitate the NZDF retaining the proceeds of an agreed proportion of particular asset sales in order to direct the proceeds to other VfM propositions such as the much needed upgrading of IT systems and meeting some of the costs of Base consolidation and capability. These matters are discussed further later in this review.

The Size of the Prize

3.172 The next part (Section C) of the report analyses most areas of the NZDF's operations, identifies substantial savings in a number of these areas and makes an extensive series of recommendations.

3.173 If fully implemented, the VfM Review would result over time in annual savings well in excess of $200 million. Indeed, the savings could reach a peak of $271 million in FY 2014/15 (or $349 million if the savings already identified by the NZDF are included for that year) with the accompanying ability to strengthen the resource base for the military and non-military tasking of the NZDF and to meet the future costs of existing and committed military platforms (and perhaps a little more) without the need to rely on increases in Defence Appropriations.

3.174 Clearly this has real benefits for the Government, the NZ taxpayer and the NZDF. For the NZDF, the prize has to be achievable (albeit demanding) but the incentives have to be right as well.

3.175 We have previously discussed the NZDF being able to retain proceeds from the sale of assets for re-investment in critical areas such as IT, base facilities and capability. We also recommend that the NZDF be able to retain its savings for re-investment into the front line, subject to the savings being clearly identifiable and removed from Budget line items for inclusion in others. This was the approach recommended in the Pappas Report in Australia and adopted by the Australian Government.

3.176 A previous chart (Figure 1.5) drew attention to the funding gap between the current and expected levels of Defence Appropriations and required levels of future funding (including depreciation and the capital charge) to meet the preferred middle pathway in the Defence Assessment.

3.177 The essence of the benefits of the VfM findings, if implemented in full, is depicted in the graphs in Figure 1.8 below. These graphs describe how the funding gap between the current and expected levels of Defence Appropriations from FY 2010/2011 through to FY 2014/2015 and the middle and high pathways referred to in the Defence Assessment can be closed.

3.178 The graphs, entitled "Middle Pathway" and "High Pathway" make it clear that, if the total savings are achieved (i.e. the VfM savings and those identified by the NZDF), the middle pathway is achievable without the need for the Government to increase Defence Appropriations. They also make it clear that, on the same savings basis, the high pathway in the Defence Assessment is also a possibility although, in the outer years, additional Government funding may be required.

3.179 In a nutshell, therefore, this is the "size of the prize". The greater the level of savings and efficiencies achieved by the NZDF, the greater the prize in terms of increased front line capability and the closer the NZDF will get to achieving its capability requirements.

3.180 There are two points of explanation: first, we understand the Defence Assessment pathways assumed the status quo with respect to operating and capital expenditure on the Defence Estate. The VfM savings, on the other hand, includes additional operating and capital expenditure to meet what has been a significant shortfall in expenditure on Camps and Bases and at other NZDF properties as well.

3.181 Second, the VfM analysis only covers the five years to FY 2014/2015 yet the Defence Assessment goes out to 2030. The level of savings will be sustainable beyond FY 2014/2015. Indeed, we would expect to see a further, positive step change in annual savings in light of the proposed Ohakea PPP and certain Base closures. Whether this step change in savings is sufficient to offset the impact of cost increases resulting from military platform replacements in 2020 and beyond was outside our terms of reference but warrants further analysis.

Impact of savings on Defence Assessment expenditure pathways

Middle Pathway | **High Pathway**

Incremental / Total

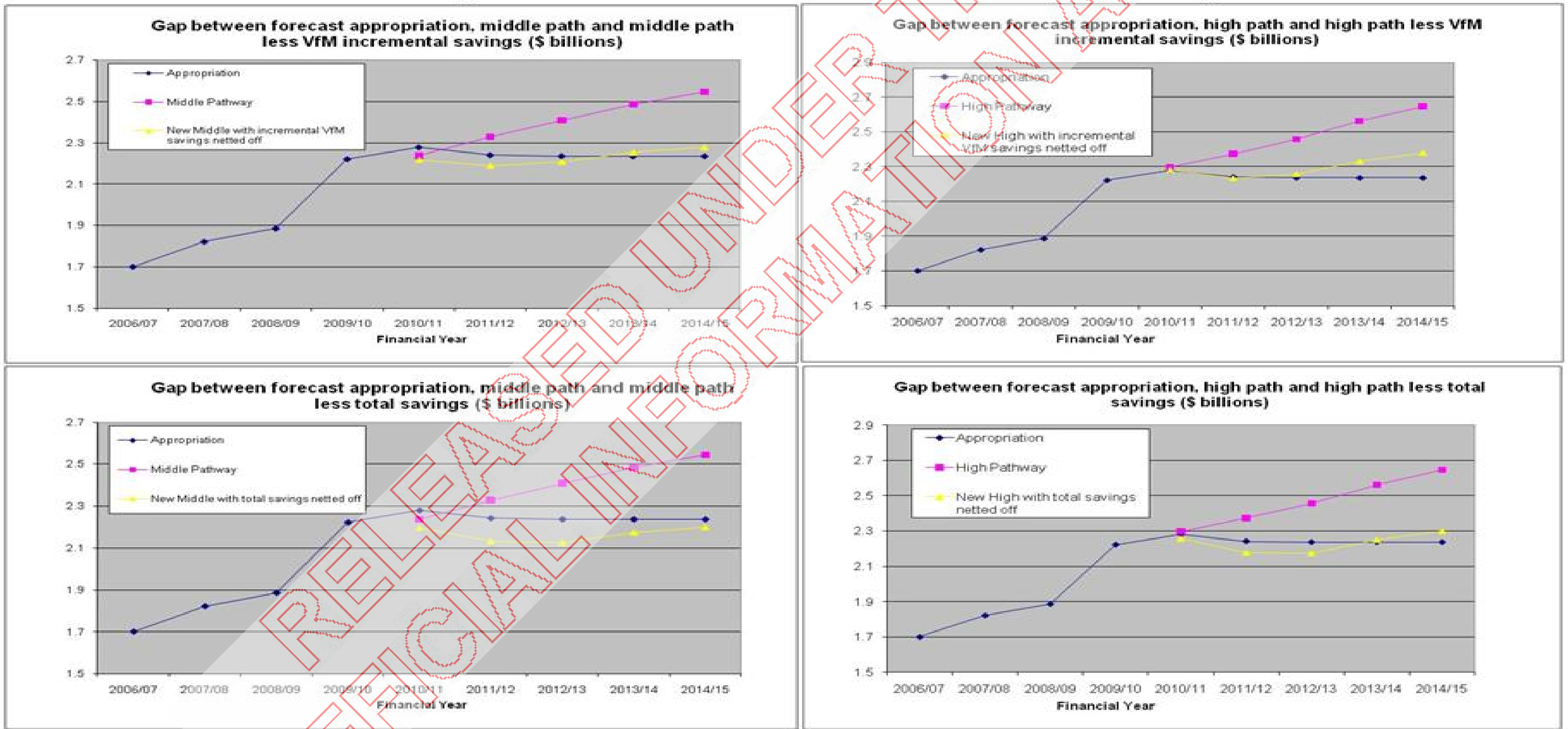


Figure 1.8: Defence Assessment Middle and High Pathways adjusted for incremental VfM and total (VfM and NZDF) savings.

Savings Timelines and Existing NZDF Programmes

3.182 As detailed in the next section of this report, many of the identified savings will require substantial changes to current processes and practices which will take time and will involve additional capital and operating expenditure. Other savings can be achieved more easily and quite quickly.

3.183 It follows therefore that different categories of savings will take longer or shorter periods of time to achieve. For example, non-military procurement savings should be relatively immediate assuming a decision by CDF to remove an amount equivalent to the target savings from the Budget and the Resources Plan.

3.184 Reducing the number of human resources (HR) personnel or redesignating personnel as civilians rather than military, on the other hand, will take a number of years, particularly so when many of these savings are reliant on significant IT upgrades and process changes.

3.185 In the case of the former, the annual savings "peak" should be reached within two years. With regard to the latter, the maximum level of savings could take three to five years to achieve.

3.186 In the Savings Spreadsheet (Appendix VIII), the targeted VfM savings are spread over a five-year period commencing in the current financial year (FY 2010/2011) and concluding in FY 2014/2015. The Savings Spreadsheet has three component parts, namely: the savings identified by the NZDF already, the incremental savings identified by the VfM Review and a combination of the two.

3.187 Where the NZDF savings were in expenditure categories reviewed by the VfM team, the savings identified by the NZDF were analysed and we then reached our own conclusions. In all but one of these cases, we concluded that there were opportunities for additional savings.

3.188 We did not undertake any independent analysis of savings areas where the NZDF had taken a cost down approach (as in the case of the NIKE and Persex areas).

3.189 A critical point, apart from the macro level of savings, is setting realistic timetables for the savings targets. It would appear that the timetables identified for some of the savings programmes already identified by the NZDF and analysed by the VfM team (particularly Logistics and HR) are optimistic. We have attempted to reflect this in the total savings column of the Savings Spreadsheet but did not amend the phasing in the NZDF savings column.

The Cost of Savings

3.190 While the potential savings are significant, achieving them will take real focus, high quality and committed management and the requirement "to spend money to make money".

3.191 The support functions and logistics categories are two examples where there will be a need to spend considerable capital to implement upgraded, replacement and new IT systems. While it is possible that some of these IT systems may be owned and provided by the private sector, upfront expenditure or expenditure spread over a number of years will be well over $100 million.

3.192 In addition to expenditure on corporate IT systems and a new data centre (which could also be a PPP), there will be a need to allocate significant personnel and contracting costs to help implement the new systems and the accompanying processes.

3.193 In the Savings Spreadsheets, we have sought to provide net operating expenditure savings numbers, i.e. after cost increases (including depreciation) required to deliver the savings. But more work will be required in some areas to settle on accurate transformation and restructuring costs.

3.194 It is not clear to us whether the NZDF has adopted a similar approach to its savings programmes with the exception of IT systems for HR where we understand that $25 million has been provided for in the Capital Plan (but not budgeted) over the next two years.

Asset Sales

3.195 The following sections of the report also identify and describe a number of opportunities for asset sales including:

- Defence housing;
- Woodbourne land and buildings;

- Buildings, related facilities and infrastructure at the Whenuapai Base;

- Some NZ Army vehicles;

- As part of the Ohakea PPP, land and buildings at Linton; and

- Also as part of the Ohakea PPP, buildings and related facilities at the Ohakea Base (given that these would be rationalised and owned by the PPP contractor).

3.196 The potential sale proceeds are likely to be well in excess of $300 million and should be vigorously pursued.

3.197 In the Savings Spreadsheet (Appendix IX), we have also included an illustrative Capital Inflows and Outflows section with a view to identifying whether scope exists to match the additional capital expenditure on IT systems and base upgrades with proceeds from asset sales, the latter assuming an appropriate agreement can be reached with the NZ Treasury.

Savings Categories

3.198 The 100 work streams did not always result in identified savings. In some cases, savings were identified but fell outside the five-year period. In other cases, we concluded that savings existed but we were unable to get comfortable with an appropriate savings target.

3.199 Examples of the former are the proposed base consolidation at Ohakea via a public private partnership (PPP); potential VfM from closer interoperability between the NZDF and the ADF and alternative ways of acquiring and operating the proposed inshore maritime surveillance aircraft. In every case, however, the individual slides identify the potential future value for money.

3.200 The savings categories were grouped as follows:

- Support and Back Office Services;

- Workforce (including Health services);

- Education and Training;
- Non-Military Procurement;
- Logistics;
- Military Platforms and Capability;
- Property and Real Estate;
- ICT; and
- Other.

3.201 In terms of total (i.e. VfM and NZDF) potential savings, the Workforce category (excluding reserves) accounts for by far the largest proportion (c. $150 million by FY 2014/2015) but also has the biggest challenges. A core assumption behind the level of savings in this area is the number of personnel required to be in uniform (PRU) and therefore the number of military positions that can be civilianised at an average 35% lower total remuneration cost.

3.202 The NZDF has started to look at this area through its R5 project.

3.203 The second largest area for savings is the provision of support services in NZDF HQ and across the NZDF as a whole and in Logistics.

3.204 NZDF, through the DTP, had already identified significant savings of around $17 million per annum in support services. The VfM Review identified an additional peak level of $20 million of annual savings in this area.

3.205 DTP had also identified opportunities in Logistics and the NZDF has proceeded to establish a centralised Defence Logistics Command (DLC). While the level of savings identified in the DLC Investment Case are significant they fall well short of what we believe is achievable.

3.206 Over a 10-year period, the VfM Review has identified an additional $200 million of savings in this area and we believe further opportunities exist if the NZDF decides to bring appropriate levels of forward logistics, maintenance and sustainment activities within the DLC's purview.

3.207 A further productive area for savings relates to Defence housing and the provision of the Universal Accommodation Allowance (UAC). It is our view that the UAC is applied too broadly, being paid for example to people in barracks. This suggests the need to increase the rental paid in barracks closer to market rates or, better still, to terminate the UAC as it relates to barracks accommodation altogether.

3.208 On the other side of the ledger, however, there is a need to enhance financial incentives to facilitate and accelerate the sale of the NZDF's housing stock in Auckland with a potential release of capital of above $200 million and reduced housing costs, over time, of $20 million per annum.

3.209 In terms of the Defence Estate, the message is mixed but there is little doubt that the approach outlined in the Defence Assessment is too cautious. However, savings in this category will not be achieved quickly. Indeed, in the short term, it is recommended that the NZDF increase its operating and capital expenditure at those bases that will not form part of the proposed consolidation at Ohakea or be candidates for greater private sector provision (such as Whenuapai).

3.210 It is clear from the VfM Review that there are sizeable potential financial and operating benefits from a reduced base footprint. Based on a KPMG analysis, a compelling case can be made for a PPP at Ohakea combining Ohakea and Linton and significant aspects of Waiouru. Base consolidation at Ohakea, through a PPP, would also likely involve some of the activities undertaken at Trentham and, possibly, the technical training activities at Woodbourne.

3.211 This will all take time but the efficiencies and savings can be significant. The NZDF should proceed forthwith to develop a business case for such a PPP and to prepare the way for the closure of Woodbourne and Linton.

VfM Savings

3.212 Set out below (Figure 1.9) is the VfM savings extract from the Savings Spreadsheet. These are the incremental savings (i.e. over and above what the NZDF has already identified). Where there are negative amounts in red, this is an area where we believe additional expenditure is required (i.e. base maintenance and IT systems). Where the numbers are $0 (as in the Logistics category), this reflects where we believe upfront expenditure and revised processes or policy changes will be necessary before savings can be expected.

Category and Sub-heading	Incremental VfM Savings ($ millions)				
	2010/11	2011/12	2012/13	2013/14	2014/15
Support Services					
Human Resources (excluding training and recruitment)[1]	$0.00	$0.00	$10.00	$19.60	$19.60
Finance	$0.00	$2.50	$4.50	$4.50	$4.50
Procurement	$0.00	$4.00	$8.00	$15.00	$15.00
Consultants and Contractors[2]	$1.00	$5.00	$5.00	$5.00	$5.00
Workforce					
Superannuation	$0.00	$1.00	$2.00	$3.00	$6.00
R5 - Warrant Officers	$0.00	$3.00	$3.00	$3.00	$3.00
Reserves[3]	$0.00	$25.00	$33.00	$33.00	$33.00
Pay Progression	$0.00	$25.00	$25.00	$25.00	$25.00
Civilianisation/ Non-deployable Military	$5.00	$26.00	$46.00	$46.00	$46.00
Non-Operational Allowances (excluding UAC)	$0.00	$12.00	$12.00	$12.00	$12.00
Recruitment[1]	$0.00	$0.00	$0.00	$0.00	$0.00

[1] DTP HRM work stream savings have been split out with Education and Training and Recruiting savings shown against separate VFM work streams. Adjusted phasing is shown in the blue cell in 2011/12 reflecting a view that current phasing is optimistic due for the requirement for ICT investment.

[2] NIKE targets were agreed by NZDF in March 2010. $10.6 million of savings have been included against the non military equipment and Consultants and Contractors categories. The remainder of $20.68 million has not been allocated against the VfM work streams and is shown below Total VFM Savings line.

[3] Savings are contingent on a change in Government policy with respect to Reserves.

Category and Sub-heading	Incremental VfM Savings ($ millions)				
	2010/11	2011/12	2012/13	2013/14	2014/15
Health Services	$3.00	$8.00	$14.00	$14.00	$14.00
Education and Training[1]	$0.00	$5.00	$10.00	$10.00	$10.00
Non-Military Procurement[3]	$1.40	$10.40	$10.40	$10.40	$10.40
Logistics[4]	$0.00	$0.00	$4.50	$14.10	$13.80
Devonport Dockyard	$0.00	$0.00	$0.00	$1.00	$2.00
Platforms and Capability					
B Fleet	$0.40	$0.70	$0.80	$0.80	$0.80
Strategic Airlift and VIP Transport (757s)[5]	$0.00	$0.00	$0.00	$0.00	$24.30
C and CL Fleet	$0.21	$0.21	$0.57	$0.57	$0.57
Property and Real Estate					
Universal Accommodation Component (UAC) - Barracks	$5.63	$13.50	$13.50	$13.50	$13.50
Whenuapai	$0.00	$1.00	$2.00	$2.00	$2.00
Woodbourne - Savings linked to Ohakea PPP	$0.00	$0.00	$0.00	$0.00	$10.00
Ohakea PPP - savings commence in FY 2014/2015	$0.00	-$1.00	-$2.00	-$2.00	$6.25
Defence Housing	$0.00	$0.00	$2.30	$10.30	$10.30
Property Maintenance	$0.00	-$10.00	-$10.00	-$8.00	-$8.00
ICT[6]	-$0.50	-$3.71	-$10.06	-$16.86	-$22.16
Other Services					
Libraries	$0.00	$0.60	$0.60	$0.60	$0.60
DTA	$0.00	$3.00	$3.00	$3.00	$3.00

4 Zero savings in the yellow cells. Our view is that the DTP Logistics work stream targets are overstated in FY2010/11 & FY 2011/12 and understated in out years. Our view on phasing is shown in the blue cells.

5 To be realised, these savings would require a Cabinet decision to dispose of the 757s.

6 Operating expenditure impacts of ICT upgrades in Logistics and HR are included in this line.

Category and Sub-heading	Incremental VfM Savings ($ millions)				
	2010/11	2011/12	2012/13	2013/14	2014/15
Military Diplomacy	$1.00	$3.00	$6.00	$6.00	$6.00
Bands	$0.00	$2.75	$2.75	$2.75	$2.75
Museums	$0.00	$2.00	$2.00	$2.00	$2.00
TOTAL VfM SAVINGS	$17.14	$138.96	$198.86	$230.26	$271.21

Figure 1.9: VfM Savings Spreadsheet

VfM Summary

3.213 The opportunity presented by the VfM Review is depicted above on a category by category basis and is expanded on in the individual slides in Section 4 and in the Savings Spreadsheets (Appendix IX).

3.214 The NZDF faces a major challenge over the next decade.

3.215 According to the Defence Assessment, the growth in the NZDF's projected operating expenditure (including depreciation) will significantly exceed the forecast increases in Defence Appropriations.

3.216 It is this dilemma which led to the need for this VfM Review.

3.217 What this review demonstrates is that it is possible to close that gap and still meet at least the middle pathway described in the Defence Assessment and perhaps also lay the ground for the high pathway.

3.218 Annual savings of the order of $200 to $300 million are possible. This is clearly a large sum relative to the NZDF's FY 2010/2011 budget of $2.2 billion.

3.219 But the VfM Review was not simply a cost reduction exercise. It is far more about a reallocation of resources from the middle and back to the NZDF's front line tasks and activities. This is why the NZDF needs to negotiate a deal with the Government to the effect that, if it can achieve the savings, it will be permitted to reinvest the gains in improvements in defence capability.

3.220 The task of achieving the savings will not be easy. But it is achievable. Other government and commercial organisations have successfully carried out analogous restructurings; indeed, in some cases to a greater extent than we are proposing here.

3.221 Success is totally dependent on a change of culture within the NZDF and strong, determined, committed and skilled leadership. Moreover, the Government has to back the NZDF.

3.222 With this in mind we have also addressed the way in which we consider the organisational and management arrangements need to change to facilitate a major shift in resources from the back and middle to the front end, or from the business part of the NZDF to the front line operations where the NZDF is so effective at delivering VfM and where the resources should be concentrated.

3.223 If the business aspects of the NZDF can be made as efficient and effective as we are sure can be the case, then the NZDF will become truly fighting fit, will have positioned itself for the future and will be able to claim legitimately that it is delivering real VfM.

Pacific Road Corporate Finance

Value for Money Review of New Zealand Defence Force

Section C – VfM Analysis

Pacific Road Corporate Finance

C1 Support Services

- C1.1 Human Resources
- C1.2 Finance
- C1.3 Contractors
- C1.4 Procurement
- C1.5 Capability Development
- C1.6 Corporate and Administration
- C1.7 Shared Services
- C1.8 Defence Transformation Programme

C1.1 Human Resources

Description of the VfM Area

- The provision of Human Resources ("HR") services, including payroll and policy.
- This area excludes health services, training and education, recruitment, psychological services, chaplaincy and similar military support.
- The key VfM questions are: how many HR FTE are providing HR services as a proportion of total NZDF FTE and relative to key benchmarks and what should the ratio be?
- What is the total cost of HR service provision relative to annual NZDF operating expenditure and what should it be?

Existing VfM

- As part of the DTP, NZDF has already moved to a shared services model for payroll services and are now looking for significant cost savings in HR across NZDF consequent on a move to a single, integrated HR model.
- NZDF is looking to replace or upgrade its existing HR information system, known as ATLAS, as a pre-condition to improving HR processes, better data collection and analysis and, ultimately, cost savings.
- DTP has already identified the opportunity to improve the ratio of HR FTE to total FTE from 1:22 to 1:49

Benchmarking

Benchmark	NZDF	s6(a)	Corporate
Ratio HR FTE to total FTE	1:22		1:200

Potential Savings
(Not including second order savings)

Ratio	Target	Savings/year
DTP	1:49	$27 million
VFM	1:100	$36 million

Stretch Target

	NZDF now	NZDF transformed
Cost	$61 million	$24.5 million
HR FTE	569	125
Cost/ HR FTE	$107,000	$199,000
Ratio	1:22	1:100
Cost/employee	$5,000	$2,000

C1.1 Human Resources

Pacific Road Corporate Finance

VfM Conclusions

- HR personnel numbers are the main driver of HR costs, currently 74%.

s9(2)(b)(ii)

- Large numbers of people are primarily a function of manual processes and outdated IT systems but this does not completely explain the overstaffing.
- Reduction in HR headcount will have second order savings in other operating costs, overheads, premises etc. These savings are dealt with in other parts of this Report.

VfM Recommendations

- Implement an HR FTE to total FTE of 1:200
- Simplify HR processes and consolidate allowances.
- Web kiosk facilities for all personnel to manage their own HR needs.
- Replace ATLAS, together with embedding of modern HR processes, by SAP HR module.
- Each manager and officer within NZDF to take responsibility for HR management of their people.

VfM Savings

- NZDF has set an annual savings target of $27 million per annum based on a 1:49 ratio. A target of 1:100, while still not best practice, is a more demanding yet appropriate target and will deliver peak annual savings of $36 million.

C1.2 Finance

Description of the VfM Area

- Finance includes accounting, financial reporting, budgets, plans and audit.
- Finance services are currently provided by NZDF HQ, the three Services and JLSO.
- The key VFM issue is how many Finance FTE are providing Finance services as a proportion of total NZDF FTE and relative to key benchmarks and what should it be?
- What is the total cost of Finance service provision relative to annual NZDF operating expenditure and what should it be?

Existing VfM

- NZDF is proceeding to a single, integrated finance service model for HQ
- This has already resulted in annual savings of $500,000.
- But there are still a significant number of personnel providing finance services within the Services, JLSO and other parts of NZDF.
- NZDF performs in the middle of the pack relative to other Government agencies but well below the best comparable agency and best practice in the corporate world.

Benchmarking

	NZDF		Corporate
Finance opex/FTE	$75,000	s9(2)(b)(ii)	
Finance/ FTE total FTE	1:71		1:200
Finance opex/total opex	0.8%		

Potential Savings

Consolidation to a single Finance entity: $5 million per year

C1.2 Finance

Pacific Road Corporate Finance

VfM Conclusions

- The initiative to develop a single, integrated model within NZDF HQ for the finance function is a step in the right direction but needs to be applied across NZDF.
- This will result in reduced costs and a higher quality and more accurate finance function.
- Miscoding and inaccurate and conflicting data is endemic.
- Current ratio of FTE to finance staff (1:71) can be markedly improved.
- The lack of activity-based costing leads to difficulties in obtaining reliable data.

VfM Recommendations

- Establish a single, integrated Finance function across NZDF, reporting to a CFO.
- Introduce activity based accounting.
- Attach priority to timely and accurate data collection and analysis.
- Transfer accounts payable shared services function from JLSO to the Finance Function.
- Target the ratio of finance staff to NZDF at 1:90.
- Retain sufficient VFM savings within the Finance function to introduce a business analysis and forensic accounting capability.
- Upgrade finance systems and processes to SAP military version, if acquired

VfM Savings

- Up to $5 million in direct costs (including the $500,000 savings already being achieved) from the establishment of a single Finance entity, the removal of duplication and the achievement of a ratio of finance FTE to total FTE of 1:93 (still below best practice). There will be second order savings that have not been calculated.

C1.3 Contractors and Consultants

Description of the VfM Area

- NZDF spends considerable sums on third party professional services of which contractors and consultants comprise approximately 60%.
- Consultants are experts engaged to provide independent advice on an issue by issue or project by project basis.
- Contractors are people hired on a temporary basis to provide a necessary resource or to fill a NZDF skill gap.
- Other professional services cover the acquisition of external legal, accounting and similar technical services.

Existing VfM

- NZDF spent $53 million on professional services in FY 2008/2009, $33 million of which was consultancy and contractor fees and payments.
- NZDF has already moved to reduce costs in this area relative to the previous year including a $4 million reduction in contractor and consultants costs, 75% of which relates to the DTP.

VfM Conclusions

- NZDF has already identified contractor and consultants expenditure as too high. The 10% + reduction in the current financial year is a useful first step but there are further opportunities.
- Without very close monitoring, which should be the responsibility of the Finance function, contractor and consultant costs can very quickly get out of hand.

C1.3 Contractors and Consultants

VfM Recommendations and Savings

- Target further savings in contractor and consultant costs.
- The finance function to monitor costs closely and to undertake a review of expenditure over the last three years.
- In addition to the $8.6 million of savings identified by NZDF in FY 2010/2011, there are additional savings of at least $5 million spread over two years.
- Over 60% of these savings will come from reduced DTP expenditure.

Potential Savings

Category	NZDF	VFM
Contractors & Consultants	$6.5 million	$10.0 million

C1.4 Procurement

Description of the VfM Area

- NZDF acquires approximately $620 million of goods and services each year, increasing to $1 billion if major capital expenditure on military platforms is included.
- Within NZDF, procurement is undertaken in a number of different areas including:
  - JLSO;
  - CIS Branch;
  - DLC; and
  - the Services.

Existing VfM

- The Acquisitions Division of the Ministry of Defence (MOD) is responsible for the acquisition of major military platforms.
- The NZDF and MOD procurement function s cost $41.6 million in direct costs and employ 332 FTE, excluding the purchasing officers attached to overseas diplomatic posts.
- What should procurement costs as a % of NZDF operating expenditure and the number of NZDF FTE per procurement FTE be?
- Non military procurement of bulk products and services has been centralised within the JLSO and savings have been achieved with additional savings projected.
- Most strategic sourcing, including munitions inventory, parts and rotables, is now the responsibility of the DLC and significant savings and inventory reduction have been targeted.
- JLSO and DLC are both projecting headcount reductions in the procurement area.

C1.4 Procurement

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VfM Conclusions

- Consolidation of the procurement function across NZDF and the MOD would remove duplication, facilitate more efficient processes and result in fewer people and lower costs. Consolidation, together with other initiatives, would also facilitate better alignment between MOD and NZDF on major capital acquisitions.
- There should be a single procurement centre of excellence within NZDF.
- Cost of procurement within NZDF and MOD as a % of total NZDF operating expenditure is 9 x the most relevant public sector benchmark.
- Procurement FTE is 10 x the most relevant public sector benchmark and above some other Defence Forces.
- NZDF and MOD do have some unique features, including the acquisition of highly complicated and expensive military equipment and platforms.

Benchmarking

Benchmark	NZDF +MOD
Procurement costs/ total operating cost	2.4%
Procurement FTE as % of total FTE	2.7%
Ratio of total FTE per procurement FTE	1:37
Procurement cost as% of procurement value	4.2%

s9(2)(b)(ii)

C1.4 Procurement

VfM Conclusions

- This should result in higher numbers within the MOD Acquisition Division and, relatively speaking, lower numbers within the NZDF to reflect the more commodity nature of the products and services being acquired. The reverse is in fact the case.
- Given the status quo and the need to strengthen significantly the large capital equipment purchasing capability, a target of 1 procurement FTE to 100 NZDF FTE is an appropriate target.

VfM Recommendations

- There should be a single Centre of Excellence within NZDF for the procurement function.
- Capability development, specification preparation, Cabinet decision making work and business case development for major capital acquisitions should be the responsibility of the MOD.
- The NZDF Capability development function should transfer to MOD.
- The Ministry's Acquisitions function, other than those involved in policy setting, Cabinet paper preparation and specification writing, should transfer to the NZDF.
- The procurement function should be consolidated within DLC. Procurement personnel in JLSO, the Services and CIS should transfer to the DLC.

C1.4 Procurement

VfM Savings

- 1:100 ratio will deliver up to $20 million direct cost savings per annum and this should be achievable over a 2 to 3 year period.
- Up to 20% of these savings are already likely to be provided for in the Logistics (DLC) Investment Case.

Potential Savings

	Intermediate Target Ratio	VFM Recommended Ratio
Procurement FTE /total FTE	1:50	1:100
Procurement FTE	332	332
FTE Target	245	123
Procurement Cost/ procurement spend	3.4%	2.2%
Annual VfM Savings	$8.1 million	$19.6 million

C1.5 Capability Development

Description of the VfM Area

- The *development* function identifies the capabilities needed to achieve policy goals.
- The capital *procurement function* purchases the capital components of capability.
- It is estimated that 240 FTE perform these functions, at an annual cost of around $30 million (including MOD costs, where appropriate).

Existing VfM

- Changes to the governance and capability development process are likely to flow from the Defence White Paper, including merging the minor and major capital programmes.
- Co-location of single Service capability branches within NZDF HQ Development Branch is underway.
- DTP is intending to review of the capability development function as part of its NZDF HQ work stream.

VfM Conclusions

- Development and procurement functions are fragmented between numerous agencies, Services and branches (HQNZDF, Ministry, Navy, Army, Air, JLSO, CIS).
- Development and capital procurement functions are often managed by staff on short posting cycles without specific capability project management training or experience.
- NZDF has historically managed a very large number of minor capital projects.
- NZDF's capability project teams are under-resourced compared to other Defence Forces.

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C1.5 Capability Development

VfM Recommendations

- Consolidate all procurement activity within NZDF and transfer development function to the MOD. See specific slide on proposed procurement organisation arrangements.
- Enhance professional training, ensure project teams are adequately staffed, reduce staff rotation and introduce a higher proportion of civilian staffing (including former military personnel).
- Apply a rigorous prioritisation and firm discipline to capital minor project proposals so that only high priority projects receive funding. This prioritisation should be led by the CFO.
- Minimise cost, delivery and performance risks by purchasing off the shelf, and joining larger production runs where possible.
- Net savings can be expected over time from lower project costs, more timely delivery, reductions in through-life costs, and reduced corporate overheads.

Metrics

Benchmark	NZDF
Annual operating cost of function per development and procurement FTE	$122,708
Annual operating cost of function as a % of total operating costs	1.71%
Ratio of development and procurement FTE to total FTE	1:51
Annual operating cost of the function as a % of annual capital expenditure	7.6%*

* Based on total capital expenditure in 2008-09 of $388 million

C1.6 Corporate & Administration

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Description of the VfM Area

- Corporate and Administration, applying the BASS definition, comprises:
  - Communications and public relations;
  - Strategy & Planning;
  - Clerical;
  - Library & Research;
  - Audit & Risk; and
  - Legal services.

- Administration and mailroom services are excluded from BASS definition.

Existing VfM

- As part of the DTP work on NZDF HQ, FTE and operating expenditure in the above areas are being reviewed. No conclusions have been reached and no savings included in the FY 2010/2011 budget and 2 year Resource Plan.

Benchmarking

	% NZDF Opex	$/FTE NZDF
Comms & PR	0.2%	$301
Strategy & Planning	0.8%	$1,160
Library & Research	0.3%	$338
Audit & Risk	0.1%	$152
Legal	0.1%	$183
Total Cost	**1.5%**	**$2,183**

s9(2)(b)(ii)

Pacific Road Corporate Finance

C1.6 Corporate & Administration

VfM Conclusions

s9(2)(b)(ii)

- If administration and mailroom is omitted, however, NZDF is higher than the most realistic public service agency comparator.
- The area of greatest expenditure compared to other agencies is in Strategy and Planning.
- The amount spent on Audit and Risk appears to be lower than other agencies.

VfM Recommendations

- There would appear to be savings opportunities in the strategy and planning function, notwithstanding the fact that NZDF could expect to have a higher demand for skills and resources in this area than most other agencies. A review of this function should be undertaken.

C1.7 Shared Services

Description of the VfM Area

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- For NZDF, this comprises:
  - Accounts payable processing;
  - Payroll processing; and
  - Property management services
- Shared services also comprises the pan NZDF procurement of certain commodities and services but this is dealt with in a separate part of this Report (Non military Procurement).

Existing VfM

- NZDF has established the JLSO as its Centre of Excellence for shared services.

s9(2)(b)(ii)

- IJLSO will assume responsibility for payroll processing across NZDF. The processing of all civilian processing has transferred to JLSO. It has been agreed in principle that military payroll processing will transfer by December 2010.

VfM Conclusions

- NZDF is already taking the appropriate organisational/shared services steps to achieve available savings. Best practice would be closer to $80,000 per payroll FTE.

VfM Savings

- The savings available from Payroll consolidation has been adequately covered in the HR work stream of the DTP.

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C1.8 Defence Transformation Programme (DTP)

Description of the VfM Area

- DTP is the vehicle for the delivery of transformational change within the NZDF.
- DTP's aim is to achieve fundamental change in the support areas (back and middle) focusing on "Simpler, Better and Cheaper, and
- The savings from DTP are intended to provide the opportunity to reinvest in capability .

Existing VfM

- The DTP commenced in 2008 as a two phase programme.
- The first phase was an internally driven "Cost Down" initiative to identify quick wins and generated cost savings, both one-off and sustainable, of $45 million from FY 2007/2008.
- Phase 2 involved the establishment of three work streams (Human Resources and Education and Training, NZDF HQ; and Logistics) with a view to developing a single, integrated approach to these areas within NZDF.
- Annual savings of $84 million have been identified but are yet to be fully included in NZDF Budget or Resource Plan.

	07/08	08/09	09/10	10/11	11/12	12/13	13/14
NZDF Tactical Savings ($000)	45,000	39,300	46,000	37,400	35,400	31,400	31,400
Total DTP Operating Savings			4,000	26,700	46,900	62,408	67,408
Total DTP Operating Costs Forecast			18,967	24,260	12,160	2,759	2,406
Net DTP Capital Cos Savings			5,900	-17,500	-10,900	6,800	8,800
DTP Saving total	45,000	39,300	55,900	46,600	71,400	100,608	107,608
Net Benefits ($000)	**45,000**	**39,300**	**36,933**	**22,340**	**59,240**	**97,849**	**105,202**

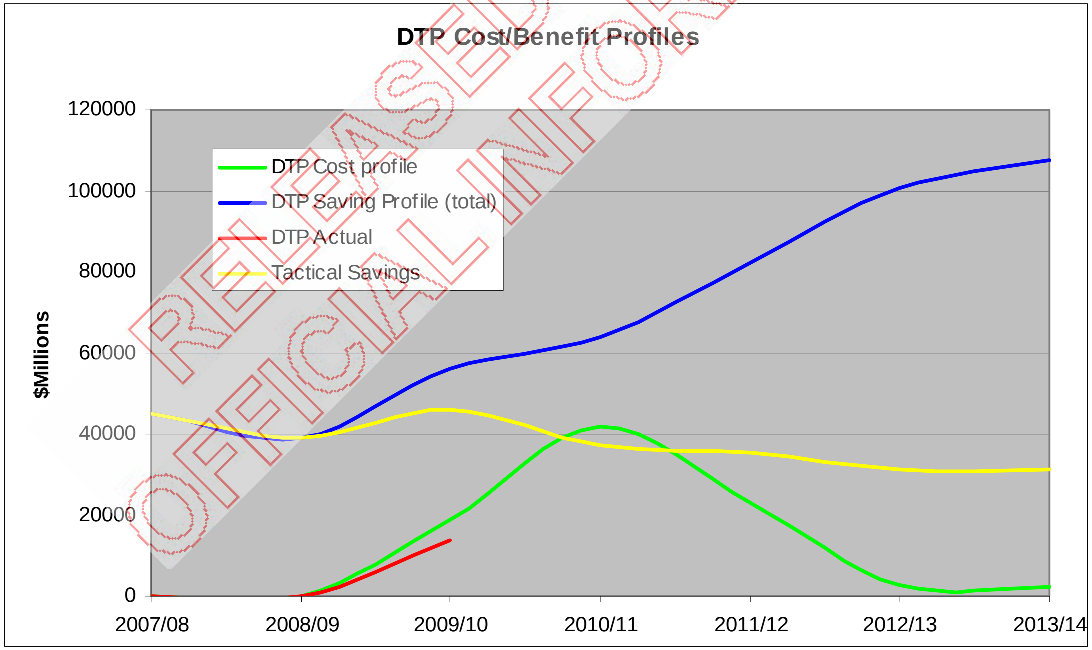
C1.8 Defence Transformation Programme (DTP)

VfM Conclusions

- Annual costs for DTP has been as high as $20 million per annum and, while reduced in FY 2010/2011 to c. $13 million, are still too high and the process is unnecessarily time consuming and complex.
- DTP has failed to identify and budget for all the IT and other costs that will need to be incurred to deliver the savings.
- DTP lacks the mandate to optimise savings, and
- The DTP cost savings targets are, as a consequence, too modest.

VfM Recommendations

- Reduce DTP costs and particularly the use of external contractors.
- Make individual functional managers responsible for the change programmes within their areas and transfer DTP resources to the function to assist with the DTP projects.
- Reduce the DTP Budget by 50%.



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C2 Work Force

C2.1 Remuneration
C2.2 Civilian/Non-Deployable Military
C2.3 Control of Establishments
C2.4 Deployability
C2.5 Reserves
C2.6 Military Recruiting
C2.7 Health Services

C2.1 Remuneration

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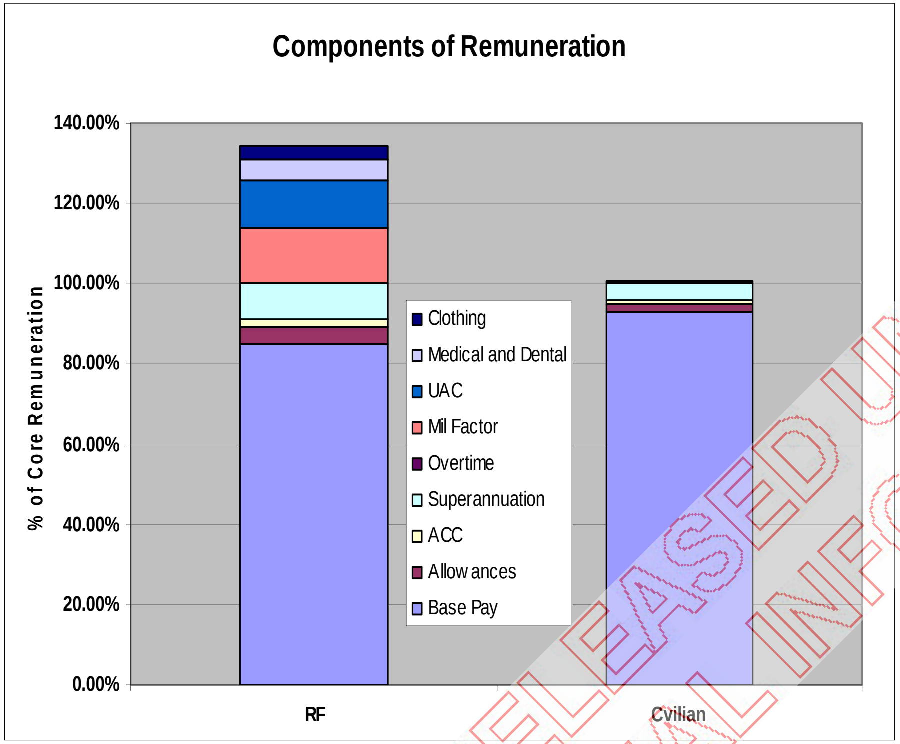
Description of the VfM Area

- Remuneration and non monetary benefits received by NZDF FTE.

NZDF Initiatives

- The Military Remuneration Scheme (MRS) was implemented in 2008 when salaries were benchmarked to market rates.
- Remuneration rates have not been updated since July 2008.
- NZDF is currently using 3 job evaluation systems:
  - Watson Wyatt Compers System – majority of civilian employees (being phased out);
  - Mercer's IPE System – all less senior appointments – covers 99% of NZDF FTE; and
  - Hay Group System – 161 Senior NZDF positions – covers 1% of NZDF FTE.
- In March 2010, average NZDF base remuneration for military personnel (excluding certain key allowances) was benchmarked at 97.7% of Mercer IPE Public Sector benchmark. For senior personnel, the Hay Group system was used with military personnel at 92.6% and civilian personnel at 96.3% against benchmarks.
- The R5 Project (Right: people; job; time; capabilities and cost) is undertaking job evaluations across certain selected ranks (44% completed). Review of Warrant Officers identified opportunities to reduce, civilianise and re-rank certain positions. This project is continuing across other ranks.
- NZDF is currently seeking to rationalise the number of non-operational allowances.
- Provision of $25 million per annum for pay progression has been included in Resource Plans from FY 2011/2012.

Pacific Road Corporate Finance



Source: Annualised SAP data 1 Jul 09 – 30 Apr 10

Value of Additional Benefits

Element	Value
Military Factor[1]	$7,074
Universal Accommodation[2]	$6,131
Medical and Dental[3]	$2,727
Non-Operational Allowances[4]	$2,412
Superannuation[5]	$4,671
Total[6]	$23,015

1. Additional pay in recognition of being in military service.
2. Intent to increase to $8,026 at a date to be determined.
3. Actual per person direct cost of provision of medical and dental services exclusive of staff and capital.
4. SAP Actual for 2009/10 for Non-Op allowances (Operational allowances an additional $18.5million).
5. Average 8.17% for uniformed staff.
6. Excludes clothing which is an average of $2,500 per RF staff member, but this includes safety and specialist military and protective clothing also – e.g. fire fighting

C2.1 Remuneration

VfM Observations and Conclusions

- Military personnel receive a number of additional benefits – the value of these additional benefits is approximately 35% over base remuneration. The margin is 31% if clothing is excluded. In $ terms, excluding clothing , this has been calculated at $23,000 per annum.
- Military personnel are treated as a homogeneous group – i.e. all receive the Military Factor and UAC allowances (excluding those in NZDF owned housing), the full cost of medical and dental treatment and superannuation, regardless of position or deployability.
- Military personnel are also eligible for additional leave as follows:
    - Incentive Leave progressive from year 6 (8 days) to year 10 (4 weeks)- $4,395;
    - Long Service leave available at year 15 (4 weeks) and every 5th year after- $4,395.
- Current military personnel numbers are significantly greater than the minimum number of people in uniform required ("PRU") using the DR09 Capability Brick analysis for the deployed force.
- While some allowances have been rationalised, the paid amount of some allowances appears to have increased.
- Opportunities already identified by R5 are yet to be acted upon.
- Remuneration benchmarking excluded the UAC and the military factor.

C2.1 Remuneration

VfM Recommendations

- Do not proceed with the $25 million military progression increment and remove this amount from the Resources Plan.
- Continue with and accelerate the R5 project and aggressively execute action plans as findings surface.
- Continue to rationalise allowances. Review not only the number of allowances, but also the basis and amount paid. Cease non-operational allowances inherent in the Military Factor – e.g. enabling allowances.
- Revise NZDF remuneration policy to ensure that additional benefits are only paid to Military personnel who are either deployed or expected to deploy.
- Make greater use of civilian staff. Civilianise positions that not directly associated with deployable force elements. See separate section of this report on Civilians / Non-Deployable Military.
- Restructure how medical care is provided – see separate section of this report on Health Services.
- Revise superannuation policy to move toward Kiwi Saver over time.
- Amend (to be less generous) the Incentive and Long Service leave provisions.

Allowances

- $42 million per annum is paid in allowances ,comprising: $23 million in non-operational allowance and $18.5 million in operational allowances.
- While NZDF is currently reviewing and rationalising non-operational allowances, the number of non-operational allowances likely to be retained still cross over with the Military Factor allowances. An example is the enabling allowances.
- The number of other allowances has been rationalised but amounts paid per other allowances has increased.
- Some allowances had their genesis in the pre-MRS remuneration system and should have been discontinued with the introduction of MRS.
- Operational allowances have not been examined as part of the VfM Review. There may be potential for further savings in this area but this is untested.

C2.1 Remuneration

Pacific Road Corporate Finance

Potential Savings

- Cease current superannuation programmes and move toward Kiwi Saver - $24 million over a 10 year period.
- Discontinue 50% of non operational allowances - $12 million per annum.
- The R5 findings for senior officers are currently being analysed. Given the average per annum remuneration in this group, there is likely to be greater savings potential in this area than already identified in the warrant officer analysis but these additional savings have not been included in the VFM.
- Civilianise (or cease paying the current uniformed premium) for up to 2,000 positions – annual savings of $46 million.
- Do not proceed with military progression increment - $25 million per annum from FY 2011/2012.

Potential Savings / Proposed Savings

Area	Up To	Proposed
Provision for remuneration increment	$25 million per annum	$25 million
R5 – WO – Senior Officers	$5.6 million per annum[1] In progress	$3 per annum[2] $10 million per annum[3]
Non-Operational Allowances[4]	$23.7 million per annum	$12million per annum[5]
Change to superannuation to Kiwi Saver[6]	$24 million per annum	$24 million over 10 year period
Civilianise / cease additional uniformed benefits to 2000 staff in middle and Back[7]	$46 million per annum	$46 million per annum.

1. Some in progress / already realised.
2. Not all benefits yet realised – estimate 50% still available.
3. Note greater remuneration of Officer Group – possible overlap in some areas with Civilianisation $10 million per annum not carried forward into the total proposed savings.
4. SAP Actual for FY 2009/10 for Non-Operational allowances (Operational allowances an additional $18.5 million)
5. Estimate 50% of value non-operational allowances should be removed.
6. Long Term – estimated 10 years to fully realise
7. Based on civilianisation of up to 2,000 positions – see separate Civilianisation slides.

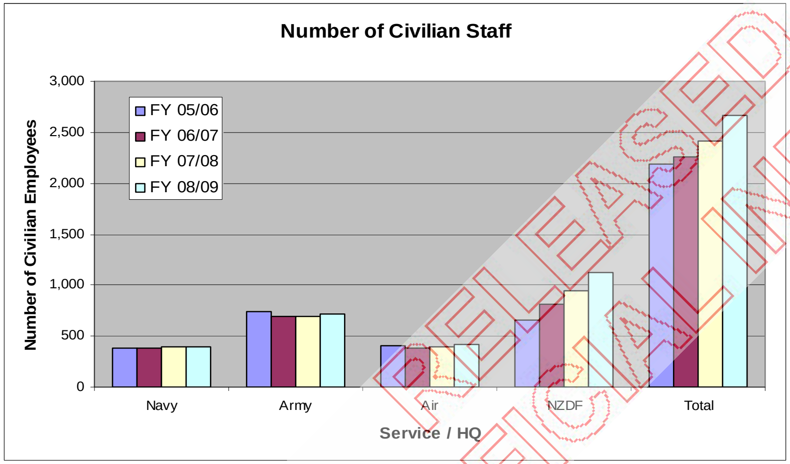
C2.2 Civilians/ Non-Deployable Military

Description of VfM Area

- Civilianisation of all positions that are not essential to be filled by military personnel or required to be filled by military personnel due to PRU requirements.

Current NZDF Initiatives

- The R5 project is investigating this opportunity.



DR09 Personnel Numbers1

	Navy	Army	Air	NZDF
RF	2,336	5,344	3,067	10,747
Civilian	473	660	447	1,580
Total FTE	**2,809**	**6,004**	**3,514**	**12,327**
Reserves	326	4,400	143	4,869

1. RF numbers vary by year with replacement of ships and aircraft, and introduction of new capabilities. RF numbers are averaged over the period of the assessment, 2009-2035.

C2.2 Civilians/ Non-Deployable Military

VfM Observations

- Uniformed staff are treated as a homogeneous group – all receive Military Factor and UAC allowances, Medical & Dental, favourable superannuation and other benefits.
- The number of personnel who might be expected to deploy under the outputs of the current SOI / Output Plan are considerably less than the current number of staff in uniform. Whether an individual is deployable is less important than whether they might be required to deploy under the Output Plan.

VfM Conclusions

- Military personnel are more expensive than a civilian by an average of $23,015 per annum.
- Rotation / posting of military personnel causes considerable disruption and undermines the ability to develop institutional knowledge and experience within non military functions.
- There has been significant growth in civilians in NZDF HQ.
- DR09 proposes an increase in the size of the current workforce, as reflected in the Defence Assessment. This is particularly the case in the Army. In Navy and Air the size of the workforce peaks and then reduces slightly in out years as scheduled replacement of current platforms is undertaken.
- The number of civilians assumed in the Defence Assessment is at odds with the current number currently employed – the discrepancy has been acknowledged by the DR09 Team and is being investigated.
- The R5 Review of Warrant Officers (WO) identified the potential to civilianise 8% of WO appointments. If this is representative across the NZDF, then ~ 780 current positions currently filled by military personnel could be candidates for civilianisation at a direct cost saving of $18 million per annum (not included in the Vfm savings)

C2.2 Civilians/ Non-Deployable Military

VfM Conclusions

- There are a number of military personnel in non deployable positions which can be civilianised. For example, there are 845 uniformed positions that are now part of the Logistics Command (120 positions are currently vacant). Civilianisation of 50% of these staff would result in direct savings of $8.3 million per annum (increases to $10 million if all vacancies are filled). If 90% were civilianised, $17.5 million per annum would be saved.
- An alternative or adjunct to civilianisation where NZDF consider it is important that certain personnel wear uniforms, is to pay non deployable, uniformed personnel at civilian rates. This approach may, however, have implications for trade models, structural overlays and training pipelines. It may also limit NZDFs exposure to fresh ideas from civilian staff and the opportunity for contracting out. This needs to be assessed.

Alternate PRU Model

- During the Defence Assessment, the Services provided "Capability Bricks" to construct deployed force with an agreed sustainment ratio.
- The VfM model applied the Option 20 Capability Brick selection, with sustainment ratios as explained below.
- The VfM Model, which is similar to NZDF's 'Front' calculations, suggests an opportunity for up to 2,000 positions either to be designated non deployable military or civilian and paid at civilian rates.

C2.2 Civilians/ Non-Deployable Military

Sustainment Ratios

- Ships and aircraft have 1½ crews per platform, including those that are not deployed.
- Ground elements are based on a 1 in 3 rotation : 1 element deployed;1 just returned and 1 preparing to deploy.

VfM Recommendations

- Civilianise all positions that are not essential to be filled by military personnel.
- Civilianise all non deployable personnel that are part of the DLC.
- Make greater use of ex RF as civilians – leveraging their military skills and training.
- Using DR09 capability bricks analysis for deployable force, make up to 2000 positions non deployable military or civilian.
- Non deployable military should not receive those benefits that are predicated on deployability. This group includes those personnel under initial recruit and officer training, or those who are downgraded as being non deployable.

		%	Navy	Army	Air	NCE/NSE[1]	Total
Front	Capability Bricks		998	3,782	715	459	5,954
Middle & Back	Command & Control	10%	100	378	72	46	595
	Instructors for Individual Training[2]	10%	100	378	72	46	595
	Specialist Military Advice	5%	50	189	36	23	298
	Casualty Factor	5%	50	189	36	23	298
Total:			1,297	4,917	930	597	7,740
Reallocate NCE / NSE (approx)			45	507	45		
Service Totals			1,342	5,423	975		7,740
						Current RF	9,836
						Opportunity:	2,096

1. NCE – National Command Element, NSE – National Support Element. These two components form the National Headquarters for New Zealand forces in a coalition environment.
2. RNZAF currently use 15% to calculate the number of personnel to provide training. 10% has been used in the VfM model because it is not calculating the number of trainers, but an estimate of the number who need to be in uniform.

C2.2 Civilians/ Non-Deployable Military

Potential Savings

Example – Not Cumulative	Savings
8% from R5 Warrant Officer study if applicable across all NZDF	$18 million per annum
Civilianise depth logistics – 50% - 90%	$14 million per annum $25 million per annum
2,000 Middle / Back positions[1]	$46 million per annum

1. Based on $23,000 as direct additional margin of uniformed staff over an equivalent civilian. Actual savings could actually be greater through cost avoidance of military training costs and efficiency increase.

C2.3 Control of Establishments

VfM Recommendations

- Existing arrangements for approval of establishments to be terminated.
- CDF to control establishment numbers in concert with the Service Chiefs.
- Existing establishments to be reviewed as part of the 2010 Defence White Paper.
- Establishment numbers to be capped at the minimum number of staff (military and civilian) required to meet outputs.
- Personnel under Training (PUT) and Manpower not effective (MNE) to be held over establishment.

C2.4 Deployability

Description of the VfM Area

- The number of NZDF personnel who are non-deployable due to medical or age factors but are being paid at full military rates.

Current NZDF Position

- NZDF actively manages medical and dental health of its deployable personnel.
- Management practices are in place and applied to manage deployable personnel who fall below required deployability standards for medical and physical fitness.
- Uniformed personnel who are permanently graded as medically unfit for service are managed out of the NZDF or civilianised.
- In some instances, to avoid costs, NZDF elects not to complete all deployment prerequisites for all military personnel. Examples are security clearances and passports for junior staff who still undergoing training or non-deployable base logistics staff.

VfM Conclusions

- At a point in time, in February 2010, 12% of existing military personnel were medically downgraded, on a temporary or permanent basis, as not fit for deployment.
- At the same time, there were some 35 personnel unavailable for deployment on welfare grounds (this could be related to family or similar constraints).
- In addition, some 75 personnel on deployment were overdue for fitness and health tests but, of necessity, this is deferred until they complete deployment.
- Finally and again at the same time, some 1,500 military personnel had either not completed their health and physical tests or had failed them.
- In the end, the actual number of military personnel who are not (and are unlikely ever to be) deployable is considerably less than the 2,000 + referred in the accompanying chart. The majority are expected to pass their next medical test and there is historical evidence to this effect.
- Only a small number of military personnel who have been identified as not fit for service (R5) have failed to be released within 2 years of receiving a R5 grade.

C2.4 Deployability

	Months	30 Jun 06	30 Jun 07	30 Jun 08	30 Jun 09	31 May 10
Navy	< 12					2
	12-24					
	24+					
	Total	0	0	0	0	2
Army	< 12	8	4	4	8	3
	12-24	1			1	1
	24+			1	1	1
	Total	9	4	5	10	5
Air	< 12	1		1	1	2
	12-24	1				
	24+		1	1	1	
	Total	2	1	2	2	2
NZDF		**11**	**5**	**7**	**12**	**9**

Number of RF Staff Permanently Medically Downgraded

	Navy	Army	Air
Service strength	2209	4890	2603
Medically downgraded	328	611	188
Expiry of grading	(142)		
Unavailable (Welfare)	18	17	
Physically unfit	351	941	246
On deployment	(12)	(54)	(9)
Fit for deployment	1666 75.4%	3375 69.0%	2178 83.7%

Breakdown of deployability statistics at February 2010

C2.5 Reserves

Description of the VfM Area

- The term "Reserve" covers two distinct groups:
  - Volunteers comprising the Naval Volunteer Reserve (NVR), the Territorial Force (TF) and the Air Force Territorial Force (Air TF), and
  - Ex-RF who may be recalled into Service – on leaving the RF with less than 20 years service a 4 year obligation, 2 years if greater than 20 years. The current strength of this group is Navy 671, Army 1403 and Air Force 523, totaling 2,597 (as at 12 July 10).
- The remainder of this section refers to the NVR, TF and Air TF who are known, incorrectly, as *Reservists*, *Reserves*, or *The Reserve*.
- The TF have contributed, and continue to contribute, to support operations. Over the past 12 months, 88 members of the TF (or 5% of total TF) have deployed on operational missions.
- Neither the Statement of Intent (SOI) nor NZDF Output Plan identify any Expense Class or Output that is reliant on Reserves.
- Reserves contribute to a number of non-output activities such as ceremonial support, civil defence, and community activities.

Summary of Reserves ($m)[1]

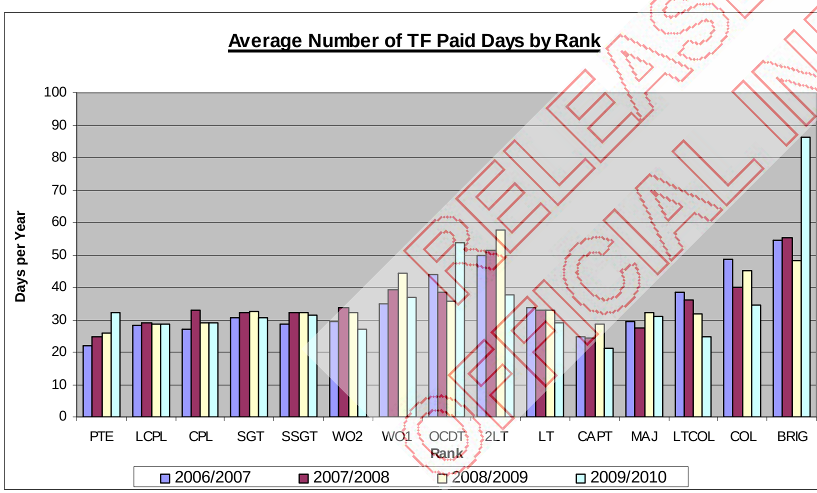
Arm	Personnel Numbers	Annual Operating	Capital – Equipment[2]	Land and Improvements[3]
NVR	335	$4.1 million	-	$4.6 million
TF	1,803	$24.7 million	$106.5 million	$17.8 million
Air TF	194	$1.4 million	-	-
NZDF[4]		$2.7 million	-	$4.2 million
Total	2,332	$32.9 million	$106.5 million	$26.6 million

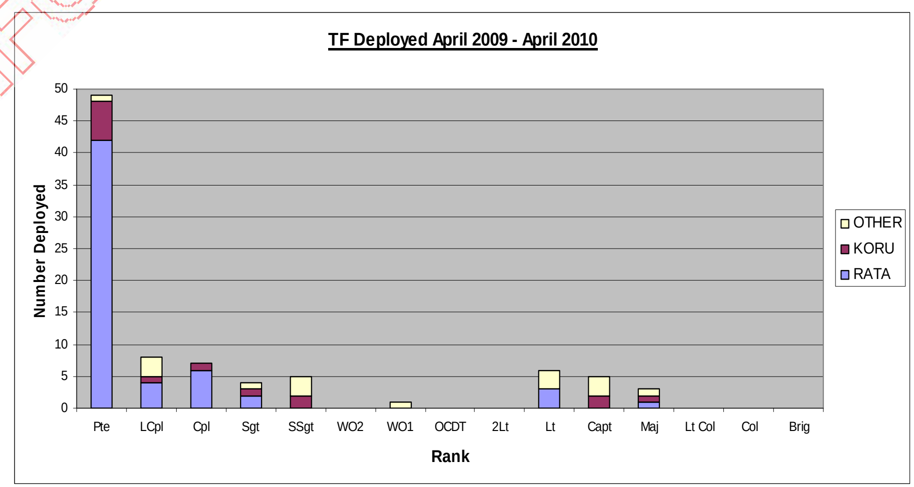
1. Personnel numbers as at 31 March 2010, financial data from SAP, property data from JLSO.
2. From SAP Fixed Asset Register - includes 18 LAVs, 13 LOVs and a range of other mil equipment.
3. Current Rateable Value based on Land and Improvements as provided from JLSO.
4. HQNZDF and HQNZJF personnel costs, and JLSO leases and property maintenance.

C2.5 Reserves

VfM Conclusions

- The rationale that underpinned the establishment of the TF is no longer consistent with the strategic environment or the workforce requirements of the NZDF.
- The NVR, TF and Air TF do not actually perform the role or functions of a Reserve. They undertake discretionary activities and contribute a small (albeit useful) number of volunteers for operational deployment.
- VFM discussions, with one exception, agreed that, in their current form, Reserves lack utility, are expensive and impose additional costs on the RF.
- On operations, predominantly TF privates are deployed. Yet, on average, they have the fewest paid days (annual average of 26 days). There is a significant senior officer overhead. The opportunity cost of current arrangements is large - the annual expenditure on Reserves is greater than the total budget of 2/1 RNZIR – the RF Light Infantry Battalion at Burnham. The Outputs of the NZDF and options for Government would be considerably enhanced if expenditure were shifted from Reserves to the establishment of a second Light Infantry Battalion.
- There is a low uptake of Reserve (TF, NVR, Air TF) service on departure from the RF. Personnel leaving the RF have valuable skills that could and should be accessed via alternate arrangements.





Note: Rata deployments 4 months duration for TF vs. 6 months for RF. Equivalent if all RF would have been 38 for RATA, 68 for all ops.

C2.5 Reserves

VfM Recommendations

- Ensure that all TF activities are directly aligned with Government outputs. If current efforts in ceremonial, civil defence, community support and youth development are required, then explicitly recognise then as separate expense classes in the SOI and fund them accordingly.
- NZDF should restructure the NZDF workforce by using part-time, uniformed staff to generate and sustain capabilities that it is either not cost effective nor practical to generate through full time uniformed personnel. Examples where this could be applied include:
  - medical specialists – surgeons, anaesthetists, etc
  - trades – carpenters, plumbers, electricians etc
  - certified engineers
  - linguists
  - musicians.
- Part-time military personnel would replace the current NVR, TF and Air TF and give CDF and the Service Chiefs the flexibility to engage part time uniformed personnel with the skills that NZDF requires to deliver outputs.
- Discontinue the current structures of NVR, TF and Air TF. Divest of properties not required for other purposes and disestablish cadre (RF staff who facilitate and assist with management of Reserve activities) positions.
- NZDF should review how to most cost effectively generate the capabilities needed to meet SOI and Output Plan requirements.
- Part-time military personnel should be integrated into RF units and formations responsible for delivering those outputs – not a separate part of the NZDF with its own units, command or policy hierarchy.
- If it is decided that, for other Whole of Government reasons ,the NZDF should continue to maintain NVR, TF and Air TF (regardless of whether or not they are categorised as *Reserves*), then the outputs that they are required to produce should be made explicit in a separate Output Expense Class covering all Whole of Government activities to be undertaken.
- The name *Reserve* should be reconsidered. The NVR, TF and Air TF are not Reserves – they are part-time uniformed members of the NZDF.

C2.5 Reserves

Potential Savings

- $33 million per annum in operating expenditure.
- An estimated, one time release of capital of circa. $26.6 million if all properties are sold. Some facilities are multi-purpose and also house IEDD response teams or recruiting so may not be saleable or require construction of or relocation to alternate facilities.
- Additional 2nd and 3rd order savings, particularly in Army, if no requirement to maintain TF Trades and training.
- Further work required to identify the number of NVR, TF and Air TF who could transfer to part-time military personnel status and the ongoing associated costs.

C2.6 Military Recruitment

Description of the VfM Area

- The recruitment of military personnel.

Existing VfM

- NZDF is evolving from a single Service recruitment model to a pan NZDF approach.
- NZDF is adopting an increasingly comprehensive approach to recruitment and has already identified annual savings of $3 million rising to $3.5 million per annum.
- The exact savings opportunity will not be known until a fully integrated model is up and running.
- Defence force recruitment has some unique characteristics that makes benchmarking less than straightforward. However, against best commercial practice, the NZDF operation is considerably (over 10 x per recruit) more costly and labour intensive.
-

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Benchmarking

Benchmark	NZDF Now	Corporate	Corporate
Cost/Recruit	$16,500	$1,433	$ 3,141
Recruit Cost/Total Cost	1.4%	1.9%	
Recruit FTE /total FTE	1:102	1:918	1:1882

Benchmark	NZDF Past	NZDF Now	2013/2014 Target
Cost per recruit	Not tracked	$16,500	Reduce by $3,000
Cost of Recruit function	$22 million	$20 million	$17 million
Recruiting FTE	118	118	?

C2.6: Military Recruitment

Pacific Road Corporate Finance

VfM Recommendations

- Develop a pan NZDF recruitment strategy and reorganise the Recruitment function to support this strategy.
- Introduce online applications, candidate management system and skills database. This will require IT investment and should be part of the HR IT Project.
- Reduce advertising expenditure through an online and digital strategy.
- Develop a strategy to involve a broader number of NZDF personnel in recruitment activities. – recruitment should not just be the responsibility of the recruiters.
- Rationalise recruitment research and remove duplication and triplication across the three Services.
- Consider the ADF outsource model and pay an external service provider a fixed fee once recruit successfully passes initial recruit training.

V M Conclusions and Savings

- A 15% reduction in recruitment costs has already been identified. This is a useful first step but is still well short of best commercial practice.
- An outsource model would likely identify a further 10% to 15% in annual savings. This will need to be verified so has not been included in the VfM savings.

C2.7 Health Services

Description of the VfM Area

- NZDF health **services** fall into 3 categories:
  - Domestic health;
  - Organic medical support; and
  - Deployable medical capability.
- There is a Navy hospital at the Devonport Naval Base with a surgical and hyperbaric capability.
- There are medical facilities at Linton together with the Army's Health command
- All military personnel are entitled to medical and dental services as part of their total remuneration package.

Existing VfM

- Some outsourcing of services, particularly in Wellington and Woodbourne.
- More efficient purchase of pharmaceuticals is underway.
- A surgical review panel has put in place to ensure consistency and relevance of outsourced procedures.
- A decision has been taken in principle to close the Devonport Hospital.

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Benchmarking

Benchmark	NZDF
Domestic health cost/FTE	$2,900 to $4,900
No. visits/FTE/year	5 to 13
Total cost for health	$50 million

Target Savings

	Year 1	Year 2	Year 3 +
Contract out domestic health + closures	$3 to 4 million	$5 to $7 million	$8 to $14 million
Reorganise organic health and deployable capability		$2 million	$2 million + (dependent on policy settings)

C2.7 Health Services

VfM Conclusions

- Provision of health services is disconnected from the outcomes required and there is evidence of over-servicing with health services seen as a free good by patient and provider.
- Internal controls and acquisition of health services within NZDF is widely dispersed.
- NZDF facilities are poorly utilised with few opportunities to improve utilisation by making those facilities available to third parties. The AME facility is unlikely to be VFM.
- There is no NZDF-wide strategic plan for health services and there are a large number of external service providers.
- In certain critical medical and surgical areas, NZDF struggles to meet deployment demands.
- There is little awareness within NZDF of what health services need to be provided and how best to provide those services.

Recommendations and Savings

- Outsource all domestic health services, subject to the condition that the providers facilitate the secondment of NZDF personnel to provide training and maintenance of skills.
- Domestic health services only to exceed standard public provision when there is an operational imperative.
- NZDF health services to be managed within a single, integrated command.
- Close uneconomic and unnecessary health facilities such as the Navy Hospital, the Hyperbaric Unit and strategic AME.
- There should be a specific Output class for health services identifying future needs and funding,

C3 Education and Training

Pacific Road Corporate Finance

C3 Education and Training

Description of the VfM Area

- This VFM category includes all individual training from initial entry training through to voluntary tertiary study funded by NZDF but does not include collective training.
- The 2007 Baseline Review estimated the cost for the Education & Training function at $118 million. Total expenditure is now estimated at between $150 and $180 million.

Existing VfM

- Changes to Education & Training are being delivered under the DTP HR work stream.
- DTP has estimated Education & Training savings at $6.4 million per annum from FY 2010/11.
- The 2007 Baseline Review recommended a 10% reduction in Education & Training operating expenditure and a similar reduction in personnel involved in E & T delivery.
- No savings have been realised to date.
- A single, integrated NZDF Training Directorate was formed in early 2010.

Benchmarking

Benchmark	NZDF Now	Polytech/IT
Cost per FTE	$78,355	~ $10,000
EFTS/ total FTE	1:166	n/a
EFTS/T&E FTE	1.7	7 to 13

(EFTS = Equivalent full time students)

NZDF Training System capacity

	2008
Training capacity in FTE Students	4538
Utilisation in FTE Students	2042
Utilisation Rate	45%

s6(a)

C3 Education and Training

VfM Conclusions

- The NZDF training system has excess capacity and significant potential for improvement.
- The Baseline Review target of a 10% reduction of personnel and other operating expenditure is achievable based on benchmark data.
- This will be achieved by: reducing duplication in training design and delivery; exploring more cost efficient training delivery methods; critically examining where NZDF is over-training (more than is required to deliver outputs); greater use of simulation (this would also apply to collective training), in-sourcing and outsourcing on the basis of cost efficiency rather than choice and reviewing the levels of voluntary tertiary study support provided.

VfM Recommendations

- Establish a 2010/2011 Education and Training baseline and within three years achieve 10% cost reduction against that baseline.
- Benchmark against other Industry Training Providers, Wananga and Universities to give NZDF a better understanding of current performance and where improvements can be made.

VfM Savings

- Over and above what has already been identified by NZDF,, there is an opportunity to save an additional $10 million per annum by FY2012/2013 and still be below the original 10% savings target.

Potential Savings

	2010/11	2011/12	2012/13	2013/14	2014/15
	$million	$million	$million	$million	$million
DTP	6.4	6.4	6.4	6.4	6.4
Baseline Review*	11.8	11.8	11.8	11.8	11.8
VfM (Low)	Phasing TBD	Phasing TBD	15	15	15
VfM (High)	Phasing TBD	Phasing TBD	18	18	18

* Based on 2006/07 expenditure levels

C3 Education and Training – Case Study

A VfM Education and Training Opportunity

- Project Management training is where NZDF can make significant VfM gains. This would required adopting a common methodology and training framework and centralising control of training management and delivery.

Status Quo

- Project management training is conducted by all three Services on an ad hoc basis with external training service providers engaged directly to deliver training, coordinated through NZDF's Planning Branch.
- The adjacent table illustrates courses NZDF personnel have recently attended. In addition, individuals are undertaking project management papers as part of directed or voluntary tertiary study and at least one Army facility teaches it as part of trade training.
- No formal effort made to identify and engage preferred service providers.
- The cost of project management training is growing and was $845,000 in FY 2008/2009.

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C3 Education and Training – Case Study

Pacific Road Corporate Finance

A VfM Education and Training Opportunity

VfM Opportunity

- VfM can be improved by:
  - Conducting a training needs analysis to determine NZDF's Project Management requirements.
  - Training to meet international good practice standards, and
  - Contracting out to a national training provider or adopting an in-house delivery model depending on which is more cost efficient.
- Savings of $350,000 per annum, based on in-house delivery, have been identified.
- It is expected that similar opportunities will be available in other Education & Training areas.

C4 Non-Military Procurement

Pacific Road Corporate Finance

C4 Non- Military Procurement

Description of VfM Area

- This VfM area comprises the acquisition of certain products and services that are not capital in nature and do not involve military equipment or inventory.
- In FY 2009/2010 NZDF spent approximately $620 million on such products and services.
- Responsibility for procurement of these products and services is currently spread between JLSO, DLC, CIS and the Services. JLSO's prime responsibility is the acquisition of commodities such as travel, utilities, fuel and oil, i.e. products that are universally available on a national base and can be sourced from a variety of service providers. It is estimated that JLSO procures 50% of NZDF's products and services.
- DLC has assumed responsibility from the Services for strategic sourcing (i.e. munitions, parts, rotables and other items required for force elements). It is estimated that total expenditure on strategic inventory is a little under 50% of total non military procurement.
- CIS procures communications equipment, computer hardware and software and IT services.

VfM Methodology

- VfM opportunities were focused on products and services representing , in value terms, 75% of the products and services being acquired by NZDF.
- Apart from their significance, these product groups were selected because the Pappas Report on the ADF had found significant potential for cost savings.
- Deep dives were undertaken on these cost elements. For other products and services, the results of the deep dives were extrapolated by applying target savings ranges.

C4 Non- Military Procurement

Existing VfM

- NZDF agreed in March 2010 to a target of $10.6 million for non military procurement savings, including contractors and consultants. $6.4 million was allocated to non military procurement.
- The DLC Investment Case contained annual savings of $24 million for strategic and commodity products although the original case had savings that were significantly higher.
- Given the dispersed nature of procurement within the NZDF, optimising savings in this area will be difficult.
- JLSO has successfully negotiated a range of savings. Examples include catering where costs have reduced by $4.2 million through better understanding of costs and improved cost recovery.
- In other areas, NZDF has imposed a top down approach to savings.

VfM Case Studies

- NZDF pays for 3248 cell phones or 1 for every 3.7 staff.
- Domestic travel analysis shows savings in some area but significant growth in others.
- Significant “off-contract” spending is still occurring presumably at less favourable rates and incurring higher transaction costs.
- Clothing expenditure per FTE is high by comparison with benchmarks.

Number of FTE per cellphone	3.7
Most cellphones with any one individual	4
Top 5 Highest Monthly call charges	$868-$1298
Travel and Accommodation spend per FTE	$2,991
Clothing Expenditure per FTE	$2,186

Pacific Road Corporate Finance

C4 Non- Military Procurement

VfM Opportunities

- There are savings opportunities on the supply (i.e. negotiating better rates by using NZDF's buying power)and the demand side (i.e. reducing usage while limiting contract leakage i.e. buying outside contract).
- On the demand side, savings will be best achieved by adopting a cost down approach, that is agreeing on a savings target and removing the annual targeted amount from budgets.
- There needs to be a firm sanction on purchasing outside contract.

s6(a)

Other Operating
Fares, Travel, Allowance & Accomodation*
Fuel & Oils
Utilities
Publications and Stationary
Professional Services
Clothing
Food, Commercial Catering and Entertainment
Office Furniture, Fixtures and Fittings
Postage and Courier
Telecommunications
Insurance
Equipment Rental
Maint of Camps & Bases - Plant & Equipment
Works Maintenance - Property
Mechanical & Electronic Components
Materials - General including Ammunition

s9(2)(b)(ii)

* While a $6 million reduction was agreed by ELT , we do not see it reflected in the FY 2010/11 budget so have included it as a savings target.

C4 Non- Military Procurement

VfM Savings

- Savings ranges in expenditure categories where significant analysis was undertaken (marked in green above) and extrapolated across other items, indicates an annual savings range of $15.6 million to $28.9 million over and above what has been required by NZDF already
- The low end of this range has been used in the VfM savings analysis with $5 million of these annual savings being allocated in the Savings Spreadsheet (Appendix IX) to Logistics.
- $15 million in annual savings equates to 5% of total annual expenditure indicating scope for further opportunities.

VfM Recommendations

- Remove an additional $10 million immediately from the FY 2010/2011 Budget and a further $5 million from FY 2011/2012.
- CDF to make it clear that there will be no procurement outside negotiated contracts.
- NZDF to target achieving not less than 5% savings, relative to FY 2009/2010 actual expenditure, by the beginning of FY 2012/2013.

NZDF Media Release on syndicated rations procurement

Media Release
Kōrero
THREE SERVICES AS ONE FORCE - BEING THE BEST IN EVERYTHING WE DO

15 June 2010

The Defence Force and the Department of Corrections have combined their buying power to deliver better value food stuffs for their organisations. The meals themselves may be different, but the savings are better for everyone.

The Defence Force and Corrections spend in excess of $20 million annually between them on what they refer to as rations – the raw ingredients like flour, milk, and eggs used in menu items for military personnel – and in the case of Corrections, prisoners.

Through the new rations procurement contract with Bidvest NZ Ltd both the Defence Force and Corrections are able to obtain better prices on products they buy, while maintaining the levels of service they need, as well as achieving administrative efficiencies.

The new rations procurement contract is somewhat unusual in that it's been negotiated across two ordinarily separate government departments.

Forming what's known as a "purchasing syndicate" between government departments is being encouraged by the Government to help public funds go further, instead of each organisation negotiating individual contracts.

In this case, the collaborative approach of the Defence Force and Corrections has delivered a reduction in food costs. That this has been achieved in an environment of rising costs demonstrates the power of the purchasing syndicate says Corrections Chief Executive Barry Matthews and Chief of Defence Force Lieutenant General Jerry Mateparae.

"Teaming up with other organisations with similar procurement needs translates into larger bulk ordering at a lower per item cost," says Mr Matthews. "The result is an increased level of savings for everyone – with no decrease in the quality of goods and services purchased."

In the new rations procurement contract, there will also be additional improvements in process and performance says Chief of Defence Force Lieutenant General Jerry Mateparae.

"Our catering people will have an on-line planning tool to coordinate menu planning, nutritional analysis, and stock ordering," he says. "This is consistent with a drive across the Defence Force to not only deliver better value for money but also to deliver simpler and better support services to our people. I am pleased that our award-winning chefs will now be included in this initiative."

Pictured left, Bidvest NZ delivers goods to HMNZS CANTERBURY.

Pacific Road Corporate Finance

C5 Logistics

Pacific Road Corporate Finance

C5.1 Summary

Description of the VfM Area

- NZDF's Logistics function comprises the following:
  - Supply chain - transportation, distribution, warehousing, and inventory; and
  - Maintenance, engineering and technical assurance of military platforms and capability.

- Supply chain and maintenance comprises:
  - Forward logistics and maintenance, i.e. all logistics and maintenance activities directly associated with front line operations and/or in support of force elements or potential force elements; and
  - Depth logistics and maintenance, i.e. all other logistics and maintenance activities.

- The NZDF Logistics function is primarily undertaken "in house." There are limited examples of contracting out including:
  - The VTF Dockyard Management contract at Devonport;
  - NZDF clothing contract with YASL;
  - Freight, transportation and courier services with Mainfreight, DHL and Courier Post;
  - Certain depth and forward logistics and maintenance at Waiouru and Trentham (NZ Army and Lockheed Martin); and
  - The Safe Air and RNZAF Aircraft maintenance contract.

- Estimated annual operating expenditure on Logistics is $620 million or 33% of NZDF's total operating expenditure. There are approximately 4,100 FTE involved in delivering Logistics or 1 in 3 NZDF personnel.

C5.1 Summary

Existing VfM

- NZDF initiated a Logistics change programme in 2007 with a view to creating a "simpler and better" Logistics function. An Investment Case process (with assistance from Deloitte) commenced in November 2008 and was completed in December 2009.
- Two options were presented to NZDF's Executive Leadership Team, namely:
  - ➢ A single, integrated Logistics Command, consolidating the disparate logistics organisations throughout NZDF; and
  - ➢ Retention of a distributed Logistics structure but with common processes and close alignment between the three Services. In this option, control and management of the Logistics function remained with the Services.
- NZDF opted in June 2009 for an integrated Defence Logistics Command ("DLC") but resolved to retain forward logistics and maintenance within the Services. As a result, only 1,800 of the 4,100 FTE were to transfer to DLC with effect from 1 July 2010.
- The initial DLC Investment Case identified savings of $413 million over a ten year period, commencing in FY 2009/2010 and reaching a "peak" of $50 million per annum in FY 2013/2014.
- The bulk of the projected savings were to come from headcount reduction, reduced strategic sourcing expenditure and better inventory control.
- The Investment Case assumed that $53 million would need to be spent, over three years, the largest proportion ($35 million) being capital expenditure associated with a proposed upgrading and pan NZDF application of the SAP Logistics functionality and processes..

C5.1 Summary

Initial Investment Case

Benefits ($ million)	**FY 09/10**	**FY 10/11**	**FY 11/12**	**FY 12/13**	**FY 13/14**	**10 Yr Totals**
Strategic Sourcing: 3rd Party Spend (Opex & Capex)	($5.1)	($14.2)	($17.3)	($20.3)	($20.3)	**($178.7)**
Inventory Reduction: Ammunition (Cash Flow)	($6.0)	($6.0)	($6.0)			**($18.0)**
Non-ammunition (Cash Flow)		($8.8)	($8.8)	($8.8)	($8.8)	**($44.0)**
Education & Training - Log			($2.7)	($4.4)	($4.4)	**($33.9)**
Personnel	($1.0)	($2.3)	($8.8)	($7.8)	($11.2)	**($87.2)**
3rd Party MRO				($1.5)	($1.5)	**($10.6)**
Other Savings	($0.5)	($0.6)	($1.1)	($2.6)	($4.2)	**($40.5)**
Total Savings	**($12.6)**	**($31.9)**	**($42.4)**	**($45.5)**	**($50.5)**	**($412.9)**

- In November 2009, NZDF reconfirmed its commitment to the DLC structure but, consistent with a decision that applied to all DTP Programmes, resolved to target 80% of the identified cost savings in the Initial Investment Case with 75% ($40 million) of the expenditure previously required to deliver the savings.
- Targeted savings reduced from $413 million to $334 million with an annual "peak" in FY 2013/2014 of $41 million.
- The major areas of reduced savings were:
  - A decrease in the number of personnel transferring to DLC (1100 down from 1800 FTE) and therefore reduced headcount reductions- $40 million of the savings differential;
  - A transfer of $20 million of the Education & Training savings to the HR DTP programme; and
  - The removal of other areas from DLC such as Health Services.

C5.1 Summary

Pacific Road Corporate Finance

VfM Conclusions

- Implementation of DLC and the transfer of people has been delayed relative to the timeline in the original June 2009 Investment Case. Projected savings in FY 2009/2010 did not eventuate and FY 2010/2011 savings will be much lower than projected in the Investment Case.
- NZDF should follow the trend of other Defence organisations and include some forward logistics and maintenance within DLC. This would open up additional savings opportunities (from including most of the 2,300 FTE currently outside DLC) and facilitate future contracting out.
- There should be a single Centre of Excellence within NZDF and the Ministry of Defence for the procurement function. DLC is the most appropriate place for this procurement function. The JLSO procurement function should be part of DLC.
- DLC has control of c. 50% of non military procurement and strategic sourcing expenditure with the balance split between JLSO, CIS, the Services and MOD. Based on annual procurement expenditure (other than on capability) of $620 million, peak annual savings of $24 million or 3.3% is highly conservative relative to the 10 to 15% savings identified in the Pappas Review of the ADF's procurement activities.
- The timing of the Lockheed Martin contract with NZ Army was unusual given the imminence of DLC. However, the performance incentive features of the Lockheed Martin contract, while yet to be implemented, may provide a potential template for future contracting out of the Logistics Function.
- Data accuracy continues to be a major problem. Inventory information is almost certainly incomplete and does not capture total inventory value.
- During an analysis of FY 2009/2010, significant (40% of value) incorrect coding was identified.
- Other than a small amount required to run the DLC set up, none of the DLC savings nor the operating and capital expenditure required to achieve those savings have been included in the 2 year Resources Plan.

C5.1 Summary

VfM Opportunities and Savings

- A number of the savings categories identified in the DLC Initial Investment Case are dealt with specifically elsewhere in this report but are referred to in this slide for completeness and to identify potential duplication.

- Examples of this are: procurement headcount reduction; non military procurement savings; civilianisation of a number of uniformed DLC personnel; education & training expenditure and health services.

- The Initial DLC Investment Case included a savings High Case target of $530 million over 10 years or approximately 9% of Logistics annual expenditure compared with the more conservative target of $412 million (8%), since reduced to $340 million (7%).

- The DLC Investment Case stated that: "*Option 1b (the DLC Option) has the potential to deliver appreciably more cost savings over time, but there are implications for the structure of the NZDF and the responsibilities of the Service Chiefs.*"

- Consistent with this, the $530 million target is considered very achievable conditional on: the necessary operating and capital expenditure needed to deliver these savings being committed to, the procurement process across NZDF and the MOD being consolidated within DLC and the proposed Manawatu and Auckland Logistics hub concept being implemented. The VfM % savings are in line with what is being targeted and achieved in other Defence Forces and in leading commercial organisations.

- There are still further savings possible (although not included in the VfM target), amounting, potentially, to 15% of current Logistics expenditure, from:
  - Integrating most of forward logistics and maintenance activities under DLC; and
  - More contracting out to the private sector which might also involve ownership transfer of certain logistics and maintenance facilities and warehouses, where this makes sense.

- The relative levels of annual savings are provided below:

Savings ($ Million)	FY 2009/2010	FY 2010/2011	FY 2011/2012	FY 2012/2013	FY 2013/2014	10 Year Total
Agreed ELT Case	$7.4	$30.0	$36.3	$41.2	$41.2	$333.9
VFM Case	$0	$10.0	$32.0	$51.0	$57.2	$530.0
Stretch Case						$650.0

C5.2 Inventory

Description of the VfM Area

- NZDF's Inventory holdings total approximately $460 million and comprise:
  - Munitions inventory of c. $134 million;
  - Non munitions inventory of c. $236 million; and
  - Other inventory of c. $70 million to $90 million which has been expensed and is most likely to be non munitions.

- As part of the inventory optimisation project, initiated as part of the Initial DLC Investment Case, a 21% reduction of non munitions inventory and 13% of munitions inventory was targeted.

- Obtaining precise inventory information is difficult because:
  - Expenditure leakage , i.e. expenditure outside the DLC and JLSO structures;
  - The lack of clarity around working capital budgets and the inventory component of capital purchases;
  - Poor IT systems;
  - The challenge of reconciling rotables; and
  - Inconsistent accounting treatment of inventory,

Existing VfM

- Inventory management within NZDF is now the responsibility of DLC.
- The initial DLC Investment Case identified $62 million of inventory reductions over 3 to 5 years comprising $44 million of non munitions inventory and $18 million of munitions inventory. This equates to a 17% reduction when compared to NZDF inventory valued at 31 December 2009 or 13%, if the estimated expensed inventory is included. The NZDF targets were drawn from the UK MOD Defence Equipment Supply Project.
- The $62 million target is common to all investment cases.

C5.2 Inventory

VfM Conclusions and Savings

- Through the establishment of the DLC and the Munitions Management Organisation, consolidating the existing activities of the Services and seeking to put in place Service Level Agreements between the DLC and the Services, NZDF has established an appropriate organisational construct to achieve its reduced inventory targets.
- Significant challenges remain with respect to accurate information collection, appropriate accounting treatment and coding, specific obsolescence provisions and the consistent application of those provisions.
- The recent Pappas Review of ADF concluded that Inventory could reduce by between 15% and 17% which equates to between $69 million to $79 million for the NZDF. On this basis, there may be potential for NZDF to reduce inventory by up to a further $10 million over 10 years.

C5.3 Strategic Sourcing

Description of the VfM Area

- NZDF spends approximately $620 million per annum with third parties on products and services including capital items with a value of less than $7 million. An additional $300 to $400 million per annum is spent on or committed to capital items (primarily military platforms) with a value of greater than $7 million.

- Procurement (excluding major capital items) is undertaken in a variety of different places within NZDF including:
  - JLSO;
  - CIS Branch;
  - DLC; and
  - The three Services

- The intention is that all procurement undertaken by the Services will transfer to DLC. Currently, approximately 50% of NZDF's procurement is undertaken by DLC with most of the balance being carried out by JLSO.

Existing VfM

- All strategic sourcing will be the responsibility of DLC but the procurement of commodities such as travel, office supplies, utilities, fuel and contracting for Property/Base management and maintenance remains with JLSO. Due to the latter, 200 less FTE transferred to the DLC.
- The agreed DLC Investment Case projected "peak" procurement savings of $20 million per annum and $178 million over 10 years. This equates to 3% of total NZDF annual procurement.
- The DLC Team initially identified procurement savings of 5% to 6% per annum or $36 million per annum but this was not included in the final DLC Investment Case, Even this higher case falls short of the 10% to 15% savings identified in the Pappas Report on ADF procurement.
- JLSO has already targeted annual savings of $10 million per annum in the commodities (non military) procurement area, which leaves $10 million per annum for strategic sourcing procurement savings.

VfM Conclusions and Savings

- Procurement cost savings of 3% are conservative. Savings between 6% ($40 million per annum) and 8% ($50 million) are achievable and are in line with what has been targeted by the ADF and being achieved by recent Corporate procurement transformation programmes .
- Critical to achieving the higher level of savings will be the creation of a single, integrated Procurement Group responsible for all NZDF and most of the MOD's acquisition activities.
- Projected savings are as follows:

Savings($ million)	FY 09/10	FY 10/11	FY 11/12	FY 12/13	FY 13/14	10 Yr Totals
Agreed ELT Case	$5.1	$14.2	$17.3	$20.3	$20.3	**$178.7**
DLC Upside Case	$5.1	$20.0	$28.0	$36.0	$36.0	**$288.0**
VfM Case *	$5.1	$20.0	$35.0	$45.0	$45.0	**$360.0**

* The VfM Case depicts total procurement savings but c. 50% of the savings are captured in the Non Military Procurement Section of this report.

C5.4 Supply Chain

Description of the VfM Area

- The Supply Chain component of logistics support comprises:
  - Transportation;
  - Distribution; and
  - Warehousing.
- It excludes:
  - Inventory management; and
  - Strategic sourcing.
- More particularly, this logistics area encompasses:
  - The transportation of parts, rotables and other inventory to warehouses;
  - The distribution of parts, rotables and inventory within NZDF, more particularly from warehouses to Logistics and MRO locations and to on board vessels; and
  - Day to day management of warehouses and armouries.

Existing VfM

- A national freight contract with Mainfreight is in place.
- DLC envisages integrated, depth logistics with warehousing and distribution associated with forward logistics (and MRO) remaining within the Services.
- DLC further envisages Logistics activities being based around two hubs – one in Manawatu (most likely Palmerston North) and the other in Auckland.
- The DLC Investment Case envisages significant FTE reductions and property management and maintenance savings based on this consolidation which also relies on significant SAP upgrades.

C5.4 Supply Chain

VfM Conclusions and Savings

- There are further opportunities for cost savings, in addition to the projected 133 FTE reductions based on:
  - Transferring a significant number of uniformed DLC personnel to Civilian remuneration structures;
  - Creating a single, integrated Procurement function within DLC; and
  - Including a portion of forward logistics within the DLC.

- Additional savings from these initiatives are referred to in the Civilianisation and Logistics Summary sections of this report.

C6 Platforms and Capability

C6.1 Land Combat – NZLAV III
C6.2 B Class Vehicles
C6.3 Strategic Air Transport - B757's
C6.4 Airfield Operations
C6.5 NZDF Maritime Capability
C6.6 NZDF Air Capability
C6.7 CL Vehicles
C6.8 Capital Programme Minor
C6.9 Non Military Taskings
C6.10 Operational Tempo

C6.1 NZLAV III

Description of the VfM Area

- NZDF acquired 105 Light Armoured Vehicles from General Motors (Canada) for protected, motorised land combat operations (104 operational vehicles including three recovery variants).

NZDF Operational Requirements

- Despite 105 vehicles being acquired requirements have changed.
- The revised operational force structure indicates that a maximum of 88 vehicles (including the recovery variants) would be required in support of a Combined Arms Task Group.
- The remaining 16 vehicles would comprise a mix of those necessary to meet combat and combat attrition and modification to other variants (e.g. Ambulance, C2). This would permit the vehicle fleet to endure a service life out to 2029 provided generational upgrades to maintain capability are undertaken

Benchmarking

NZ Army has critically reviewed the requirement for motorisation and protected mobility and established that current number of vehicles is in line with information within the ABCA fraternity

C6.1 NZLAV III

VfM Conclusions

- The current LAV underutilisation results from there being no requirement to deploy large numbers of LAV in contemporary land combat operations. This situation is unlikely to change.
- In hindsight it is possible to make a case that too many LAVs were acquired but the force structures at that time were different.
- This fact led Deloitte and Lockheed Martin to claim that identified a 40% fleet size reduction (42 vehicles) was possible although no detailed analysis in support of that conclusion was undertaken.
- There may well be an opportunity to sell or lease surplus vehicles.
- The sale of a small number of vehicles may not, however, attract a buyer as the proposed number and age of vehicles do not provided sufficient critical mass to be of real value to a military force. Furthermore, the sale value per vehicle is likely to be well below what was originally paid for the vehicles.
- Lockheed Martin has indicated that it might be possible lease some of the vehicles (value of lease not known). It is possible that this may generate some modest revenue.

VfM Recommendations

- Until Government no longer requires the NZDF to be capable of deploying a protected motorised or composite Combined Arms Task Group (CATG), ownership of the LAV fleet should not change.
- NZDF should proceed with conversion of some vehicle to variants necessary to deliver the capabilities expected (e.g. ambulance and C2 etc) in the CATG.
- As an immediate measure, NZDF should place a number of vehicles in preservation and recognise that the ability of the NZDF to generate a CATG will be increased and may exceed currently agreed response times.
- Review the opportunity to proceed with a limited leasing option.

Potential Savings

- **Status Quo** - Savings will only be achieved through lesser maintenance and upkeep routines if vehicles are put into deep preservation
- **Sell some vehicles** – Relatively low market value and capacity to deal with attrition through damage is lost
- **Lease some vehicles** – Estimated return from lease not significant (approx 5 to 10% of CV).

C6.2 B Class Vehicles

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Description of the VfM Area

- The NZDF acquired a number of B Class Vehicles (M BENZ UNIMOG 1300L and 1700L) in the early 1980's to replace general purpose trucks.
- These vehicles (211 x U1300 including 15 ambulances and 464 x U1700L) were to support a deployed Brigade (comprising three Battalions). Since that time the Land Combat Force Structure has changed to meet the contemporary requirement to deploy a Combined Arms Task Group (up to one Battalion) (or smaller Task Groups, as required).
- The number of trucks may no longer be required.

Existing VfM

- The NZDF has commenced a project to replace the B-Vehicle fleet (*Land Transport Capability Programme; LTCP)* with an appropriate number of vehicles that will meet contemporary needs. The replacement vehicles should be progressively introduced over a five year period.
- The current U1700L fleet comprises:
  - 13 x U1300L ambulances; and
  - 410 x U1700L vehicles (Army and Air Force fleets)
- The proposed replacement fleet is likely to comprise no more than **237** vehicles.
- These vehicles would be designated for operational use and training. However an increasing amount of training will be conducted through simulation and utilisation of lower specification vehicles.

C6.2 B Class Vehicles

VfM Recommendations

- NZDF should move to dispose of vehicles excess to contemporary requirements and in advance of fleet replacement.
- Deloitte and Lockheed Martin believe that 78 vehicles are surplus. Divestment will reduce costs by between $0.57 million and $0.81 million and attract one off sale proceeds.
- NZDF should consider alternative ownership structures for the replacement fleet. Only those trucks likely to be deployed should remain in NZDF ownership.

VfM Savings

- Up to $0.81 million of cost savings from selling 78 vehicles.
- Sale proceeds – unknown value at this stage.
- At the time of replacement of the fleet, sell the remaining 400 trucks (one off sale proceeds) and put in place an alternative ownership structure for some or all of the vehicles accompanied by a whole of life fleet management and maintenance arrangement. There should be further savings (unquantified) from such outsourcing.

C6.3 Strategic Air Transport B757s

Description of the VfM Area

- Two B757 aircraft provide strategic military air transport operations, including aeromedical evacuation, support to Antarctic NZ, support services for Whole of Government and the community, VIP Transport, disaster relief and emergency response.

NZDF Operational Requirements

- NZDF requires a strategic air transport capability to support the deployment and sustainment of deployed forces and provide a response capacity for emergency tasks.
- This is presently delivered through the combined utilisation of five C130H Hercules and two B757 combi passenger/freight aircraft (currently reduced C130H capability due to LEP).
- The B757s are also used for VIP Transport, domestically and internationally.
- At the time the decision was taken to replace the 727s with the B757s, some consideration was given to alternative ownership structures, including sale and leaseback options. At the time, it was felt that ownership afforded greater control.

Benchmarking

Benchmark	NZDF
Cost/Flight Hour	$31,000
Flight Hours per aircraft per annum	700
Maintenance/ Opex	29%

s6(a)

Small Fleet	Large Fleet
$11,000	$15800
2700	4000+
	13%

C6.3 Strategic Air Transport B757s

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s9(2)(b)(ii)

VfM Conclusions

s9(2)(b)(ii)

- In purely financial terms, there are likely to be more cost effective ways of accessing strategic transport capability. However, selling the 757s, relying more on the C130s for strategic air transport tasks in support of deployed forces and acquiring other transport services from third parties such as Air New Zealand would reduce NZDF's flexibility. In such circumstances, a case can be made for the status quo.

C6.3 Strategic Air Transport: B757s

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VfM Conclusions

- NZDF has three realistic options:

  s9(2)(b)(ii)

  - Sale of the 757s, increased usage of the C130s and contracting other Strategic and VIP transport services from a different party such as Air New Zealand; or

  s9(2)(b)(ii)

- In terms of reduced operating costs for NZDF, the sale of the aircraft and the acquisition of certain Strategic and VIP Transport services from the likes of Air New Zealand would deliver the greatest VFM.
- Air New Zealand has advised that they would expect to be able to meet all NZDF's needs with the possible exception of certain freight services, flights to and from the Antarctic Continent and flying in or close to hostile environments.

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Description of VfM Area

- The NZDF owns three airfields and airbase facilities (Whenuapai, Ohakea and Woodbourne), although the full range of NZDF aircraft are only operated from two (Whenuapai and Ohakea). Woodbourne is the location for Safe Air and RNZAF's technical training centre

NZDF Operational Requirements

- The NZDF requires the capability to operate and maintain a range of operational and training aircraft from secure facilities. The preferred profile would be the capacity to operate from two separate airfields. One in the Manawatu and the second in Auckland.
- The NZDF requires the capability to operate and maintain a range of operational and training aircraft from secure facilities.
- There is a need to ensure the overall coherence with maritime forces for surveillance and patrol operations, the tactical air transport capability for Special Forces and the capacity to respond to emergencies with other agencies and organisations (e.g. ICRC) in and around New Zealand and the South Pacific region.
- The previous Government resolved in principle to close Whenuapai and to consolidate air operations to Ohakea. The current Government reversed that decision.

Expenditure

	Woodbourne	Whenuapai	Ohakea
Land Value	$12.5 million	$52.85 million	$12.57 million
Annual OPEX	$17.97 million	$36.77 million	$30.94 million
Annual CAPEX	$2.85 million	$3.83 million	$8.89 million
Fcast CAPEX		$59.88 million and additional infrastructure expenditure of $103.5 million FY 2013 to FY 2018	$126.07 million expenditure resulting from work authorised under *Project Takatini*

C6.4 Airfield Operations

VfM Conclusions

- Woodbourne is a training facility and that function can be relocated as can the Safe Air operation. The base could then be sold noting the potential iwi claim over the land (see separate slide on Woodbourne).
- Collaborative commercial arrangements with Auckland Airport would realise significant benefits at Whenuapai but may require collocation to be of real value (see separate slide on Whenuapai).
- There is an opportunity to consolidate Army and Air Force operations at Ohakea via a PPP structure (see separate slide on the PPP)

VfM Recommendations

- As part of the Ohakea consolidation, relocate the Ground Training Wing from Woodbourne to the 'Manawatu Hub' and Safe Air to Air New Zealand at Auckland or Christchurch
- Exit completely from Woodbourne and dispose of the base
- Negotiate agreement(s) with Auckland Airport to make best use of shared facilities and avoid costs of duplicating facilities at Whenuapai
- Keep under active review the option to co-locate with AIAL at its proposed northern runway

C6.5 NZDF Maritime Capabilities

Description of the VfM Area

- The NZDF maritime capability under review comprises: two *ANZAC Class* frigates, the fleet replenishment ship *Endeavour* and the military hydrographic ship *Resolution*.

NZDF Operational Requirements

- The Government requires NZDF to operate and maintain maritime forces that have the capability to secure the sovereignty of New Zealand and its resources, ensure freedom of manoeuvre, assist neighbouring island states in time of emergency and be prepared to participate in multinational maritime combat operations elsewhere.

	Frigate	Fleet Tanker	Survey Ship
Availability	NZ: 271 days AUS: 224	NZ: 242 days AUS: 329	NZ: 283 days AUS: 313 days
Utilisation	NZ: 67% AUS: 61 to 82%	NZ: 61% AUS: 90%	NZ: 65% AUS: 75%
Fleet	AUS has 12 frigates (eight ANZAC FFH) and more deployments	AUS has two ships and a greater level of deployments	AUS has two ships and provides significantly more hydrographic products

Data sourced from NZDF, ADF and Annual Reports

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C6.5 NZDF Maritime Capabilities

VfM Conclusions

- Favourable comment was received about the performance and professionalism of NZDF maritime forces assigned to multinational operations.
- Vessel availability is broadly consistent with other Western Defence forces despite those Defence forces having significantly larger fleets.
- Increased utilisation is a matter for the Government but any change could be expected to reduce cost per sea day but impact on through life costs and, depending on the additional requirement, require additional personnel.
- The Navy is delivering VfM but is under pressure from fiscal constraints.

s9(2)(b)(ii)

VfM Recommendations

s9(2)(b)(ii)

C6.6 Air Capability

Description of the VfM Area

- NZDF air capability comprises: up to five C130H Hercules, six P3K Orion surveillance and response aircraft and five SH2G Seasprite naval helicopters.
- The availability of both C130H and P3K aircraft has been reduced over the last four years owing to major delays in the life extension and upgrade programmes.
- The B757 aircraft have been reviewed separately.
- The Government is considering acquiring short range maritime surveillance aircraft.
- The Government has acquired NH90 helicopters to replace the Iroquois. Air Trainers are leased from Pacific Aerospace.

NZDF Operational Requirements

- The Government requires the NZDF to operate and maintain an air capability that ensures the security and sovereignty of New Zealand and its resources (Orion), has an appropriate airlift capacity (Hercules) and a maritime capability embarked in the naval combat, support and patrol ships; for operations at home, in the region and globally.
- These air capabilities are also to be ready to assist neighbouring island states in times of emergency and to be prepared to participate and support multinational combat operations elsewhere.

	C130 Hercules	P3 Orion	Seasprite
Availability	NZ: 84.4% AUS: 102%	NZ: 242 days AUS: 329 days	NZ: 100% AUS: 89%
Utilisation	NZ: 678 hours AUS: 454	NZ: 535 hours AUS: 403	NZ: 220 hours AUS: 212
Cost/Flying Hour	NZ: $18,800K AUS: $20,600 The C130J has a cost of $10,200	NZ: $25,100 AUS: $16,300	NZ: $33,100 AUS: $26,800
Fleet	AUS has 24 Hercules and four C17 strategic airlift aircraft and a greater level of deployments.	US has 19 aircraft and a greater level of deployments	Naval helicopter has 72.4% availability when operating from shore

Data sourced from NZDF, ADF and Annual Reports.
Benchmarking was limited to where the RNZAF and the RAAF operate similar aircraft.

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C6.6 Air Capability

VfM Conclusions

- Favourable comment was received from other Defence forces on the NZDF capability assigned to multinational operations worldwide.
- Aircraft availability is less than the ADF primarily due to a lower level of deployed operations.
- With respect to the Seasprites, where the provision of spares is a significant problem and availability and utilisation is below expectations, the equivalent ADF aircraft is cheaper to operate.
- Unless there is a realistic chance of significant improvement then, from a VfM perspective, early replacement of the Seasprites may be required.
- There is a material operating cost gap with respect to the Orions with is worthy of further investigation.
- Increased utilisation is a matter for Government. Any change would likely see reduced cost per flight hour but increased whole of life costs and the potential for additional personnel. But on the utilisation front NZDF is performing better than the ADF.
- It appears that the Air Force are delivering VfM but under pressure from fiscal constraints, exacerbated by a reduced number of C130 and P3 airframes which is impacting on costs while increasing per aircraft utilisation.
- Some ILM and most depot level maintenance is contracted out. There is a paucity of aviation engineering capability in NZ especially for large aircraft and complex systems. This capability is generally limited to the RNZAF and Air New Zealand (including Safe Air).
- Using the cost per flying hour for each aircraft, RNZAF maintenance expenditure and overall operating costs would appear to be comparable.
- The C130J is cheaper to operate than the C130H.

VfM Recommendations

- Review the ability of the NZDF to maintain the naval helicopter capability with the Seasprite, with the limited spares and consumables available, until the end of service life and consider if a less expensive replacement aircraft should be sought earlier.

s6(a)

C6.7 Commercial Vehicles (CL Fleet)

Description of the VfM Area

- NZDF owns 536 commercial vehicles and leases a further 49. 25 of the owned vehicles are part of executive remuneration arrangements.
- The fleet is comprised of small, medium and large cars, vans, utilities and mini-buses.
- This is in addition to the military B Vehicle fleet covered elsewhere in this report.

Existing VfM

- NZDF agreed in May 2010 to reduce CL Fleet FY 2010/2011 operating expenditure by $150,000.
- However this is against a backdrop of a growing CL fleet.

VfM Conclusions

- While operating expenditure per annum is reducing marginally, the actual size of the fleet appears to have increased. Accordingly VfM appears to be deteriorating in terms of the number of CL vehicles to NZDF FTE (i.e. there is now 1 CL vehicle for every 21.5 NZDF FTE compared with 1:25 2 years ago.
- It is difficult to obtain reliable information on fleet size and, more importantly, fleet costs per vehicle. No usage data is available
- Deloitte identified a potential 20 to 40% fleet size reduction but this was based on total fleet size of 785 vehicles (it appears they included non CL vehicles in their analysis)
- Demand management does not seem effective and there has been no market testing of alternative forms of ownership.
- There appears to be little justification for the increase in CL numbers between January 2008 and now.
- The CL fleet is not VFM.

Benchmarking

Benchmark	NZDF (January 2008)	NZD (FY2009/10)
CL Fleet size	497	560
FTE / vehicle	24.8	21.5
FTE/Corporate vehicle		28.7
Average Fleet age		40 months
Annual km/vehicle		20,215km

C6.7 Commercial Vehicles (CL Fleet)

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VfM Recommendations

- Implement immediate fleet reduction of 10% (56 vehicles).
- Put in place a process to measure utilisation together with ongoing operating costs per vehicle and per vehicle kilometre
- Implement an ongoing process for measuring fleet operating costs and identifying variances.
- Once utilisation and costs can be accurately determined, proceed with a further reduction in fleet (assumed to be an additional 10%) and test the market to determine opportunities for a sale and lease back of the fleet. Target corporate benchmark = 440 vehicles.
- New vehicles should proceed by way of a sale and leaseback arrangement.
- Manage the CL fleet through the DLC.

VfM Savings

- A 20% fleet reduction would bring NZDF into line with corporate benchmarks. Annual operating cost savings would be $1.3 million.
- There is an opportunity to sell the fleet and lease it back for one off sale proceeds and reduced depreciation.

Potential Savings

	Investment Required	Opex	Capex
Savings achieved to June 2010	-	-	-
Savings Planned & in FYOP	-	$150,000	-
Savings – 10% fleet reduction	-	$667,450*	$360,000
Savings – 20% fleet reduction	-	$1,334,900**	$720,000

*Includes depreciation of $360,000 that may not be able to be retained

*Includes depreciation of $720,000 that may not be able to be retained

C6.8 Operational Tempo

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Description of the VfM Area

- *'Operational tempo'* is the rate of effort applied to all activities being undertaken or conducted by the NZDF from the most basic of training, through routine training activities to maintain core competencies, national sovereignty operations and responses to emergencies, to the roles, tasks and sustainment of deployed forces engaged in multinational military operations and on United Nations missions.

NZDF Performance

- Operating tempo of deployed operations is driven by the requirement to attain and maintain and have the core skills and competencies to operate safely and efficiently. These skills can take time to develop.
- NZDF is required by the Government to be capable of being ready to be employed on military tasks as directed.
- Force elements are held at a level of capability – DLOC - (required number of personnel, properly equipped and at a trained state) from which they can achieve operational status (OLOC) within a specified time and subsequently deployed to conduct specific military tasks.
- The competencies required for deployed operations are not generated in full until a force element is directed to make ready for an operation
- Concurrently with deployed military operations beyond New Zealand's national borders and resource boundaries, the NZDF is one of a number of Government organisations required to secure New Zealand against external threat, protect sovereign interests including the EEZ and be able to take action to meet likely contingencies in the region.
- The NZDF maintains an appropriate level of capability to meet these requirements from the capabilities developed through military training activities.

VfM Conclusions

- Operating tempo is governed by the roles and tasks required to meet the requirements of the Government.
- There is no ability unilaterally to reduce operating tempo.
- The operating tempo for sovereignty operations and non military tasking is equally non discretionary.
- Having reviewed operating tempo and preparedness there would only be potential savings if the Government accepted a greater Response Time (measured in months) for the deployment of forces. The potential savings would still be limited (unless the response time change was material) and there would be additional expenditure later as tempo increased or forces were called up for deployment.

C6.9 Capital Programme Minor

Description of the VfM Area

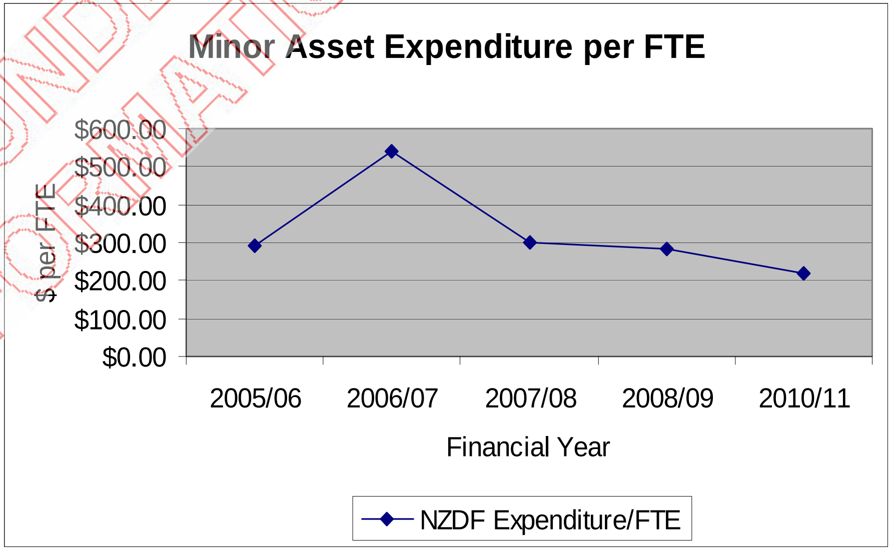
- This area covers minor assets purchased via the NZDF operating budget. It includes: office equipment; furniture and fittings and other minor assets. Although often considered part of this area, computer hardware is excluded and is dealt with in the ICT section of this report.

Existing VfM

- NZDF has been conscious of the need to reduce expenditure in this area in total and on a per FTE basis. Expenditure has been reducing and will reduce again in FY 2010/2011.

VfM Conclusions

- In times of financial constraints, organisations target the capital expenditure programme first and foremost. While NZDF has been a little slow to do this, the evidence is that this is now happening.
- Benchmarking suggests there are limited opportunities for additional VfM.
- Continued monitoring is required.



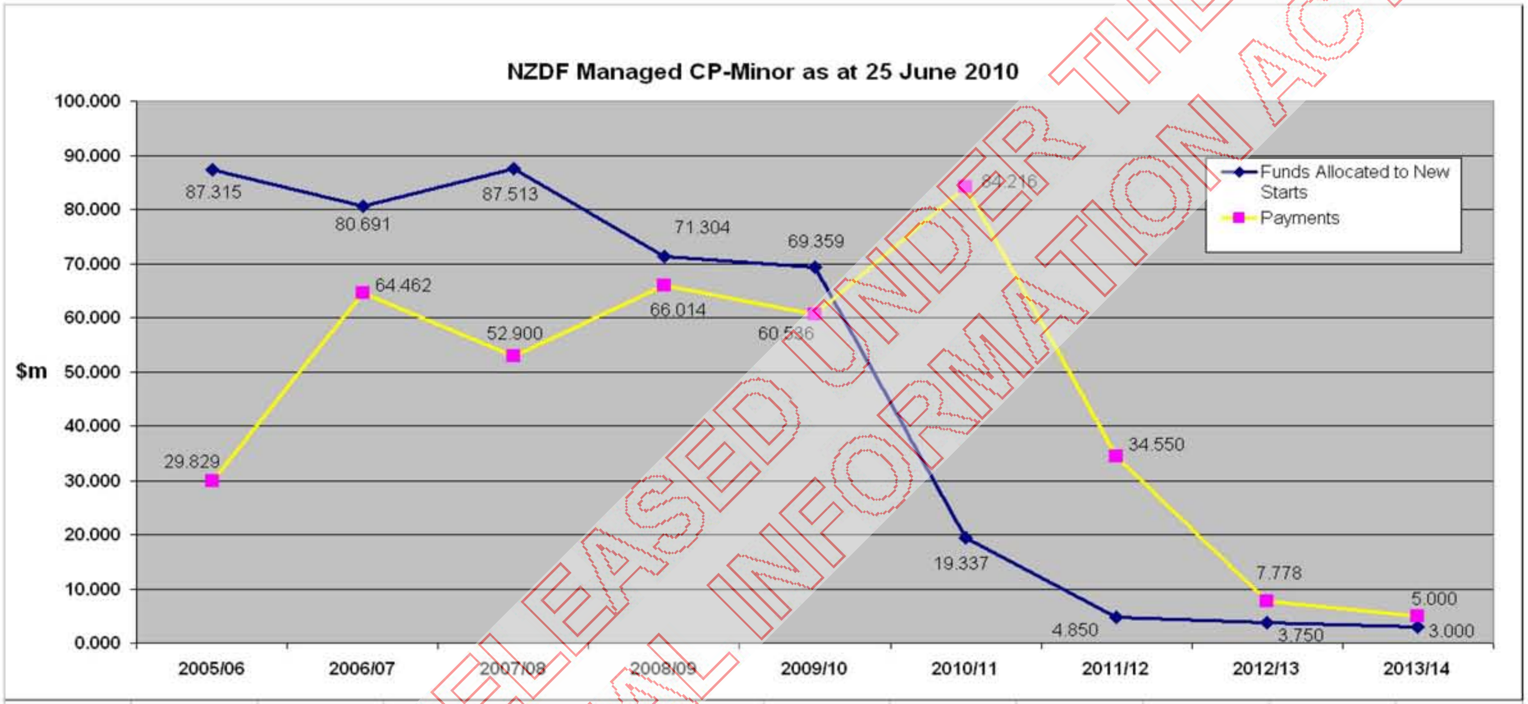
VfM Recommendations

- Ensure central management and oversight of the programme.
- Undertake monthly reviews by the ELT.
- Require formal CDF sign off of expenditure.
- Target expenditure at $200/FTE.

	Actual 2005/06	Actual 2006/07	Actual 2007/08	Actual 2008/09	Forecast 2009/10
Expenditure	$3,185,985.67	$6,023,905.52	$3,444,876.57	$3,465,727.82	$2,622,292.87
FTE	11,003	11,168	11,547	12,335	12,023
NZDF Expenditure/FTE	$289.56	$539.39	$298.34	$280.97	$218.11

C6.9 Capital Programme Minor

- As the chart illustrates, funding for Capital Minor projects peaked in 2007 then steadily declined
- The Defence White Paper will lead to a new capital programme. The funding path for Capital Minor projects is likely to pick up, but is not expected to return to levels similar to the 2005 – 2007 period.



Notes:	
1	The above represents CP-Minor new starts funding allocations and payments only in the period FY 05/06 to FY 09/10 (incl). A breakdown of all NZDF managed Capital project allocations during that period is at the attached spreadsheet
2	There are funding allocations post FY 09/10 as some projects appd in the period FY 05/06 to FY 09/10 have multi-FY funding approvals
3	With the exception of the CP-Discretionary and Vehicle Rolling Replacement Programme budgets no further funding allocations are forecast from the FY 10/11 CP-Minor
4	The current low funding allocation levels (FY 10/11 out) are not expected to last as the situation with regard to the CP-Minor budget post FY 10/11 will be clear following approval of Review 09 by Government
5	Payments do not relate exactly to funds allocated in a specific FY due to the lag between allocation to a project and payment (primarily caused by lack of NZDF resources, longer then forecast lead times and unforeseen work being discovered (particularly for software development and infrastructure projects)). Unspent project allocations are carried forward into the FY(s) that payment will take place.
6	Total Funds Allocated do not equal Total Payments, primarily, as some project underspends have been returned to the Reprioritisation Account (Capital)

C6.10 Non Military Tasking

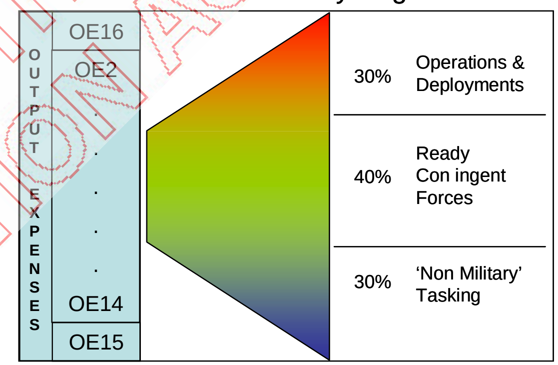
Description of VfM Area

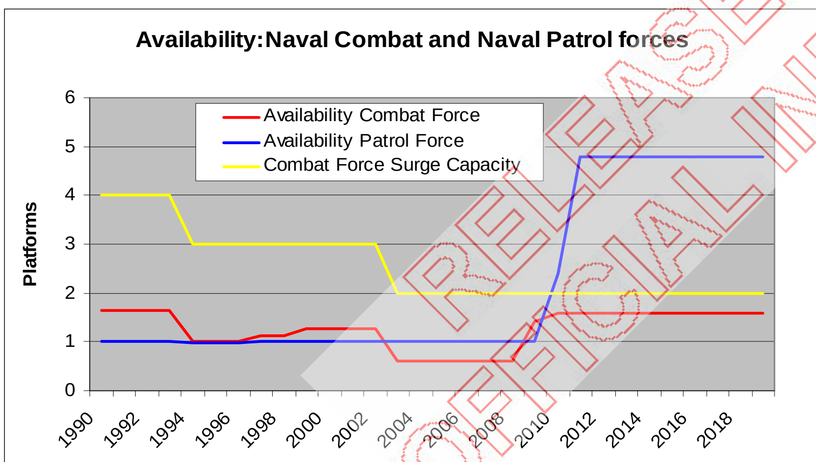
- The NZDF generates outputs in; Operations and Deployments; Readiness and Contingent Forces and as a service provider to other Government Departments;
- NZDF conducts activities in support of approximately 25 Government Departments from within the NZDF Baseline.

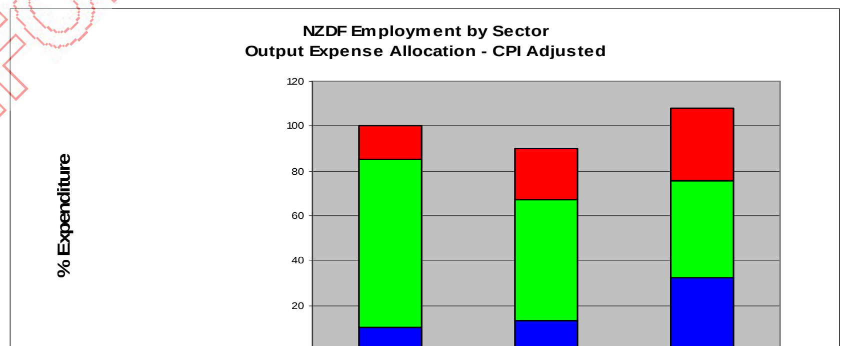
Existing VfM

- Project Protector delivered a five times increase in naval capacity for Whole of Government service provision;
- 30% of NZDF's outputs are allocated to non military matters compared with 10% in 1990; and
- This three fold increase has been accommodated despite modest increases in Defence expenditure. NZDF has still managed to meet its military and deployment objectives

NZDF Mission Delivery Segments







	1990	2000	2010
Ops & Deployments	15	22	32
Ready Contingent Forces	75	54	43
Whole of Government	10	13	32

C6.10 Non Military Tasking

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VfM Recommendations

- NZDF should be specifically recognised for its delivery in all three mission delivery segments;
- The NZDF Output Statement needs to be reviewed and the non military activities separately identified and funded;
- Within a fixed budget, extra requirements in one mission delivery segment reduces delivery in another. The Government needs to clearly identify its priorities where resource conflicts arise.
- While marginal changes in and between the three segments can be tolerated, significant increases or changes would demand step changes in operating costs and personnel; and

VfM Conclusions

- The use of the NZDF as a service provider for other Government Departments makes sense and represents VFM from a Whole of Government perspective;
- There are real operational benefit to the NZDF from these activities through training and combined Whole of Government and military/deployment activities;
- The NZDF receives insufficient recognition for activities in support of other Government departments and there is no transparency of these activities in the NZDF Outputs model
- The point has been reached where too much "non military" tasking is eroding readiness, deployments and operational capability and is compromising the achievement of optimal VFM in core military and operational areas.

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C7 Property and Real Estate

C7.1 Summary
C7.2 PPPs
C7.3 Whenuapai
C7.4 Woodbourne
C7.5 Accommodation Policy
C7.6 Defence Housing
C7.7 Property Maintenance

C7.1 Summary

Description of the VfM Area

- NZDF has 61 sites (see below) including nine major bases - Devonport, Whenuapai, Papakura, Waiouru, Ohakea, Linton, Trentham, Woodbourne and Burnham.
- Over the last 10 years, NZDF has closed two bases - Wigram and Hobsonville. To a large degree, this reflected the decision to not replace the air fighter arm.
- Some of the bases remain inappropriately located, require significant maintenance and upgrading (see below), are expensive to operate and lack modern facilities and infrastructure. NZDF faces very significant capital expenditure to make most of these bases fit for purpose.
- The Defence Real Estate Review, undertaken as part of the Defence Assessment, concluded that a modern NZDF required a "base" presence in three geographical areas, namely: Auckland; Manawatu and the South Island. In addition NZDF HQ would be based in Wellington.
- Consistent with this proposed geographical footprint, the previous Government decided in principle to close Whenuapai as an RNZAF base and to consolidate at Ohakea ("Project Takatini). The current Government reversed this decision.
- Capacity to rationalise bases has been constrained by a lack of capital and by the philosophy that NZDF needs to own and operate its bases.
- Furthermore, NZDF does not always have a free hand to deal with its bases as it deems fit. As with most Defence Forces, the closure of bases, often in local economies that rely heavily on the Base for employment and revenue generation, can be sensitive politically.

Sites per Service	Nth	Sth
Navy	12	2
Army	24	13
Air Force	7	3
Total per Island	43	18
Total Sites	**61**	

Benchmark Description	NZDF Past (2007)	NZDF Now (2009/10)	Future Planned Position (not achievable without redirecting resources)
Recapitalisation Rate	218 years	91 years	68 years
Average Age of Fleet		48 years	reducing
Ratio of Property FTE to total FTE		123:1	

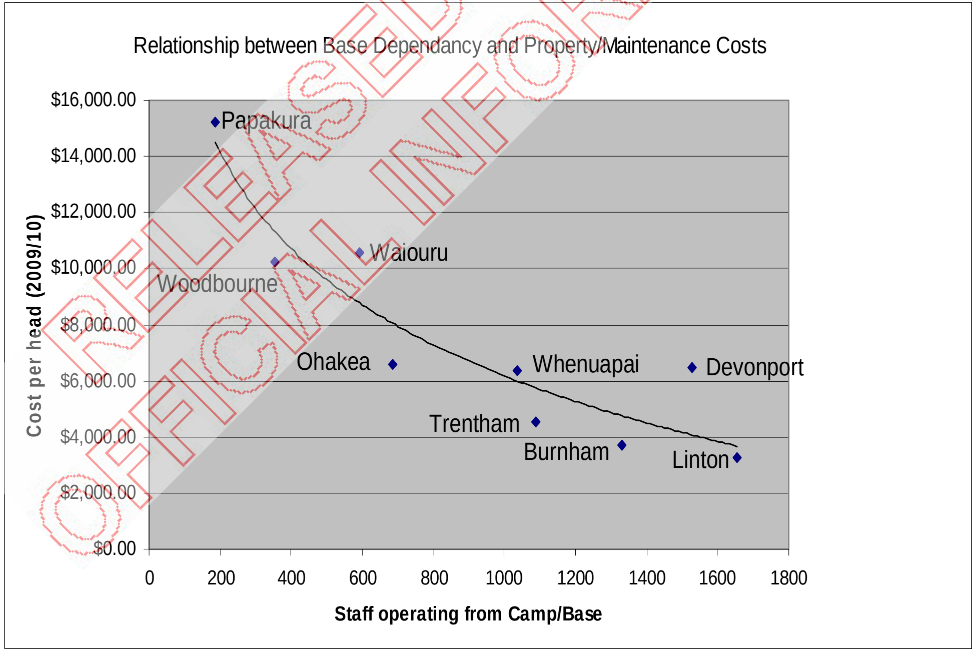
C7.1 Summary

Existing VfM

- Property services have been centralised internally within JLSO.
- There has been some ongoing disposal action, for example: Watts Peninsula, parts of Woodbourne and Defence houses.
- A Defence Estate Strategic Plan was completed in 2009 and its findings are reflected in the Defence Assessment.

VfM Observations

- There has been significant under-investment in the Defence Estate and this is clearly visible at camps and bases.
- Further camp and base consolidation is required as is modernisation of many parts of the Defence estate.
- Capital investment requirements are significant are not reflected in capital plans.
- Alternative ownership structures such as PPPs and PFIs have not been considered to any great degree within the NZDF and may provide one means of transitioning to a smaller, fit for purpose Defence Estate.



C7.1 Summary

VfM Constraints

- The Defence Assessment advocated a pragmatic approach to base consolidation reflecting concerns about capital constraints. The base Consolidation VfM Opportunity described in this report recommends a less conservative, yet still achievable, strategy.
- The actual and perceived obstacles to the preferred base configuration would require the following policy changes:
  - The use of PPPs to ensure the availability of private sector capital and operating capability to the NZDF;
  - A willingness to contract out the management and maintenance of base facilities, infrastructure and services;
  - Working with Safe Air and the Marlborough Airport Limited ("MAL") to enable the closure of Woodbourne ;
  - Proceeding with a much more aggressive strategy for selling Defence housing and accompanying land;
  - Working closely with tangata whenua to resolve surplus property issues and ownership; and
  - Resolving any political constraints with respect to Base closures and consolidation.

VfM Projects

- As part of the VfM Project and as summarised elsewhere in this Report, separate analysis was undertaken on the following Defence Estate VfM opportunities: Ohakea Consolidation (PPP); Woodbourne; Whenuapai; and Defence housing.

VfM Opportunity

- The optimum Base configuration for NZDF from a VfM perspective is likely to be as follows:
  - Devonport Naval Base;
  - A single Auckland location for the RNZAF, currently at Whenuapai;
  - A SAS location in Auckland together with a Battle Training Facility which required rebuilding, possibly via a PPP;
  - A more limited NZ Army Training Facility at Waiouru;
  - A Manawatu consolidation centred on Ohakea, accompanied by the closure of Linton and the transfer of certain personnel and services from Trentham;.
  - The closure of Woodbourne, the transfer of Safe Air to Auckland and/or Christchurch and the training facility to Ohakea;
  - The retention of Burnham and Tekapo but on a reduced scale; and
  - Limiting NZDF HQ's footprint in the Wellington CBD to Defence House with any overflow to Trentham.

C7.2 PPPs

Description of the VfM Area

- The Defence Estate provides opportunities for PPPs. These opportunities were assessed against the background Government's decision to proceed with a PPP for the new Corrections facility at Wiri in South Auckland.
- Historically, NZDF's philosophy has been to own the Defence Estate and accompanying facilities. But many of the bases are old and maintenance and replacement costs are increasing. In many cases the bases fall well short of being fit for purpose and will not be helping retention. NZDF has diverted capital to military platforms and capability. The extent of future Defence Estate costs have not been adequately addressed in the Defence Assessment.
- A compelling case can be made to rationalise existing bases. There is a particular opportunity to rationalise a number of existing bases around a single Manawatu footprint, most likely at Ohakea.
- There are a range of PPP opportunities (with the private sector financing, owning, maintaining and operating) with respect to the Defence Estate and including:
  - Base rationalisation and consolidation at Ohakea;
  - Defence housing provision, although NZDF's 2008 decision to divest all housing assets (see separate section in this Report) is noted; and
  - Base property, facilities and infrastructure at Whenuapai (these same opportunities may exist at Burnham, Papakura and Trentham as well). This is dealt with in the Whenuapai section of this Report.

VfM Opportunity

- Only one PPP opportunity was analysed in depth, namely the Ohakea base consolidation project.
- This analysis assumed:
  - The closure of Linton and relocation of facilities, services and people to a newly developed Ohakea; and
  - The transfer of all but certain training facilities and personnel from Waiouru to Ohakea.
- The analysis did not assume:
  - The transfer to Ohakea of all NZ Army personnel and facilities located at Trentham;
  - The transfer of training facilities and personnel at Woodbourne; or
  - Whether some Burnham services might be relocated.

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PPP Analysis

- The VfM Team worked with NZDF, the Treasury's National Infrastructure Unit ("NIU") and KPMG to determine whether:
  - The proposed PPP project at Ohakea met the specified NIU criteria for successful PPP projects; and
  - Based on preliminary financial analysis, the proposed project would be better VFM than the status quo.
- Based on the following key criteria, NIU determined that the Ohakea Project had the elements of a successful PPP project and warranted more detailed analysis:
  - Durability of service specification – proposed PPP would involve a 30 year service contract with asset lives > 50 years;
  - Project size – at between $400 million to $500 million of capital expenditure, the project met this criteria;
  - Timetable for service delivery – 3 to 5 years to execute project was considered acceptable;
  - Whole of life savings – high;
  - Potential to bundle contracts – high;
  - Synergies with other Government services – low;
  - Private sector revenues – limited opportunities constrained by security/military issues;
  - Scope for innovation – significant in terms of operations and maintenance;
  - Transfer of risk – significant, particularly in the area of build time, costs and risk;
  - Complexity – medium to high;
  - Private sector capacity and interest – high; and
  - Regulatory change – none required although some RMA and Treaty issues to consider.
- The status quo (base case), against which the proposed Ohakea PPP was compared, assumed no base consolidation at Ohakea, existing ownership arrangements but with sufficient capital and operating expenditure being spent at all bases to achieve full fitness for purpose.
- The proposed Ohakea project understates the VfM opportunity because:
  - It excludes the opportunity of transferring certain personnel and services from Trentham, Woodbourne and, possibly, Burnham; and
  - It did not capture the potential cost savings and synergies (other than in the property management and maintenance areas) from consolidating a range of NZ Army and RNZAF functions and activities at one base and transferring a number of services to the private sector. Additional savings could be between $10 million and $20 million per annum.

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VfM Savings and Recommendations

- On an NPV basis, which values the PPP project against the public service comparator (i.e. The base case), KPMG have calculated a range of $33.1 million (or 6.1% savings relative to the Base Case) to $173 million (or 27.2% cost savings), with a mid point of $94 million or 16.4%. With the other VfM opportunities included, the NPV could be as much as 20% higher.
- In the VfM savings analysis, it is assumed that no savings will be secured until FY 2014/2015 and that, at $6.5 million, they will be part year savings and understated as explained above.
- KPMG concluded that, based on its analysis, the Ohakea PPP provides significant value for money benefits and recommended that more detailed consideration, including the preparation of a full business case, take place. It is recommended that the NZDF proceed in this direction as a top priority. Some external assistance may be required.

C7.3 Whenuapai

Description of the VfM Area

- In 2005, the Government approved in principle the consolidation of all RNZAF flying operations at Ohakea. This decision was reversed in 2009 when it was resolved that Whenuapai would remain an exclusive RNZAF facility. The decision was then made to spend $60 million to upgrade the runway and related infrastructure. At the same time, it was noted that a further $100 million would need to be spent to upgrade Whenuapai's facilities.
- Whenuapai is increasingly a victim of urban encroachment. An extensive housing portfolio, primarily outside the base boundary, is located on high value land and the portfolio is in a poor state of repair. Curfews on operational and training flights and local resource management decisions that seem to favour residential development constrain the RNZAF's ability to deliver the full spectrum of flight operations at best cost from a VFM perspective.
- Notwithstanding Project Takatini, it is now accepted within NZDF that an Auckland RNZAF facility makes sense because:
  - There is merit in the Naval Helicopter Force being located in close proximity to the Devonport Naval Base;
  - Tactical fixed wing aircraft (in this case the C130s) need to be located or capable of being located in support of the SAS; and
  - It is likely to be more cost efficient for the P3K maritime surveillance and patrol operations to operate out of Auckland.
- The challenge is how to proceed against the background of the NZDF's cost and funding constraints and within the context of the Government's decision to remain at Whenuapai.

VfM Opportunity

- Whenuapai is a high cost operation. In 2008/09, its operating cost per aircraft movement was $3,000. Auckland Airport ("AIAL"), by comparison, was $128 per air movement. AIAL, of course, has 10 times the air movements but this does not entirely explain the significant cost differential.
- Between $100 million and $150 million will need to be spent at Whenuapai over the next 5 years to upgrade airfield and related infrastructure.
- Annual operating expenditure on property ownership, maintenance, facilities etc at Whenuapai is $37 million. Land value is over $50 million although the potential market value could be considerably higher.
- Base facilities are old and maintenance expenditure is increasing. Management of most of the services at Whenuapai is still undertaken in house.

C7.3 Whenuapai

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"Whenuapai Retention"

- There will almost certainly be significant advantages in a collaborative relationship between RNZAF and AIAL with respect to northern flying operations for the RNZAF. Discussions have commenced between RNZAF and AIAL.
- Discussions between AIAL and RNZAF are covering the following areas:
  - Fire rescue and other safety management ;
  - Fuel and other joint procurement;
  - Runway management and maintenance;
  - Shared infrastructure (i.e. fuel farm);
  - Wildlife management; and
  - Master planning.

- While no costings have been prepared, it is conceivable that RNZAF could save up to $2 million in annual operating costs at Whenuapai and a portion (up to 20%) of the $50 million of capital set aside for runway upgrades and the fuel farm) by being able to rely on AIAL facilities.
- In concert with contracting out the management and maintenance of most of the Whenuapai base facilities, infrastructure and services (perhaps in concert with a PPP) and a more aggressive sales programme for the 300 Defence houses servicing the base, the Whenuapai Retention option should generate meaningful cost savings while reducing capital expenditure.

C7.3 Whenuapai

"Whenuapai – Divestment"

- Whenuapai divestment is still likely to be the highest VfM option for NZDF.
- Should the Government decide at some point in the future to revisit its decision to retain Whenuapai as an exclusive military airfield,, the optimal VfM outcome would likely be to relocate RNZAF's northern flight operations to the proposed Northern Runway precinct at AIAL and for Whenuapai to be sold. The land at Whenuapai (excluding Defence housing land and land at Hobsonville) is valued at $53 million. Market value is likely to be higher than this.
- Although AIAL have delayed again the Northern runway decision, they would expect to be in a position to allocate, on an exclusive basis, sufficient land at Mangere for all of RNZAF's requirements and for the RNZAF to have use of the new runway and apron facilities for all aircraft that currently use Whenuapai. AIAL would also be willing, in principle, on a PPP basis, to finance, own, manage and operate the RNZAF facilities and infrastructure. s9(2)(b)(ii)
- On a base operating cost basis and allowing for costs associated with leasing the Mangere facilities and infrastructure, a $20 million operating cost savings per annum could be possible, quite apart from savings from proceeding with a reduced capital programme at Whenuapai and securing the sale proceeds from the sale of Whenuapai land and facilities.
- There would be further VfM for the RNZAF through access to state of the art infrastructure and facilities at Mangere without the risk of losing key personnel from a consolidation at Ohakea.

C7.4 Woodbourne

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Description of the VfM Area

- Woodbourne is not used by the RNZAF for flight operations.
- It is the primary ground training facility for RNZAF and houses an aircraft depot level maintenance facility owned by Safe Air (Air New Zealand).

s9(2)(b)(ii)

C7.5 Accommodation Policy

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Description of the VfM Area

- NZDF has a policy of compensating military personnel because of the compulsory posting requirement within and outside New Zealand.
- Until 2008, compensation was provided via a Private Rental Subsidy (PRS) and a mortgage subsidy (DTLS). This system was considered inequitable as each recipient received a different value and some people got nothing.
- Significant underinvestment in housing stock and barracks maintenance meant NZDF was facing a significant capital liability to bring its aging housing stock up to modern standards.

Existing VfM

- In 2009, the NZDF updated its Housing and Accommodation Assistance Policy.
- PRS and DTLS were terminated and replaced by the Universal Accommodation Component (UAC) or the provision of service housing where available or the provision of barrack accommodation where available.
- The UAC is currently set at $6131.00 (gross) per person per annum. Individuals are no better or no worse off regardless of posting location.
- UAC is being paid to those living in barracks.
- What has not been implemented but has been agreed in principle by NZDF is a Variable Accommodation Component (VAC). The VAC was designed to cover regional variations in housing.

	Costs of providing Accomodation Assistance		
2009/2010 Costs	Defence Housing Costs	Barracks Costs	Own arrangements
UAC	$0	$13,555,641	$35,633,372
Maintenance	$15,175,847	$1,955,858	
less recoveries	-$12,900,000	-$4,694,971	
Total	**$2,275,847**	**$10,816,528**	**$35,633,372**
Ownership Costs			
Depreciation	$5,664,189	$3,444,933	$0
Capital Charge	$8,818,671	$12,874,737	$0
Total	**$16,758,707**	**$27,136,198**	
People Count*	1842	2211	5812
Cost per head (ex ownership costs)	$1,236	$4,892	$6,131
Cost per head (incl ownership costs)**	$9,098	$12,273	$6,131
*As at Mar 2010			
** Cost of land excluded from calculations			

1. Total Cost of Housing and Accommodation Assistance	$79.5 million
2. Cost per RF member	$8,061

C7.5 Accommodation Policy

VfM Conclusions

- Partial policy implementation has not resolve inequities, merely changed the status quo.
- Paying UAC to those in barracks does not represent good VfM and is likely encouraging individuals to stay in barracks reducing NZDF's ability to divest of old barracks stock.
- UAC appears to be the lowest cost way of providing assistance but this is due to VAC having not been implemented.
- The level of assistance provided is questionable given NZDF's recent implementation of a Military Remuneration system (MRS) linked to market rates.
- A VAC or alternative methodology needs to put in place to facilitate exiting from Defence housing.

VfM Recommendations

- Cease providing UAC to individuals living in barracks (savings of $13.5 million).
- Review whether the current level of Housing and Accommodation assistance is appropriate given the move to MRS.
- Accelerate current actions to divest of current service housing stock by a VAC in Auckland or some alternative methodology.

C7.6 Defence Housing

Pacific Road Corporate Finance

Description of the VfM Area

- As at February 2010, NZDF owned 2,469 houses, 24% of which were considered surplus and disposable. A further 842 were earmarked for disposal by the end of 2011, leaving 1,046 to sell. NZDF also owns barracks on all of its core camps and bases.
- The book value of the barracks is $172 million and annual operating costs are $5.4 million, including depreciation.
- The book value of the Defence housing portfolio is $171 million but the replacement value of $371 million is probably closer to the likely market value. Annual operating costs including depreciation are $21 million.
- In September 2008, NZDF made the decision to exit from the provision of housing and to put in place a UAC as an incentive for NZDF personnel to seek accommodation within their adjacent communities. While the decision was taken to exit housing provision, no specific timetable was set. Instead, NZDF resolved to exit in a fashion that did not compromise (negatively) local housing markets, unknowingly trigger Treaty of Waitangi claims and offer back obligations or place undue timing pressure on personnel to exit from current Defence housing.
- NZDF is proceeding to exit from its housing stock in a judicious manner and in accordance with agreed policy. The most significant development has been the sale of Defence housing and land in the Hobsonville area to Housing New Zealand for an initial payment of $15 million and two subsequent payments.
- Including depreciation, maintenance and management costs (but excluding the capital charge, rates and insurance), annual gross operating costs for NZDF's housing (including barracks accommodation but excluding recoveries)) portfolio is $27 million or some $4,650 per occupant.

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VfM Opportunities and Recommendations

- At present, annual housing and accommodation operating costs for NZDF total more than $70 million per annum (excluding the capital charge). The largest proportion of this (60%) is the UAC.
- There is a clear opportunity to accelerate the sale of the portfolio and this should be a key priority for NZDF.
- NZDF should give personnel residing in Defence houses notice that they will need to exit from hosing within an agreed period.
- In the Auckland region this will require the introduction of a VAC or, preferably, a one off payment to encourage personnel to seek alternative housing.
- The result would be
  - Significantly reduced maintenance and other housing ownership costs; and
  - One off proceeds from the sale of the housing portfolio for re-investment (in whole or in part) in capability and/or areas requiring significant additional investment (i.e. IT and Base maintenance).

VfM Savings

- Annual operating cost savings of $10.5 million per annum following the sale of the portfolio in Auckland in particular phased over 3 years. In the initial years, the savings would be offset by one off payment in Auckland to facilitate personnel seeking alternative accommodation.
- Release of up to $300 million to invest in capability and other key priorities reducing the need for the Government to provide new capital.

C7.7 Property Maintenance

Description of the VFM Area

- This area covers maintenance of the Defence Estate and should be read together with the sections on PPPs, Woodbourne and Whenuapai.
- Maintenance costs related to Service housing are excluded from this section of the report and instead are covered under the earlier Accommodation Assistance section.

VfM Conclusions

- Poor VFM is being achieved in this area. Assets are not being maintained to an acceptable level which will inevitably lead to higher whole of life costs. There will be a requirement for additional expenditure.
- Deferred investment over time was a factor in the requirement for the UAC.
- Any base consolidation will take at least 5 years. Over this period increased maintenance expenditure will be necessary.

From 2005 to 2009 this gap equates to $100 million of deferred maintenance

Maintenance Expenditure Benchmarking

Benchmark	NZDF (2007)	NZDF (2009)	Future Position
Annual expenditure	$31 million	$35 million	similar to 2009
FM spend/ replacement value	1.4%	1.6%	Target 2.5% (not funded)

VfM Recommendations and Opportunities

- Set an appropriate sustainment target and fund it. 2 to 2.5% is recommended.
- Ensure adequate reinvestment in the Defence Estate consistent with NZDF's strategic plan and the proposed Base consolidation programme proposed in this report.
- Over the next 5 years increase operating expenditure (including depreciation) on the Defence Estate by between $8 million and $10 million per annum.
- Increase capital expenditure by between $10 million and $20 million per annum.
- Expenditure priority should focus on those bases and camps that will be retained but are not part of the Ohakea consolidation initiative.

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C8 Information and Communications Technology (ICT)

C8 ICT

Description of the VfM Area

- ICT within the NZDF comprises:
  - ➢ Back office services mainly managed by CIS Branch;
  - ➢ Network and infrastructure overseen by CIS and managed by CIS and Services;
  - ➢ C2 systems, with responsibility split between CIS, the Services and JFHQNZ; and
  - ➢ C4 systems supporting deployed forces and those embedded in, or providing control over war fighting capabilities, managed by the Services.
- CIS Branch also undertakes the procurement of certain ICT products and services.

Existing VfM

- DTP and other initiatives have achieved some savings ~ $3 million per year.
- NZDF consider that further savings are possible from consolidation of software licensing, re- tendering of services, syndicated purchasing etc.
- ICT operating and capital expenditure is low against most benchmarks.
- ICT delivery is dispersed across NZDF and too much is "leaking" outside CIS Branch.

Benchmarking

Benchmarks	NZDF		Corporate
ICT FTE	309		217
Total FTE	12266	s9(2)(b)(ii)	10667
ICT FTE/ Total FTE	1:40		1:49
ICT opex	$72 million		$102 million
ICT capex	$1 million		$32 million
ICT opex/FTE	$6,000		$9,000
ICT opex% total opex	4.2%		2.60%
Capex % total capex	0.05%		0.8%
capex% ICT opex	1.2%		31.4%

C8 ICT

The Importance of ICT

- ICT is a fundamental enabler of all modern military forces. It underpins:

  - HR, payroll, finance, administration, document management and other corporate systems;
  - Intranet and Internet communication through web-based applications;
  - military personnel related information including medical, fitness and service records;
  - Enabling processes including procurement, logistics, resupply;
  - Fleet maintenance within Navy, Army and Air Force;
  - Worldwide voice/data networking and Interoperability with allies and partners;
  - Operational planning, military appreciation and access to centralised databases and intelligence; and
  - C4 systems (command, control, communications, computers) throughout the operational arms of the NZDF.

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ICT: VfM Findings

- As part of the VfM exercise, an experienced, external IT professional was added to the VfM Team to provide an independent analysis of ICT issues and recommendations for remediation.
- His findings, which we endorse, were:
  - There is a lack of an overarching ICT Strategic Plan and no sense of whom is responsible for one and how it should be implemented;
  - There is no direct ICT representation on the ELT leading to poor, or poorly informed, decision making;
  - The NEC strategy, rightly focussed on war-fighting, has no recognition of its dependence on "corporate" infrastructure and systems, nor on the demands it places on other systems;
  - There is chronic underfunding of ICT infrastructure, application development and new projects;
  - There is a high demand for ICT changes without recognition of the cost and appropriateness of the requests and resource unavailability;
  - There is culture of customising software packages rather than changing and updating business processes to match the software capabilities;
  - There is a lack of Service Level Agreements and KPIs;
  - There is no costing of internal resources in project costs, leading to CIS being seen as a "free good" and unable to make additional resources available due to a lack of funding;
  - There is a lack of consistent business processes for undertaking project development and implementation;
  - There is a lack of understanding, especially within the Services, of the role of "business" processes and how these processes can impact on the front line

s6(a)

ICT: Priorities and Recommendations

- Review current and future ICT requirements across the NZDF and all activities. The NZDF requires a clear understanding of its present and future requirements from ICT (both corporate and military i.e. C4), how they inter-relate and how they impact on operations – culminating in a broad, ICT strategic plan.
- Develop an implementation strategy – how the strategy will be achieved and the benefits delivered - with timing, costs and resources.
- Rationalise ICT personnel resources, progressively consolidating most of the effort into one branch as CIS skills improve.
- Establish a shared services model with customer relationship managers embedded with the major ICT users.
- Maintain existing personnel numbers but change skill-set to match NZDF's future requirements.
- Establish a sub-committee of ELT, chaired by CDF, to oversee the ICT remediation programme, to hold individuals responsible for project and benefit delivery, to remove road-blocks and to expedite decision-making.
- The CIO should report directly to CDF and be a full member of the ELT.
- ICT operating budget to be reduced in the first instance from $72 million to $65 million per year through various savings initiatives then increase (primarily in depreciation) as a result of increased capital investment of between $35 million and $50 million per annum on infrastructure and other key projects (HR, Logistics, finance systems etc.).
- Undertake a budget reprioritisation of capital and operating to provide ICT with the necessary funding and people resources. Ensure budget matches NZDF's ability to undertake projects and to deliver benefits.

Pacific Road Corporate Finance

ICT: Priorities and Recommendations

- Upgrade SAP to the enterprise licence and standardise on the military version for all ERP applications.
- Replace the Porirua data centre with one of appropriate military/commercial standard, preferably shared with other government agencies.
- Consider alternative ownership structures for certain current and replacement systems.
- Upgrade the Logistics support within SAP to enable procurement/logistics consolidation and savings.
- Migrate all HR services into SAP to deliver HR process re-engineering and savings.
- Establish a rolling upgrade for all network and infrastructure services.
- Realign ICT workforce to match skills to tasks and set remuneration accordingly.
- Establish SLAs for all important ICT services, and publish regularly KPI performance against targets.

ICT Operating Principles

- In support of the above priorities and recommendations, the following operating principles are also recommended:
  - All ICT proposals should be fully costed, including the internal resources required to implement and operate;
  - SAP should be mandated as the sole ERP solution, its primacy agreed with NZ Treasury, and an enterprise licence for the military version be negotiated with SAP;
  - All future ERP applications and business cases should be based on SAP – any customisation should require ELT approval;
  - Greater emphasis on risk reduction, in recognition of the reliance of all NZDF on ICT; and
  - Only progress projects of highest priority, with greatest benefit realisation, and within the NZDF's capacity to deliver and reap the benefits.

Pacific Road Corporate Finance

C9 Other Services

C9.1 Libraries
C9.2 Bands
C9.3 Museums
C9.4 Military Diplomacy
C9.5 Defence Technology Agency

C9.1 Libraries

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Description of the VfM Area

- NZDF operates 10 libraries, including libraries at the Wellington HQ and the Trentham Staff College.
- Direct costs are $1.3 million per annum with 21 FTE. Indirect costs and overheads are unknown but are likely to bring total costs to c. $3 million per annum.
- Local libraries contribute to the "educational and wellbeing" obligation of the NZDF.
- Libraries in Camps and Bases have significant donated holdings.

Existing VfM

- DTP has suggested consolidation to 1 library but this was not implemented.

VfM Conclusions

- Libraries are a useful repository for NZDF historical and reference collections.
- The NZDF libraries perform well against relevant benchmarks.
- Much more use could be made of Internet and online access to reduce costs. This would require enhanced Internet access in camps and bases.
- While libraries are a small overall cost, savings are possible.
- The potential for a single library with enhanced online access has merit and should be pursued.

VfM Recommendations

- Consolidate to 1 major NZDF library and make better use of online access. This is what most commercial organisations have done.
- Camp and base libraries to be closed or significantly reduced with most books and publications relocated to the central facility.
- Reduce subscriptions to printed journals.
- A more "radical" solution would be to close all NZDF libraries and merge collection with National Library. This is not recommended but could be considered.

Benchmarking

Benchmark	NZDF	NZULS Libraries
Number of Libraries	10	10
Opex/FTE	$101	$762
Holdings/FTE	12.7	80
Staff/100 FTE	0.14	0.3 to 0.7
Opex/ total Costs	0.02%	-

s6(a)

Potential Savings

Central facility	$600,000
Closure & transfer to National Library	$1.3 million

C9.2 Bands

Pacific Road Corporate Finance

Description of the VfM Area

- NZDF operates 10 bands – 2 regular force and 8 territorial bands.
- The Bands employ 201 personnel comprising 61 RF personnel, 137 TF and 3 civilians.
- Total direct costs are $5.5 million per year, 80% of which is personnel costs. Indirect costs and overheads are unknown.
- The Bands undertake 450 to 500 engagements each year, 50% of which are free public concerts and 5% for Government. Each performance costs on average $10,000.
- The Bands are not a specifically funded output for NZDF.

Existing VfM

- NZDF has reduced funding slightly for the Bands.
- An internal review was undertaken but no decisions have yet been taken.
- Deloitte has recommended consolidation to 1 part-time band. This option was identified in the internal review.

Metrics

Benchmark Description	NZDF
Number of people:	201
Number of performances per year	450 to 500
Average cost per performance	$10,000
Average cost per bandsman:	$55,000

Potential Savings

Consolidate and fix expenditure	$2.75 million
Discontinue activity	$5.5 million

C9.2 Bands

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VfM Conclusions

- Together with the museums, the Bands represent one of the few connections between the NZDF and the Public.
- In times of financial constraints, spending over $5 million per annum on military Bands is unlikely to be the best use of NZDF's Budget. No military output is dependent on a Band.
- The Bands are more expensive than they need to be because most of the personnel are uniformed and receive additional uniformed allowances yet deployment is highly unlikely.
- Most performances are unrelated to military outcomes. They are a public relations activity.
- If Bands are regarded as an output in their own right they should be funded through a separate output class (e.g. "Ceremonial").

VfM Recommendations

- NZDF should:
  - Consolidate the number of Bands;
  - Consider whether it is appropriate to pay full military allowances to Band personnel; and
  - If Bands are required for ceremonial purposes, decide whether there should be a Specific output and a maximum level of expenditure.
- Total expenditure on Bands should be at 50% of current levels.

C9.3 Museums

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Description of the VfM Area

- NZDF has three Service - specific museums, each structured as and managed by a Trust.
- The Trust owns ~95% of the Museum assets.
- The Museums are operated and staffed largely by NZDF personnel, many of whom are uniformed and receive the standard set of military allowances.
- The Museums are funded through a specific output class at $7.3 million per annum.
- All external revenue from visitors goes to the Trusts with most expenses paid by NZDF.
- The Museums had 108,000 visitors in FY 2008/2009.

Existing VFM

- NZDF's current position is to retain the status quo although Deloitte, in its Cost down Diagnostic, identified the Museums as providing cost savings potential.

Benchmarking

Benchmark Description	NZDF	Comparable Museum
Opex/visitor	$54	$30
Personnel costs/visitor	$31.90	$15.30
Visitors/year	119,000	109,800

C9.3 Museums

VfM Conclusions

- The Museums provide a unique and valuable insight into New Zealand's military history. They are popular with the public, particularly the Army museum at Waiouru.
- But they are expensive to run and NZDF is likely, from a VfM perspective, to have better uses for the $7 million per annum expenditure.
- Furthermore, there is considerable duplication of costs within the 3 Trusts and performance (measured by visitor numbers and cost per visitor number) is variable and considerably higher than relevant benchmarks. For example, the Museums have double the number of staff compared to similar museums.
- In addition, only 1 Museum currently charges entry fees.

VfM Recommendations and Savings

- Museums are not core business for the NZDF, yet they do provide an important historical insight and a point of connection between the NZDF and the New Zealand Public.
- There is significant scope for the Museums to be more efficient. If the Museums achieved operating costs per visitor in line with benchmark organisations, about $2 million could be saved.
- The alternative would be to transfer the Museums to the Ministry of Culture & Heritage to operate. There would be some direct saving from this option but the Budget appropriation would likely transfer with ownership.
- Transfer of responsibility would save up to 9 military positions and related costs and the removal of capital and depreciation from NZDF balance sheet.

Potential Savings

Transfer to Culture & Heritage	$7.3 million transfer of appropriation and $2 million NZDF savings
Restructuring of 3 Museums	$2.0 million

C9.4 Military Diplomacy

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Description of the VfM Area

- Defence Attaches are NZDF personnel attached to overseas diplomatic posts.
- Defence Liaison people, IDR, SCI and MAP costs have been excluded from the VfM analysis.
- There are 17 locations – with 29 RF and 33 locally employed civilians.
- Direct costs of Defence Attaché posts are $22 million + per year or 1.6% of the NZDF budget.
- Defence Attaches represent >20% of senior officer pool.

Existing VfM

- 1 post has been closed but with no overall reduction in staff numbers.
- Costs have risen by average of 6% per year compounded over last 5 years.

Defence Attaché (DA) Benchmarking

	NZDF
Number of DA posts	17
Number of DA positions	27
Average DA/ post	1.6
Direct costs/post	$1.22 million
Direct costs/DA	$770,000
Direct costs/NZDF cost	1.2%

s6(a)

*converted to NZ dollars at 0.8

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C9.4 Military Diplomacy

VfM Conclusions

- Military diplomacy is a discretionary function. Liaison is more directly related to outputs.
- Contribution by Defence Attaches to military outcomes is unclear. There appears to be a lack of strategic direction and guidance.
- While having the potential to add value to New Zealand missions overseas, the Defence Attaches are often not trained or do not have the skills to meet requirements.
- The Attaché positions are seen as training opportunities rather than an output delivery.
- Having 20% of senior officer ranks in overseas posts is also a driver for higher overall numbers in these ranks, in turn inflating numbers in lower ranks. This contributes to significant increases in personnel costs which are to a degree hidden.

VfM Recommendations and Savings

- Review the number and location of overseas posts, in consultation with MFAT.
- Review rank level and number of personnel.
- Establish outputs and KPIs for each post.
- Appoint people on merit from present and past senior officers and provide appropriate pre-deployment training.
- Consider opportunities for "regional" posts with a broader geographical coverage.

Potential Savings

2010/11	2011/12	2012/13+
$1 million	$3 million	$6 million

These savings do not include second order effects such as the reduction in the numbers of lower ranks driven by reduced senior officer positions.

C9.5 Defence Technology Agency

Pacific Road Corporate Finance

Description of the VfM Area

- The DTA provides NZDF's only R&D capability.
- It employs 78 personnel.
- Total direct costs are $9.4 million per annum – 75% are personnel costs.
- DTA undertakes a mix of fundamental and applied research as well as technology support to platforms, including failure analysis.
- DTA is funded as a discretionary activity, rather than as a specific output.

Benchmarking

Benchmark	DTA
DTA Cost/FTE	$179,000
% staff above $100,000	23%
Scientists/Admin Staff	85:15
Research outputs/FTE	1.5

s9(2)(b)(ii)

VfM Conclusions

- Full cost of DTA is not known – estimated at $16.5 million.
- Cost/FTE is higher than other research providers. A significant % of staff are in higher salary ranges – this may reflect the older age profile of staff.
- Administration cost within DTA is more typical of a stand-alone enterprise.
- DTA is input funded. The connection between funding and outputs is weak. Moreover, it is difficult to determine whether DTA work programmes meet the needs of NZDF, especially in the capability development area.

VfM Recommendations and Savings

- Restructure DTA as a crown-owned commercial entity.
- DTA to bid for NZDF and MOD funding. DTA outputs purchased by NZDF need to be clearly related to prioritised needs and delivered under funder-purchaser model.
- DTA to seek to optimise third party income by being able to provide fully costed services to third parties and leveraging its IP. Some security constraints will need to be established.
- DTA funding to be set at a maximum of $10 million together with an assumed $6 million in "paid for" services in the first year. Thereafter to be phased into fully costed purchase of outputs.
- Annual savings will be $3 million.

Pacific Road Corporate Finance

C10 Private Sector Relationships

C10.1 Summary
C10.2 Contracting Out
C10.3 Alternative Ownership Structures
C10.4 The Private Sector – Air New Zealand

C10.1 Summary

Description of the VfM Area

- NZDF engages with the private sector in the following ways:
  - Acquisition of certain products and services including military hardware and platforms; general products and services (i.e. fuel, travel and office supplies) and other plant and equipment (i.e. IT, office equipment and furniture etc.);
  - Outsourcing and contracting out to the private sector for a range of services and activities such as facilities management and maintenance; canteen and hospitality services, certain logistics and other base services (armoury and range management); and
  - MRO (maintenance and sustainment) of key platforms and logistics (i.e. the relationships with Safe Air, Vosper, Thorneycroft and Fitzroy ("VTF") and Lockheed Martin), among others.

VfM Opportunities and Recommendations

- NZDF has not optimised the contracting out opportunity either in terms of the activities and services capable of being outsourced or the geographical/Service coverage for such outsourcing. There is a significant opportunity to extend contracting out beyond what is happening today and to look more at pan NZDF opportunities (i.e. national contracts).
- While NZDF has started to think about alternative ownership structures to free up capital and introduce private sector disciplines, there are few examples of this happening. The obvious exceptions have been the VTF Dockyard Management contract at Devonport where some asset ownership changed hands and the CT4 and King Air training aircraft which are owned by Pacific Aerospace Limited ("PAL") and are leased back.
- With respect to Defence housing and bases (see specific sections in this report), there are opportunities for PPPs similar in nature to the proposed PPP for the new Corrections facility at Wiri in South Auckland.

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C10.1 Summary

VfM Opportunities and Recommendations continued

- Opportunities exist to leverage and expand existing relationships with the private sector. For example, RNZAF has an existing aircraft maintenance relationship with Air New Zealand (via Safe Air) yet there is significant scope to expand that relationship (see specific section in our report). Similarly, Lockheed Martin is providing logistics and base services to NZ Army at certain bases where that could be expanded to include other Bases and Services.
- Key relationships with private sector providers should not be one way. As part of the tendering process, service providers should be encouraged to identify how they can work with NZDF to generate joint opportunities and revenues. Lockheed Martin's proposal to work with RNZAF on third party pilot training opportunities was a case in point.

Potential Constraints

- While contracting out to the private sector and alternative ownership structures including PPPs should be vigorously pursued by NZDF, they should not be seen as a panacea for poor management or a reluctance to take hard decisions. There must be a compelling business case in each circumstance.
- New Zealand is a small market with a limited number of service providers capable of meeting NZDF's needs on a national basis. With few exceptions, pan NZDF contracts should only be pursued where there is, and will in the future be, a competitive market for the particular service.

C10.2 Contracting Out

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Description of the VfM Area

- Excluding the acquisition of military and non military assets and the procurement of general products/services, existing NZDF outsourcing relationships include:
    - Safe Air/Air New Zealand – aircraft maintenance ;
    - VTF – Dockyard Management and Platform Maintenance Services;

s9(2)(b)(ii)

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VfM Opportunities and Recommendations

- While precise data are difficult to extract, it is estimated that NZDF spends between $100 and $120 million on outsourced services or between 5.5% and 6.5% of NZDF annual operating expenditure. There is an opportunity to increase this to between 10% and 12% per annum at greater VfM that the in house cost today.
- The greatest proportion of NZDF expenditure on outsourced services will come from extending existing or future contracts from the existing Service or region/base specific approach to national contracts and seeking new opportunities for outsourcing, perhaps in concert with transferring ownership of the underlying asset to the private sector as well.
- National contracts in the following areas should be considered:
  - ➢ Property and infrastructure maintenance, including buildings, facilities, houses, grounds, rifle ranges, armoury facilities, security and cleaning;
  - ➢ Canteen and mess management (including food and hospitality);
  - ➢ Health services;
  - ➢ Vehicle fleet management (B, C and CL vehicles);
  - ➢ Warehouse management, logistics and distribution services (a national freight contract is already in place);
  - ➢ ICT services, including management, maintenance and data centre operations; and
  - ➢ Certain HR services including payroll, recruitment and superannuation management.

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C10.2 Contracting Out

Issues and Constraints

- A key condition precedent to any contracting out initiative (particularly national contracts) is the existence of sufficient service providers capable of providing the outsourced service during the term of the contract and subsequently.
- In some of the recommended areas for contracting out (canteen and mess services, health services and certain logistics and MRO activities), NZDF needs to be satisfied that its ability to deploy cooks, medics and logisticians is not compromised. The model adopted by NZ Army namely that, as part of mess/canteen contracts, the service provider be required to accept on secondment, train (to NZDF requirements) and make available for deployment any NZDF people seconded to the service provider, makes sense.
- There needs to be clear responsibilities for the negotiation, execution and management of these contracts to maximise value and return for NZDF. At present, these responsibilities are dispersed between JLSO, the new Logistics Command, CIS, the MOD and the three Services. There should be a single centre of excellence within NZDF (including the MOD where appropriate) for the negotiation and management of these contracts (see our separate comments on Procurement and NZDF Organisation and Governance).
- Many service providers we spoke to found dealing found it challenging to deal with NZDF. We quote from a letter we received:

  "NZDF uniformed operational units require above average account management and are .... high maintenance. NZDF's bureaucratic practices interfere with efficient procurement outcomes. Power is held in silos and makes implementation of anything other than the status quo difficult. Uniformed middle management can obstruct senior command officers in implementing change"

Potential Savings

- Based on increasing the quantum of annual contracting out to between $150 million and $180 million (8% to 10% of total operating expenditure from 5.5% to 6.5% today), NZDF could achieve additional annual savings, relative to the cost of providing such services today in house, of between $5 million and $8 million. It should be noted that some of these savings may already be captured in the additional VfM opportunities from Logistics and MRO as referred to elsewhere in this Report.

s9(2)(b)(ii)

C10.3 Alternative Ownership Structures

Description of the VfM Area

- Opportunities exist for NZDF to consider alternative ownership structures for existing and future assets.
- Historically, NZDF's philosophy has been to own assets as being the best means of controlling costs and ensuring flexibility and ease of access. There has also been a natural caution about considering alternative ownership structures for assets likely to be deployed in hostile environments.
- The key exceptions to this "must own" rule have been:
  - The CT4 and King Air Trainers which are owned and maintained by PAL;
  - Certain plant and assets associated with the VTF Dockyard Management Contract; and
  - Certain C vehicles (bulldozers, graders etc.) which are in the process of being contracted out and leased back to NZ Army.
- There are additional opportunities to consider different ownership and lease back/contracting back regimes. These opportunities do not need to be limited to non military assets and facilities, subject to the hostile environment caveat.

Issues and Constraints

- Alternative ownership structures should only be considered for assets that are unlikely to be deployed in hostile environments. The risk premium an alternative owner would require would almost certainly outweigh any financial and operating benefits from the capital cost saved. The United Kingdom has leased its air refuelling fleet.
- The success in VfM terms from alternative asset ownership structures will depend on robust financial modelling comparing the NPV of NZDF with third party ownership (including, in each case, whole of life costs) and on effective commercial negotiations and contracts. Among other things, the contract should provide clearly for NZDF to have the option to gain future ownership of the assets on attractive terms.
- Critical from a value perspective, apart from avoiding the upfront capital cost for the asset and whole of life cost savings, will be the ability to replace some or all of the depreciation and capital charges with a lower lease cost (even with a profit margin). A critical part of the analysis would be the need to understand the accounting treatment of lease costs. It is likely that a number of the assets will be the subject of finance rather than operating leases which will end up on NZDF's Balance sheet.
- Responsibility for negotiation and management of the contracts with the third party owner/service provider should reside in a single centre of excellence within NZDF (see our separate comments on Procurement and NZDF Organisation and Governance).

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VfM Opportunities and Recommendations

s9(2)(b)(ii)

- **Strategic Airlift and Transport Capability** – The Government and NZDF have a number of options with respect to continuing ownership of the 757s.On a pure VfM basis, it is difficult to justify continuing ownership of the two 757's although, in this case (and particularly the VIP use of these aircraft), there is a significant subjective element to the VFM calculation.

- NZDF could sell the aircraft to a third party and enter into a contract with Air New Zealand to provide certain VIP and strategic transport capability with any airlift and/or transport in hostile or similar environments being provided by the C130s. As an alternative, NZDF could seek to sell the aircraft to Air New Zealand with the expectation that they will still be used for strategic airlift and transport but also for a range of other services required by Air New Zealand. Either way, the $1.45 billion provided for in the Defence Assessment to replace the C130s and the 757s would be reduced by c. $300 million. NZDF could, of course, retain the aircraft but more aggressively seek to lift utilisation and lower costs;

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VfM Opportunities and Recommendations

s9(2)(b)(ii)

- **Maritime Patrol aircraft** – The Defence Assessment proposes the acquisition and ownership of 4 short range surveillance aircraft at a potential capital cost of $200 million. There are alternative and joint ownership opportunities for this platform which could save capital and operating costs. See separate section in this report on Air New Zealand; and

s9(2)(b)(ii)

C10.3 Alternative Ownership Structures

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Potential Savings and Sale Proceeds

s9(2)(b)(ii)

- The sale of the 757s and contracting out the provision of certain Strategic Airlift and VIP Transport services (offset by increased use of the C130s and annual payments to Air New Zealand), should the Government opt for this course of action, could reduce annual operating costs by up to $29 million per annum. The sale of the two 757s is indicatively estimated to result in one off sale proceeds of c.$65 million including parts and a one off (non cash) write down of c. $180 million although these numbers have not been market tested. The $300 million capital cost to replace the 757s around 2020 would be avoided.

s9(2)(b)(ii)

- The $200 million capital cost for the short range surveillance aircraft could be avoided and there would be reduced annual depreciation and capital charges and, ideally, whole of life operating costs (not tested). The reduced depreciation and capital charge would be offset in part by lease costs. VfM could be greater still if the owner of the aircraft (perhaps Air New Zealand) could identify a dual use for the aircraft.

s9(2)(b)(ii)

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C10.4 The Private Sector – Air New Zealand

Description of VfM Area

- RNZAF and Air New Zealand have an existing relationship in two areas:
  - Aircraft maintenance, primarily via Safe Air; and
  - Pilot training via Air Nelson.
- Recently, RNZAF and Air New Zealand have discussed the establishment of a strategic alliance covering a range of opportunities including:
  - An Aviation Training Academy;
  - Safe Air;
  - Fleet integration and rationalisation with a focus on air trainers and short haul maritime surveillance aircraft;
  - Pilot training;
  - Shared infrastructure and joint procurement; and
  - VIP and strategic transport.
- Progress in developing and implementing these opportunities has been slow.

VFM Opportunities and Recommendations

- NZDF in particular and New Zealand in general face challenges because of small scale, geographical remoteness and skills retention. As a general principle, it makes economic sense for New Zealand organisations which do not compete (and often some who do) to seek opportunities to co-operate and share resources to the benefit of both.
- In order to maximise opportunities, such organisations need to be able to compromise and be satisfied with 90% rather than 100% solutions.
- NZDF (RNZAF) and Air New Zealand fit the above criteria and they also have a common owner. NZDF and RNZAF should immediately commit to a tight timeframe to assess the merit of a broad strategic alliance working together on the following (and other) opportunities Clear direction and leadership must be provided by the Chief Executive of Air New Zealand and the Chief of the RNZAF.

C10.4 The Private Sector – Air New Zealand

VfM Opportunities and Recommendations continued

- The most attractive opportunities include:
  - **Strategic Airlift and VIP Transport** – There are opportunities for Air New Zealand to provide Strategic and VIP Transport services to NZDF and the New Zealand Government in a way that saves NZDF up to $29 million in annual operating costs while delivering additional revenue to Air New Zealand and providing fleet optimisation opportunities. As noted elsewhere in this Report, retention of the 757s or a sale and leaseback option, while delivering sizeable cost savings, will inevitably limit the Government and the NZDF's flexibility. In addition, there is a subjective VFM component (which cannot be quantified in $ terms). The Government and NZDF need to weigh whether such subjective VFM outweighs the potential for NZDF to convert real cost savings from outsourcing certain strategic airlift and VIP transport to Air New Zealand and diverting the savings to more important areas.
  - **Maritime Surveillance Aircraft** - $200 million has been identified in the Defence Assessment for the acquisition of 4 maritime surveillance aircraft, to be operated by the RNZAF but proving whole of Government services to Customs, Fisheries and so on. The prime purpose of these aircraft would be to monitor New Zealand's EEZ. An opportunity exists either to utilise surplus capacity in Air Nelson's existing Q300 fleet of 23 aircraft or to integrate and jointly manage and operate any additional aircraft acquired alongside the exiting Air Nelson fleet.

    By integrating the Air New Zealand and RNZAF fleets, there would be significant VFM opportunities in the areas of: shared spares; joint maintenance; common use of a pilot pool, shared flight simulator facilities and joint training.

    The opportunity would require the RNZAF to agree to use Q300 aircraft for the surveillance activities and for the aircraft to be on the civil rather than military register. Given the purpose of the aircraft, this would not appear to be a problem.

    An opportunity would also exist (if additional aircraft are required) for those aircraft to be financed by a third party and leased to Air New Zealand who could, in turn, enter into a service contract with the RNZAF. Such an arrangement would remove the need for the upfront capital and would proceed on a fee for service basis with the likelihood of no balance sheet impacts.

C10.4 The Private Sector – Air New Zealand

VfM Opportunities and Recommendations continued

- **Air Training Aircraft** - Air New Zealand responded to the RNZAF's Request for Proposals with respect to replacements for the King Air aircraft. Air New Zealand proposed a similar arrangement to that outlined for the maritime surveillance aircraft and Beach 1900s (Air New Zealand currently owns 16 Beach 1900s). Air New Zealand acknowledged that the Beach 1900s did not comply fully with the specification (no glass cockpit and no autopilot) but indicated that the overall package would be lower cost. On the face of it the proposed fleet alignment in the air training space would bring benefits to RNZAF and Air New Zealand at a lower overall cost to both organisations.

- **Joint Training Academy** – Civil aviation training in New Zealand is undertaken primarily by RNZAF, Air New Zealand s9(2)(b)(ii) with a degree of replication across all three organisations. RNZAF and Air New Zealand spend a significant amount each on pilot and engineering/trades training. The Joint Academy proposal would see s9(2)(b)(ii) coming together to provide ab initio pilot training, aircraft engineering training, and, for commercial airlines primarily, flight attendant training. The intention would be that, other than specialist areas, training would be undertaken by the new academy which would become a Centre of Excellence in New Zealand and provide an opportunity to pursue international opportunities. The initial business case identified export earnings of s9(2)(b)(ii) together with estimated domestic revenues of s9(2)(b)(ii)

  A feasibility study was completed in October 2009 with the recommendation that RNZAF and Air New Zealand proceed to a full business case. In May 2010, having been unable to obtain formal approval from RNZAF, Air New Zealand decided to proceed on its own although the opportunity still exists for RNZAF participation.

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C10.4 The Private Sector – Air New Zealand

VfM Opportunities and Recommendations continued

- **<u>Safe Air and Aircraft Maintenance</u>** – Safe Air, which is 100% owned by Air New Zealand, provides a range of aircraft maintenance services with a particular focus on the P3 Orions and the C130 Hercules. To all intents and purposes, Safe Air is RNZAF's prime outsourced maintenance provider. While RNZAF spent $14 million with Safe Air in 2009/10 and is Safe Air's largest customer, Safe Air still represents less than 15% of RNZAF's total maintenance expenditure.

  Neither party appears satisfied with the relationship yet both can see opportunities for VfM. Air New Zealand is concerned about the viability of Safe Air (which RNZAF can go someway towards resolving) and RNZAF is concerned about Safe Air's performance, its position on the C130 upgrade programme and its competitiveness.

  s9(2)(b)(ii)

  Air New Zealand and RNZAF should consider alternative ownership and operating models designed to deliver better service at better VFM for RNZAF and greater certainty of maintenance contracts for Safe Air. To date, a win/win situation has eluded both parties.

  There is an opportunity for the RNZAF to exit from Woodbourne and consolidate its training resources at Ohakea or Whenuapai. s9(2)(b)(ii) Reaching agreement with Air New Zealand on the future of Safe Air will be critical to a final decision on Woodbourne.

C10.4 The Private Sector – Air New Zealand

Savings and Sale Proceeds

- Operating cost savings of up to $29 million per annum and one off proceeds from the sale of the 757 aircraft are available in the short term in the event the contracting out option is chosen. A long term contract with Air New Zealand would obviate the need for NZDF to spend $300 million replacing the 757s in 2020. Retention or the sale and leaseback option would offer much lesser savings.
- There are significant potential capital and operating cost savings from pursuing, where appropriate, a fleet alignment and integration strategy with Air New Zealand without compromising RNZAF's core values and independence. Some compromises will be required. Such a strategy would obviate the need for RNZAF to own the proposed in shore maritime surveillance fleet and, possibly, replacements for the King Air Trainers. The capital savings would be between $200 million and $275 million and, if structured as service contracts, the fleet could be held off balance sheet.
- There would be cost savings (s9(2)(b)(ii) by Air New Zealand) for Air New Zealand and the RNZAF and revenue generation (c. s9(2)(b)(ii) per annum) that might be available by implementing the joint Air Academy approach. RNZAF would continue to preserve to themselves pilot and engineering training specific to its fleet of aircraft but all ab initio training could be handled through the Academy with cost savings from economies of scale and the ability to access a broader universe of potential RNZAF pilots.
- The RNZAF/Safe Air relationship is in need of a major independent review to come up with a proposition that adds value to both organisations. There is potential for significant VFM to be generated by a closer relationship between the two organisations.

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C11 Australian Defence Force

C11 ADF Interoperability

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Description of the VfM Area

- NZDF and ADF (and the two Defence Departments) have a multifaceted relationship covering:
  - Information exchange and intelligence sharing;
  - Joint capability development;
  - Joint procurement and equipment complementarities;
  - Security and reconnaissance co-operation;
  - Defence research;
  - Joint training and exercises;
  - Personnel exchanges; and
  - Common doctrine.
- The cornerstone of the Defence relationship is the closer Defence Relations Agreement signed in 1998 and reviewed from time to time.
- A recent and significant development is the proposed establishment of a South Pacific focused Rapid Reaction Force.

s6(a)

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C11 ADF Interoperability

VfM Opportunity

s6(a)

VfM Recommendations

s6(a)

C12 Revenue Generation Opportunities

C12 Revenue Generation Opportunities

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Description of the VfM Area

- What opportunities are there to increase the revenue NZDF receives from the "revenue other" category (i.e. from third parties?)
- NZDF revenue is classified as either:
  - Revenue Crown – Revenue received from the Crown (FY 2008/09 - $2,083.94 million);
  - Revenue Department – Revenue received from other Departments (FY 2008/09 - $13.579 million); and
  - Revenue Other – Revenue from all other sources (FY 2008/09 $6.837 million)
- Departmental and other revenue represent less than 1% of NZDF's total annual income.

Existing VfM

- Revenue generating initiatives under investigation include: international pilot training at Ohakea; Air Academy partnership with Air New Zealand; Boeing 757 lease.

Metrics

Benchmark Description	NZDF 2008/09
1. % of total revenue from other departments	0.6%
2. % of total revenue from other sources	0.3%

C12 Revenue Generation Opportunities

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VfM Conclusions

- There are no over-arching constraints on departments generating additional revenue, although specific legislation may apply depending on circumstances. The NZDF should therefore be open to opportunities to generate revenue, provided that doing so does not interfere with normal business or require substantial additional resources.
- As part of the VfM Review, 20 potential opportunities were reviewed. Most of these are not viable for the following reasons:
  - ➢ Reducing capacity – NZDF capacity to supply services is reducing in some areas: hydrography, plant equipment, housing;
  - ➢ Reciprocal charging – charging international partners for the use of NZDF capabilities / services / facilities could lead to reciprocal charging that leaves New Zealand financially worse off;
  - ➢ Security/foreign policy – a number of potential opportunities would not be appropriate on either security or foreign policy grounds; and
  - ➢ Change programmes – NZDF is revamping NZDF Logistics, and Education and Training. Potential revenue opportunities in these areas should be reviewed once the new arrangements are in place and any spare capacity can be quantified

VfM Recommendations

- NZDF should take a positive view on revenue generation and seek all meaningful opportunities.
- Reorganising the DTA along similar lines to a Crown Research Institute and allowing it to bid for research projects and sell intellectual property rights (see specific slide) should open up a range of opportunities that should be pursued.
- NZDF should participate in the whole of government carbon credits scheme.

VALUE FOR MONEY REVIEW OF NEW ZEALAND DEFENCE FORCE

APPENDICES

Appendix I

Terms of Reference: External New Zealand Defence Force Value for Money Review

Context

1. The Government has commissioned a full review of New Zealand's defence policies and capabilities to 2035 (the Defence Review 2009). This Review is being undertaken in the context of constraints on Government expenditure and the Government's wider objective of achieving better value for money (VFM) across the State sector. To inform its decisions relating to the Defence Review and to obtain assurance, the Government has commissioned this external NZDF VFM Review.

2. The Government currently spends on Vote: Defence Force about $2 billion in operating funding per annum, and there have been significant capital investments. The Defence Assessment has confirmed the existence of a gap previously identified between current defence funding baselines and projected defence costs. A number of Defence initiatives are underway to narrow that gap.

3. At the Strategy Committee meeting (STR) on 7 December 2009, Ministers directed officials to provide advice on how the Government can get improved VFM out of their current and future spending in defence, including in a number of specific areas, which are covered below.

4. At STR on 15 February 2010, Ministers directed officials to pursue VFM efforts in Vote: Defence Force, to:

    - identify efficiencies;
    - identify options for shifting resources to front-line activities; and
    - provide assurance and options around the cost effectiveness and sustainability of NZDF.

5. The Defence Assessment and this associated external VFM Review will together inform advice for Ministers and a White Paper.

Objectives

5. The purpose of the VFM Review is to provide external advice, which will give Ministers greater assurance of, and options for improving, the New Zealand Defence Force's efficiency, cost effectiveness and sustainability, thereby informing decisions for the White Paper later this year. This will give effect to Ministerial directions from the STR meetings of 7 December 2009 and 15 February 2010.

6. The specific objectives of the VFM Review are to:

- undertake a high level and fundamental review of the NZDF's business model and cost structures, informed by the experiences of others;
- identify any significant changes to the NZDF's business model that would improve the NZDF's financial sustainability, and to quantify the net impact of any changes; and
- provide a plan to implement any value for money gains identified by the review (with implementation to follow the publication of the White Paper and looking out to 2020 and where relevant to 2035).

Scope

7. The VFM Review team may investigate any areas that may yield substantial cost-effectiveness gains. In particular, the VFM Review will consider how improved VFM can be obtained through:

- shifting resources (broadly defined) from the NZDF's (non-deployable) supporting structures to its (deployable) military capabilities;
- implementing the organisational changes proposed by the Defence Review 2009;
- exploring alternative models of asset ownership;
- reassessing policy requirements as set out in the Output Plan;
- reducing the current tempo of operations to some extent; and
- carefully managing new capital spending on essential projects.

8. The VFM Review should also look at:

- specific capabilities and number of platforms to deliver that capability, alongside different modes of delivery such as ownership vs. lease, and contracting out;
- interface among the services (principally duplication questions);
- cost-effective ways to deliver operational tasking and training and preparedness outputs, including the links between them;
- the NZDF interface with civilian agencies, including the contribution made by the NZDF to whole-of-government activities;
- the use of military and civilian personnel, including Reserves and Military Attachés and greater use of civilian capabilities for specialised professional areas; and
- the use, replacement and upgrade of technology over time to enhance productivity.

9. The VFM Review should build on work already done. If the external Lead Reviewer identifies other areas – including those already looked at – where substantial value for money gains, might be possible, the external Lead Reviewer should raise these with the Governance Committee.

10. The following areas are excluded from the scope of the VFM Review:

- the strategic context, defence policy priorities, tasks and the broad capabilities (expressed in output terms such as ability to transport x troops up to y kilometres within z hours) already agreed by STR;
- the application of military craft, including command and management of specific past or present military operational deployments.

Leadership

11. The external Lead Reviewer will be well-informed about organisational efficiency and effectiveness.
12. The external Lead Reviewer will not be a current or recently serving member of the NZDF or Ministry of Defence.
13. Additional advisers may be engaged to support the Lead Reviewer.

Governance and Resources

14. The external Lead Reviewer will determine the method of the VFM Review,

15. The Secretary of Defence will chair a Governance Committee that will include the Chief of Defence Force and the Secretary to the Treasury (or their delegates). The Secretary to the Treasury is representing the central agency chief executives, who may also attend the Governance Committee where relevant. Circulation of the material includes all three central agency chief executives.

16. The Deputy Secretary of Defence (Policy & Planning) will chair a Management Committee that will include one senior representative each from the NZDF, Treasury, State Services Commission, and the Department of the Prime Minister and Cabinet.

17. The Management Committee will make resources (including staff) available as appropriate to the external Lead Reviewer.

18. The external Lead Reviewer will provide regular progress updates to the Governance and Management Committees.

Deliverables, Timeline and Completion

18. Regular engagements are expected through the VFM Review, forming a substantial part of the deliverables.

19. An early deliverable is a work plan to be presented to the Governance Committee, setting out the planned approach of the VFM Review, methods to be used and any resourcing issues.

20. Following this, the external Lead Reviewer should offer relatively early judgement and advice on any material areas ($10ks / $100ks) where focusing further work is expected to deliver the greatest VFM gains. This includes a quick review of the work already done and the areas in the scope above to identify any material areas for VFM gains and to narrow the focus of the VFM Review, i.e. some areas in the scope will only need a quick assessment, while others need thorough analysis.

21. A final report should be submitted no later than 30 June 2010. The report is expected to:

- cover the specific objectives in paragraphs four and seven above;
- specify and quantify the VFM gains, including the operating and capital expenditure impacts and the time frames; and
- provide international comparisons and benchmarks.

Terms and conditions

22. Terms and conditions will be set forth in a contract between the external Lead Reviewer and the Secretary of Defence.

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Appendix II

NZDF VFM Review Team Members

- Dr Roderick Deane, Chairman Pacific Road Group
- Greg Kay, Executive Director, Pacific Road Corporate Finance
- Steve Bradley, IT Consultant

s9(2)(a)

Appendix III

VFM Review – Internal Meetings and Discussions

Ministry of Defence

s9(2)(a)

Headquarters New Zealand Defence Force

s9(2)(a)

s9(2)(a)

Ohakea

s9(2)(a)

s9(2)(a)

Whenuapai

s9(2)(a)

Devonport

s9(2)(a)

Linton

s9(2)(a)

Trentham Camp

s9(2)(a)

Headquarters Joint Forces New Zealand

s9(2)(a)

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Joint Logistics Support Organisation (JLSO)

s9(2)(a)

New Zealand High Commission, Canberra

s9(2)(a)

New Zealand High Commission, London

s9(2)(a)

Appendix IV

VFM Review - External Meeting and Discussions

Ministers

- Hon John Key, Prime Minister
- Hon Bill English, Minister of Finance
- Hon Dr Wayne Mapp, Minister of Defence
- Hon Heather Roy, Associate Minister of Defence

Ministerial Staff

s9(2)(a)

The Treasury

s9(2)(a)

The Department of Prime Minister and Cabinet

s9(2)(a)

Ministry of Foreign Affairs and Trade

s9(2)(a)

New Zealand Trade and Enterprise

s9(2)(a)

State Services Commission

s9(2)(a)

National Maritime Coordination Centre

s9(2)(a)

Australian Department of Defence & Defence Materiel Organisation

s9(2)(a)

s9(2)(a)

s9(2)(a)

Others

s9(2)(a)

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Appendix V

VFM Review – Reference Material

Capability and Policy

- Defence White Paper, 1997
- Inquiry into Defence Beyond 2000, Foreign Affairs Defence & Trade Select Committee, 1999
- Maritime Patrol Review, 2001
- Maritime Forces Review, 2004
- Government Defence Policy Framework, 2000
- Government Defence Statement, 2001
- Defence Review, 2009
- United Kingdom Audit: Delivering Multi-Role Tanker Aircraft Capability, National Audit Office, 30 March 2010

Funding and Resourcing

- NZDF: National Real Estate Review. Coopers and Lybrand, December 1997
- Resource Management Review 1988. Strategos Consulting, 1988
- Financial Management Review, Price Waterhouse Coopers, 1999
- Defence Capability and Resourcing Review, 2005
- Defence Sustainability Initiative, 2005
- Defence Capital Asset Management Plan (DCAMP) Review and the SAHA Report to Treasury, 2006
- Baseline Review, 2007 (including sub-reports such as the Martin-Jenkins HR workstream report)
- Defence Transformation Programme, initiated in 2007

- NZDF NEC Strategy, 11 October 2007
- Firecone / Defence Review, 2009
- Defence Review 2009 on Real Estate
- The Strategic Reform Program 2009: Delivering Force 2030, Department of Defence Australia, 2009
- NZDF Communications and Information Systems, February 2009
- 2008 Audit of the Defence Budget, McKinsey and Company, 3 April 2009
- R5 Job Evaluation Project Report and Findings, Hay Group, April 2010
- NZDF: A Review of Potential PPP Opportunities, Deloitte, May 2009.
- Investment Case Logistics Change Programme, Deloitte, 22 June 2009
- MoD Annual Report for the Year Ended 30 June 2009, June 2009
- Protecting Staff in PPP/PFI Deals, National Audit Office, October 2009
- Private Finance Projects, National Audit Office, October 2009
- Performance of PFI Construction, National Audit Office, October 2009
- Australian Defence Force Audit, George Pappas 2009
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- 2010-2013 New Zealand Defence Force Statement of Intent, June 2010.

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- Draft New Zealand Defence Force Annual Report 2009-2010

Organisational structure

- Resource Management Review 1988. Strategos Consulting, 1988
- Inquiry into Defence Beyond 2000, Foreign Affairs Defence & Trade Select Committee, 1999
- Review of Accountabilities and Structural Arrangements between the Ministry of Defence and the New Zealand Defence Force, Hunn Review, 2003
- Defence Capability and Resourcing Review, 2005
- Defence Sustainability Initiative, 2005
- Baseline Review, 2007 (including sub-reports such as the Martin-Jenkins HR workstream report)
- Defence Transformation Programme, initiated in 2007
- Defence Sustainability Initiative Review, Simon Smelt, 2008
- Cost Down Diagnostic, 2009
- Progress with the Defence Sustainability Initiative, Auditor General, 2009
- Wintringham / Defence Review 2009

Procurement processes

- Acquisition of Light Armoured Vehicles and Light Operational Vehicles, Auditor General, 2001
- Further report on the acquisition and introduction into service of Light Armoured Vehicles, Auditor General, 2004
- Government Procurement Policy, A Study of Effects on the Defence Industry. NZIER, 2005
- Deloitte Report on Defence Acquisition for DCAMP, 2006
- Defence Capital Asset Management Plan (DCAMP) Review and the SAHA Report to Treasury. 2006

- Defence Transformation Programme, initiated in 2007
- Review of Value Governance of Four CIS Projects. Fujitsu Consulting, 2008
- Reporting the progress of defence acquisition projects, Auditor General, 2008
- Independent Review of Safety and Functionality of HMNZS Canterbury, 2008
- Aurecon / Defence Review, 2009.

A more extensive list of documents are available in the VFM Review library

Appendix VI

The Reviewers

Dr Roderick Deane – Chairman, Pacific Road Group

PhD, BCom (Hons), FACA, FCIS, FNZIM, Honorary LLD

Roderick Deane has had an extensive career in business as Chairman and as a Director of a number of major New Zealand and Australian companies and earlier in the public sector and central banking. He has also had a considerable involvement with charitable and cultural organisations. He is currently Chairman of the New Zealand Seed Fund, a Director of Woolworths Limited, Joint Patron with his wife Gillian of NZ's largest voluntary welfare organisation, IHC Inc., and Chairman of the IHC Foundation.

Dr Deane was previously Chairman & Director of Fletcher Building Ltd, and its predecessor Fletcher Challenge Ltd, Telecom Corporation of NZ Limited, ANZ National Bank Ltd, Te Papa Tongarewa (the Museum of New Zealand), and the City Gallery Wellington Foundation. He was also a Director of the Australia and New Zealand Banking Group Ltd.

In the past Dr Deane has been involved in the executive branch of Government, as Chairman of the State Services Commission, Deputy Governor of the Reserve Bank of New Zealand, and an Alternate Executive Director of the International Monetary Fund. He was also Chief Executive of the Electricity Corporation of NZ Ltd and Chief Executive and Managing Director of Telecom NZ Ltd.

He had previously been Professor of Economics and Management at Victoria University of Wellington, a Director of TransAlta Corporation in Canada, Chairman of the Mayoral Business Advisory Group in Wellington, and a member of the Prime Minister's Enterprise Council.

Dr Deane is a Distinguished Fellow of the Centre for Independent Studies and the NZ Association of Economists. He was the inaugural NZIER Economist of the Year in NZ, and has been CEO of the Year, Chairman of the Year, and Executive of the Decade in the NZ Management Awards. He was named a Wellington City Icon In the Wellington City Gold Awards, is a member of the NZ Business Hall of Fame, and with his wife Gillian was honoured with the Patronage Award by the Arts Foundation of NZ.

More recently Dr Deane has also chaired the Advisory Panel for the Review of Special Education.

Greg Kay, Executive Director, Pacific Road Group

BA, LLB, Dip. Bus

Greg has been engaged in senior management and non-executive Director positions in a diverse range of sectors in New Zealand and Australia over the last 15 years.

From 1988 to 1992, Greg was Commercial Director for Telecom Corporation of New Zealand Limited and was closely associated with Telecom's privatisation and listing, as well as its initial move into Australia. From 1992 to 1995, he was Chief Executive of Coal Corporation of New Zealand Limited (now known as Solid Energy), a government owned enterprise and New Zealand's largest coal producer and marketer.

More recently, from 1995 to 1999, Greg was Chief Executive of Wrightson Limited, New Zealand's largest agricultural services company. Greg has also had a long involvement with New Zealand's electricity sector as a non-executive Director of Capital Power Limited and, more recently, TransAlta New Zealand Limited, which evolved from a merger of Capital Power and Energy Direct Limited.

Since Pacific Road New Zealand's inception, Greg has acted for companies in the coal, equipment hire, engineering, food, waste, ports, public transport and retail sectors.

Greg holds degrees as a Bachelor of Arts and a Bachelor of Law from Auckland University and a Post Graduate Business Diploma from Massey University in Palmerston North. He has been admitted as a Barrister and Solicitor of the High Court of New Zealand.

Pacific Road Group – Government Sector Advisory Work

Government Sector Advice

South Australia

Government of South Australia

- Advisor to the electricity structure reform review
- Advice on internal power purchase arrangements between government owned entities
- Joint lead advisor on A$5,000 million privatisation of ETSA Utilities, ElectraNet, Flinders Power, Optima Energy, Synergen and Terra Gas Trader
- Advice and management of Pelican Point power station tender process

Victoria

Victoria The Place To Be

- Advisor in relation to Hazelwood power station

Western Australia

westernpower

- Western Power Corporation – advice and management of the SWIS II 330 MW power procurement process

verve ENERGY

- Advice on windfarm development project
- Financial Structure advice

Government Sector Advice

ACT

ACTEW CORPORATION

- Advice on funding instruments
- Advice on dividend policy
- Advice on capital structure

Federal

Australian Government

- Land and Water project

NEMMCO

- Advice on design and implementation of interregional settlements residue auction

Australian Hearing

- Australian Hearing Services – strategic advice

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Government Sector Advice

Queensland

Queensland Government

- Advice on and management of the sale of Brisbane Markets
- Aurukun Bauxite and Aluminum Refinery tender process
- Advice on Kogan Creek development
- Advisor in relation to electricity network assets
- Strategic advice on major port development
- Corporatisation of Queensland Electricity Commission
- Advice in relation to Queensland Gas Pipeline

Gold Coast City Council

- Reform Public Benefit Assessment

Government Sector Advice

NSW Government

New South Wales Government

- Water for Growth Centres review
- Scoping Study on Waste Services
- Commercial arrangements in respect of the Port Kembla Coal Loader
- Corporatisation of:
  - State Water, Sydney Water, Hunter Water
  - NSW Electricity Distributors
- Capital Structure reviews:
  - Power – generation & retail
  - Utilities – distribution & transmission
  - Water
  - Forests
  - Rail
- Design of Capital Structure policy for government owned enterprises

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Government Sector Advice

NSW Government Agencies

EnergyAustralia

- Power Station development project
- Strategic advice for retail business
- Advice on NSW industry structure
- Advice in relation to retail privatisation

Liverpool city council

- Strategic and financial advice on TAFPS land development project

Port Kembla Port Corporation

- Advisor on capital structure and potential port expansion

Sydney Catchment Authority

- Assistance in pricing methodology and pricing submission to IPART
- Advice on future operating and capital expenditure

Sydney Water

- Strategic advice on proposed seawater desalination plant
- Review of organisational arrangements
- Establishment of Sydney Catchment Authority
- Capital Structure Review

Steve Bradley, Independent IT Consultant

BSc (Hons) in Applied Science and Electronics

Director and Chairman Outback Stores, Darwin, July 2007 - Current

Outback Stores is a not for profit company bringing decent food stores to remote aboriginal communities. Operating in some of the most disadvantaged and difficult locations in Australia, it has federal government funding to support the start up phase and will become self funding after 4 years. Started in late 2006 it currently manages 22 stores and is planning to reach 150 in the longer term.

Director, Statewide Independent Wholesalers, Tasmania, 2004 – 2007

SIW is Tasmania's largest grocery wholesaler with sales of $400 million. It is 60% owned by Woolworths and 40% by Tasmania's independent retailers.

Previously, Chief Logistics and Information Officer, Woolworths Ltd, Sydney 2004 – 2007

- Reported to the CEO with responsibility for Woolworths supply chain. Managed over 6,000 staff across 35 sites and an annual spend of over $1 billion.
- Responsible for all information systems in Woolworths, one of the largest networks in Australia, with over 40,000 devices.
- Drove the implementation of the second stage of Project Refresh, a massive transformation of the supply chain with $1 billion investment. This involved many changes to people, systems, processes and infrastructure and successfully delivered savings of over $400 million pa.
- Managed around 40 concurrent business change initiatives with 300 project staff so that over 90% were delivered on time and budget and those that missed were the smaller ones. This is a performance that very few companies achieve.

General Manager Information Technology, Woolworths Ltd, Sydney 1999 – 2004

- Key member of a small senior management group reporting to the CEO that devised and drove Project Refresh, a transforming initiative that delivered over $9 billion in benefits.
- Changed IT from being an isolated and poorly performing silo to an integral part of the business with a strong customer focus.
- Delivered real business value to Woolworths with strong business ownership of change.
- Managed many complex and risky change programs with a great success record.

Appendix VII

Illustrations of the high regard in which the NZDF is held internationally

US Presidential Citation for service in Afghanistan

In December 2004 a Presidential Unit Citation was presented to the Combined Joint Special Operations Task Force, including the New Zealand Special Air Service, in recognition of the group's actions in southern Afghanistan over the period 17 October 2001 – 30 March 2002. The NZSAS Commanding Officer at the time, the current NZSAS Commanding Officer and a NZSAS NCO received the citation on behalf of the NZSAS from President Bush.

To be awarded the citation, a military unit must "display such gallantry, determination, and esprit de corps in accomplishing its mission under extremely difficult and hazardous conditions as to set it apart and above other units participating in the same campaign." While the award was presented for the service of those involved in the initial deployment to Afghanistan in December of 2001, the 1st NZSAS has served four times in the region with distinction. NZDF staff have also been awarded US Bronze stars.

Multinational Force and Observers

The Multinational Force and Observers (MFO) is the international military force based in Sinai that monitors the peace agreement between Egypt and Israel. Over 1600 troops from 12 nations, together with 800 specialist civilian employees monitor the 210km common border between Egypt and Israel. The MFO has been in operation since 1981, and the NZDF has maintained a constant presence in the mission.

In February 2006, James Larocco, Director General of the MFO, visited New Zealand. "New Zealand is making a vital contribution in the Sinai. Its contingent is playing a key role in the command of the MFO, and has contributed enormously to the mission's morale and performance," Mr Larocco said. "At the same time, the New Zealanders I have worked with have been outstanding ambassadors for their country, their people and their culture."

"During my meeting with Phil Goff, I noted that with the current Middle East situation, the role of the MFO is of heightened importance to the stability of the region. In that capacity New Zealand's contribution has taken on a heightened importance of its own," Mr Larocco said. "I know both Egypt and Israel value New Zealand's contribution and are keen to see it continue to play a role in the region," Mr Larocco said.

On 1 March 2010, New Zealand Defence Force Major General Warren Whiting took command of the MFO in the Sinai. Major General Whiting is the second New Zealand officer to command the Force.

NZ Army Officer First Kiwi to Receive NATO Medal

In 2009, the first ever NATO Meritorious Service Medal (MSM) awarded to a New Zealander was presented to Lieutenant Colonel Jeremy Ramsden, MNZM at a special ceremony in Brussels. LTCOL Ramsden was presented with his medal by NATO Secretary-General His Excellency Mr Jaap de Hoop Scheffer, at a North Atlantic Council meeting. The medal was awarded for outstanding service while LTCOL Ramsden was working for the International Security Assistance Force (ISAF) in Kabul, Afghanistan. He was deployed for six months as the Deputy Chief of Plans on the ISAF HQs, spending some eight weeks as the Acting Chief of Plans. His medal citation commends his superior leadership and example, stating that “he was extremely proactive, pursuing excellence to ensure the quality and tempo of his branch’s work. He focused on maintaining momentum and the Commander’s intent as multiple command and staff changes occurred, in an often tumultuous environment”.

Australia thanks New Zealand for East Timor contribution

In November 2002, the Australian Government awarded a Meritorious Unit Citation to 3 Squadron, Royal New Zealand Air Force for outstanding service during East Timor operations.

The Australian Minister for Veterans’ Affairs and Minister Assisting the Minister for Defence, the Honourable Danna Vale praised New Zealand’s contribution to United Nations peacekeeping operations in East Timor. Minister Vale said, “Over the past three years, the New Zealand Contingent has made a remarkable contribution to peacekeeping in East Timor and they have played a key role in securing a young country’s future. “”New Zealand can and should be proud of the role it has played.”

In presenting 3 Squadron RNZAF with the Meritorious Unit Citation, Minister Vale said the award was further recognition of the esteem with which Australia holds the professionalism and dedication of coalition partners, like New Zealand, in East Timor.

The text of the Meritorious Unit Citation notes that “ The support provided by Number 3 Squadron, Royal New Zealand Air Force Squadron has been characterised by exemplary flexibility, responsiveness and exceptional airmanship in a very challenging operational environment.”

Australian Defence White Paper, 2000

Australia's 2000 Defence White Paper states that "The high quality of New Zealand's forces is beyond question. They made an outstanding contribution to INTERFET [in Timor Leste], and Australia is grateful for the speed and generosity with which they were committed and supported...we know that the men and women of the NZDF will continue to constitute a highly professional force." [p.42]

Australian Defence White Paper, 2009

Australia's 2009 Defence White Paper states that "Our defence relationship with New Zealand continues to be reinforced by our work together on successive deployments and combined operations in East Timor, Solomon Islands and elsewhere. Security crises in East Timor, instability in Fiji, and insurgency in Afghanistan underscore the coincidence of our security interests and the critical need for close coordination of defence postures and forces. The Government especially reaffirms its commitment through this White Paper to working with New Zealand to promote security, stability and development in the Pacific and East Timor." [p.97]

Samoa Tsunami Response

In the aftermath of the September 2009 tsunami, the contribution made by the NZDF and the New Zealand Police was substantial. It included reconnaissance and humanitarian relief flights, engineers, medics, environmental health officers, divers, specialist search staff, disaster victim identification experts, dog handlers, radio technicians and many support staff. Well over 100 Defence and Police personnel were in theatre for several weeks and HMNZS Canterbury deployed with emergency supplies.

The Samoans expressed their appreciation for this assistance and agreed that training activities, patrols, and a visit of HMNZS Canterbury earlier in the year had made New Zealand's contribution to the emergency response that much more seamless and effective. A number of Samoan contacts emphasised that what they particularly appreciated about the NZ Inc assistance was that it was offered in support of Samoan Government initiatives. New Zealand did not attempt to 'take over' or run a separate show.

2010 Defence Assessment

New Zealand's 2010 Defence Assessment makes particular mention of the importance of people as a component of capability. The Assessment notes that "The greatest asset of our armed forces is, and will remain, the quality of our people. The NZDF is a valued partner in New Zealand and throughout the world because its personnel are honest, impartial, culturally respectful, and accountable to civil authorities. They are also disciplined, well-trained, and understand their constitutional and legal obligations. These attributes are more rare than many might think."

"We require personnel and capabilities that can undertake a wide range of tasks. Our forces will never be large, but the range of demands we make of them will be. These demands will reflect the range of our national security interests. This versatility also enhances our ability to add strategic weight to the forces of our international partners." [4.1 – 4.2]

This level of professionalism and cultural affinity is highlighted in Defence engagement in the Pacific and Asia in particular. Our leading role in the Truce Monitoring Group Bougainville in its early stages and more recently in Timor Leste and the Solomons has drawn favourable comments from defence partners and the nations concerned.

Multi Agency Operations and Tasks

The NZDF undertakes or co-ordinates a range of activities in support of other NZ Government agencies, including:

- Maritime surveillance
- Search and Rescue (SAR)
- DoC support to the outer islands
- HM Customs support/constabulary tasks
- MFish operations
- Police support (land SAR and also anti-drug operations)
- Support to the Antarctic Programme
- Co-ordination of improvised explosive device disposal (IEDD) and explosive ordnance disposal (EOD)
- Counter-terrorism
- RWC2011 support/assistance
- Civil Defence assistance in New Zealand
- Fire fighting support within New Zealand and Australia
- Ceremonial, protocol and representational support

While most people only ever associate defence with high profile overseas operations, every day in NZ defence personnel are engaged in equally dangerous and note worthy activities. Some of these are unseen because they are contributing to the outputs of other agencies. In most cases this support involves the provision of specialist personnel and capabilities that would normally put some tasks beyond the reach of the agency concerned.

The expansion of the Limited Service Volunteer scheme and the introduction of the Youth Life Skills programme are tangible examples of the NZDF supporting the social structure within NZ as both a valued partner to MSD but also as part of the community itself.

Pacific Road Corporate Finance

Appendix VIII

Savings Spreadsheet

Illustrative Capital expenditure and inflows

Category and Sub-heading	Unbudgetted Asset Sale Proceeds ($ Millions)					Unbudgetted (non SME) Capital Expenditure ($ Millions)					Net Inflow/Outflow ($ Millions)				
	2010/11	2011/12	2012/13	2013/14	2014/15	2010/11	2011/12	2012/13	2013/14	2014/15	2010/11	2011/12	2012/13	2013/14	2014/15
Platforms and Capability															
B Vehicle Fleet	$ 1.00										$ 1.00	$ -	$ -	$ -	$ -
757s - loss on sale of ~$185 million likely					$ 65.00						$ -	$ -	$ -	$ -	$ 65.00
Property and Real Estate											$ -	$ -	$ -	$ -	$ -
Maintenance						-$ 7.00	-$ 18.00	-$ 7.00	-$ 7.00	-$ 7.00	-$ 7.00	-$ 18.00	-$ 7.00	-$ 7.00	-$ 7.00
Linton Note 1											$ -	$ -	$ -	$ -	$ -
Woodbourne Note 2				$ 20.00							$ -	$ -	$ -	$ 20.00	$ -
Ohakea PPP Note 3					$ 50.00						$ -	$ -	$ -	$ -	$ 50.00
Defence Housing Note 4			$ 50.00	$ 50.00	$ 100.00						$ -	$ -	$ 50.00	$ 50.00	$ 100.00
Reserves Note 5		$ 10.00	$ 10.00								$ -	$ 10.00	$ 10.00	$ -	$ -
ICT Note 6						-$ 20.00	-$ 47.00	-$ 50.00	-$ 40.00	-$ 20.00	-$ 20.00	-$ 47.00	-$ 50.00	-$ 40.00	-$ 20.00
Logistics											$ -	$ -	$ -	$ -	$ -
Auckland Logistics Hub								-$ 10.00			$ -	$ -	-$ 10.00	$ -	$ -
Grand Total	$ 1.00	$ 10.00	$ 60.00	$ 70.00	$ 215.00	-$ 27.00	-$ 65.00	-$ 67.00	-$ 47.00	-$ 27.00	-$ 26.00	-$ 55.00	-$ 7.00	$ 23.00	$ 188.00

Note 1 Any proceeds from Linton would be realised post 2014/15.
Note 2 Woodbourne closure and proceeds conditional on Ohakea PPP.
Note 3 Assumes the PPP proceeds
Note 4 Assumes decision taken to accelerate sale programme ($250 million is indicative)
Note 5 Assumes our Reserves recommendations are adopted
Note 6 Based on estimated capital expenditure and assumes NZDF ownership of assets and networks

Category and Sub-heading	Savings identified by NZDF and/or in Budget/2YRP ($ millions)					Incremental VFM savings ($ millions)					Total savings (includes VFM & amounts identified by NZDF) ($ millions)				
	In 2YRP 2010/11	In 2YRP 2011/12	2012/13	2013/14	2014/15	2010/11	2011/12	2012/13	2013/14	2014/15	2010/11	2011/12	2012/13	2013/14	2014/15
Support Services															
Human Resources (excluding training and recruitment) Note 1	$0.80	$13.40	$16.40	$15.90	$15.90	$0.00	$0.00	$10.00	$19.60	$19.60	$0.80	$8.40	$26.40	$35.50	$35.50
Finance	$0.50	$0.50	$0.50	$0.50	$0.50	$0.00	$2.50	$4.50	$4.50	$4.50	$0.50	$3.00	$5.00	$5.00	$5.00
Consultants and Contractors Note 3	$4.00	$4.00	$4.00	$4.00	$4.00	$1.00	$5.00	$5.00	$5.00	$5.00	$5.00	$9.00	$9.00	$9.00	$9.00
Procurement	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$4.00	$8.00	$15.00	$15.00	$0.00	$4.00	$8.00	$15.00	$15.00
Workforce															
Superannuation	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$1.00	$2.00	$3.00	$6.00	$0.00	$1.00	$2.00	$3.00	$6.00
R5 - Warrant Officers	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$3.00	$3.00	$3.00	$3.00	$0.00	$3.00	$3.00	$3.00	$3.00
Reserves Note 2	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$25.00	$33.00	$33.00	$33.00	$0.00	$25.00	$33.00	$33.00	$33.00
Pay Progression	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$25.00	$25.00	$25.00	$25.00	$0.00	$25.00	$25.00	$25.00	$25.00
Civilianisation/ Non-deployable Military	$0.00	$0.00	$0.00	$0.00	$0.00	$5.00	$26.00	$46.00	$46.00	$46.00	$5.00	$26.00	$46.00	$46.00	$46.00
Non-Operational Allowances (excluding UAC)	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$12.00	$12.00	$12.00	$12.00	$0.00	$12.00	$12.00	$12.00	$12.00
Recruitment Note 1	$3.00	$3.00	$3.00	$3.50	$3.50	$0.00	$0.00	$0.00	$0.00	$0.00	$3.00	$3.00	$3.00	$3.50	$3.50
Health Services	$0.00	$0.00	$0.00	$0.00	$0.00	$3.00	$8.00	$14.00	$14.00	$14.00	$3.00	$8.00	$14.00	$14.00	$14.00
Education and Training Note 1	$6.40	$6.40	$6.40	$6.40	$6.40	$0.00	$5.00	$10.00	$10.00	$10.00	$6.40	$11.40	$16.40	$16.40	$16.40
Non- Military Procurement Note 3	$6.60	$6.60	$6.60	$6.60	$6.60	$1.40	$10.40	$10.40	$10.40	$10.40	$8.00	$17.00	$17.00	$17.00	$17.00
Logistics Note 6	$30.00	$36.30	$41.20	$41.20	$41.20	$0.00	$0.00	$4.50	$14.10	$13.80	$2.10	$28.20	$45.70	$55.30	$55.00
Devonport Dockyard	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$1.00	$2.00	$0.00	$0.00	$0.00	$1.00	$2.00
Platforms and Capability															
B Fleet	$0.00	$0.00	$0.00	$0.00	$0.00	$0.40	$0.70	$0.80	$0.80	$0.80	$0.40	$0.70	$0.80	$0.80	$0.80
Strategic Airlift and VIP Transport (757s) Note 5	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$24.30	$0.00	$0.00	$0.00	$0.00	$24.30
C and CL Fleet	$0.15	$0.15	$0.15	$0.15	$0.15	$0.21	$0.21	$0.57	$0.57	$0.57	$0.36	$0.36	$0.72	$0.72	$0.72
Property and Real Estate															
Universal Accommodation Component (UAC) - Barracks	$0.00	$0.00	$0.00	$0.00	$0.00	$5.63	$13.50	$13.50	$13.50	$13.50	$5.63	$13.50	$13.50	$13.50	$13.50
Whenuapai	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$1.00	$2.00	$2.00	$2.00	$0.00	$1.00	$2.00	$2.00	$2.00
Woodbourne - Savings linked to Ohakea PPP	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$10.00	$0.00	$0.00	$0.00	$0.00	$10.00
Ohakea PPP - savings commence in FY 2014/2015	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	-$1.00	-$2.00	-$2.00	$6.25	$0.00	-$1.00	-$2.00	-$2.00	$6.25
Defence Housing	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$2.30	$10.30	$10.30	$0.00	$0.00	$2.30	$10.30	$10.30
Property Maintenance	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	-$10.00	-$10.00	-$8.00	-$8.00	$0.00	-$10.00	-$10.00	-$8.00	-$8.00
ICT Note 6	$0.00	$0.00	$0.00	$0.00	$0.00	-$0.50	-$3.71	-$10.06	-$16.86	-$22.16	-$0.50	-$3.71	-$10.06	-$16.86	-$22.16
Other Services															
Libraries	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.60	$0.60	$0.60	$0.60	$0.00	$0.60	$0.60	$0.60	$0.60
DTA	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$3.00	$3.00	$3.00	$3.00	$0.00	$3.00	$3.00	$3.00	$3.00
Military Diplomacy	$0.00	$0.00	$0.00	$0.00	$0.00	$1.00	$3.00	$6.00	$6.00	$6.00	$1.00	$3.00	$6.00	$6.00	$6.00
Bands	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$2.75	$2.75	$2.75	$2.75	$0.00	$2.75	$2.75	$2.75	$2.75
Museums	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$2.00	$2.00	$2.00	$2.00	$0.00	$2.00	$2.00	$2.00	$2.00
Total VfM Savings	$51.45	$70.35	$78.25	$78.25	$78.25	$17.14	$138.96	$198.86	$230.26	$271.21	$40.69	$196.21	$277.11	$308.51	$349.46
NIKE Note 3	$20.68	$20.68	$20.68	$20.68	$20.68						$20.68	$20.68	$20.68	$20.68	$20.68
Persex Note 7	$3.00	$5.00	$5.00	$5.00	$5.00						$3.00	$5.00	$5.00	$5.00	$5.00
Total VfM Savings including Nike and Persex	$75.13	$96.03	$103.93	$103.93	$103.93						$64.37	$221.89	$302.79	$334.19	$375.14

&

Note 1 DTP HRM work stream savings have been split out with Education and Training and Recruiting savings shown against separate VFM work streams. Adjusted phasing is shown in the blue cell in 2011/12 reflecting a view that current phasing is optimistic due for the requirement for ICT investment.

Note 2 Savings contingent on a change in Government policy with respect to Reserves.

Note 3 NIKE targets were agreed by NZDF in March 2010. $10.6 million of savings have been included against the non military equipment and Consultants and Contractors categories. The remainder of $20.68 million has not been allocated against the VfM work streams and is shown below Total VFM Savings line.

Note 4 To be realised, these savings would require a Cabinet decision to dispose of the 757's.

Note 5 Opex impacts of ICT upgrades in Logistics and HR are included in this line.

Note 6 Zero savings in the yellow cells. Our view is that the DTP Logistics work stream targets are overstated in FY2010/11 & FY 2011/12 and understated in out years. Our view on phasing is shown in the blue cells.

Note 7 Persex is the amount of personnel savings the ELT included in the two year Resource Plan in March 2010.

Other: Only those workstreams where savings have been quantified are included in this spreadsheet. Identified, yet unquantified savings are noted in individual workstream power point slides.

We cannot satisfy ourselves that there is not double counting between some NZDF savings initiatives (Nike and DTP for example).

Appendix IX

Glossary

- **ADF – Australian Defence Force**
- **AIAL – Auckland International Airport Ltd**
- **AME – Aero medical Evacuation**
- **ATA – Aviation Training Academy**
- **ATF – Territorial Air Force**
- **Back Office – (Human Resources, Finance, Procurement, Corporate Administration, Shared Services)**
- **CATG – Combined Arms Task Group**
- **CDF – Chief of Defence Force**
- **CEO - Chief Executive Officer**
- **CFO – Chief Financial Officer**
- **CIO – Chief Information Officer**
- **CMF – Capability Management Framework**
- **COO – Chief Operating Officer**
- **COMJFHQ – Commander Joint Force Headquarters**
- **CPM – Capital Programme Minors**

- **CRI – Crown Research Institute**
- **CSS – Combat Service Support**
- **C4 – Command, Control, Communications, Computers**
- **DA – Defence Attaché**
- **DAB – Defence Advisory Board**
- **DLC – Defence Logistics Command**
- **DLOC – Directed Level of Capability**
- **DTA – Defence Technology Organisation**
- **DTLS – Mortgage Subsidy**
- **DTP – Defence Transformation Programme**
- **EFTS – Equivalent Full Time Student**
- **ELT – Executive Leadership Board**
- **EMB – Executive Management Board**
- **EEZ – Exclusive Economic Zone**
- **EOD – Explosive Ordnance Disposal**
- **FTE – Full Time Equivalents**
- **HRM – Human Resource Management**

- **HQ – Headquarters**
- **ICT – Information Communications and Technology**
- **IEDD – Improvised Explosive Device**
- **INTERFET – International Force East Timor**
- **ISAF – International Security Assistance Force**
- **ILM – Integrated Logistics Management**
- **JLSO – Joint Logistics Support Organisation**
- **JMB – Joint Management Board**
- **KPI – Key Performance Indicator**
- **LAV – Light Armoured Vehicle**
- **LEP – Life Extension Programme**
- **MAOT – Non Military Activities**
- **MAP – Mutual Assistance Programme**
- **MFO – Multinational Force of Observers**
- **MoD – Ministry of Defence**
- **NCE – National Command Element**
- **MDS – Military Remuneration System**

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- **MNE – Manpower Not Effective**
- **MSD – Ministry of Social Development**
- **MSE – National Support Element**
- **MRO – Maintenance and Sustainment**
- **NATO – North Atlantic Treaty Organisation**
- **NMIT Nelson/Marlborough Institute of Technology**
- **NIKE – The "Just Do It" savings project**
- **NVR – Naval Volunteer Reserve**
- **NZDF – New Zealand Defence Force**
- **NZSAS – New Zealand Special Air Service**
- **OAG – Office of the Auditor General**
- **OLOC – Operational Level of Capability**
- **OSG – Organisational Support Group**
- **PAL – Pacific Aerospace Limited**
- **Persex – an NZDF savings project**
- **PPP – Public Private Partnership**
- **PRU – Personnel Required in Uniform**

- **PRS – Private Rental Subsidy**
- **PTUM – Part Time Uniformed Member**
- **PUTS – Personnel Under Training**
- **R5 – Right people, Right job, Right time, Right capabilities, Right cost**
- **SAR – Search and Rescue**
- **SCI – Strategic Commitment and Intelligence**
- **SME – Non Military or Non Specialised Military Equipment Procurement**
- **TAF – Territorial Air Force**
- **TF – Territorial Force**
- **UAC – Universal Accommodation Component or Allowance**
- **VAC – Variable Accommodation Component**
- **VCDF – Vice Chief of Defence Force**
- **VfM – Value for Money**
- **VT Fitzroy – Thorneycroft and Fitzroy**
- **WO – Warrant Officer**