MINISTRY OF DEFENCE ANNUAL REPORT

for the year ended 30 June 2017

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

New Zealand Government

New Zealand MINISTRY OF DEFENCE
Manatū Kaupapa Waonga

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HMNZS *Canterbury* crew helping to evacuate people onto a landing craft following the November 2016 Kaikoura earthquake

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PART 1: OVERVIEW

BY THE SECRETARY OF DEFENCE

The Ministry of Defence is a larger, more mature organisation this year. This is a result of our continued transformation programme, which over four years is almost doubling the size of the Ministry. This is a necessary step for us as we move into an extended period of investment in Defence – with $20 billion of investment in military capability to be delivered through to 2030.

The challenges for us this year have been particularly great. The November 2016 earthquake required us to quickly re-house the Ministry in temporary accommodation, where we will remain until a permanent home for Defence is found. This Annual Report reflects the impact of the earthquake on the Ministry and its finances – but it also highlights the way our people have continued to deliver, whether developing and delivering major capability projects, contributing to strong international defence relationships, advising on deployments, providing defence policy advice, advising on the performance of Defence, or supporting these activities.

During 2016/17, the Ministry released a Defence Capability Plan to outline the investments to deliver the 2016 Defence White Paper force structure, and we started to undertake more regular defence assessment advice. We provided support for the work of two Ministers of Defence, as well as advice on deployments of defence personnel and assets in Asia, Africa and the Middle East. We also delivered to Ministers six business cases for significant defence capability investment.

In February 2017, Defence stood up six new Integrated Project Teams (IPTs). IPTs are at the core of the transformation of the Capability Management System that we are delivering with the New Zealand Defence Force. These bring Ministry and Defence Force staff together into a single team that spans my responsibilities and those of the Chief of Defence Force. As well as the IPTs themselves, we introduced a number of additional supports – including eight new Project Boards.

The Ministry released an evaluation report on Defence Force recruitment activities, and we participated in international efforts to make sure Defence remains free of fraud and corruption. This is an area where New Zealand leads internationally.

You may be reading this report on the Ministry's new website, a significant redevelopment that we launched in October 2016. Further development in the current year will make the website more useful for Defence Industry, as part of an industry engagement strategy we launched last November.

Our new website was one of a number of investments in the Ministry's processes and systems to make sure that, as we grow, we remain fit for purpose and take the opportunities from having more – and increasingly diverse – people.

As we move into 2017/18, it is with real confidence in the results of our work to improve the Ministry. I am confident that we can continue to deliver on the government's aspirations for Defence, support our Defence Force men and women, and be a great employer for our people.

Helene Quilter
Secretary of Defence

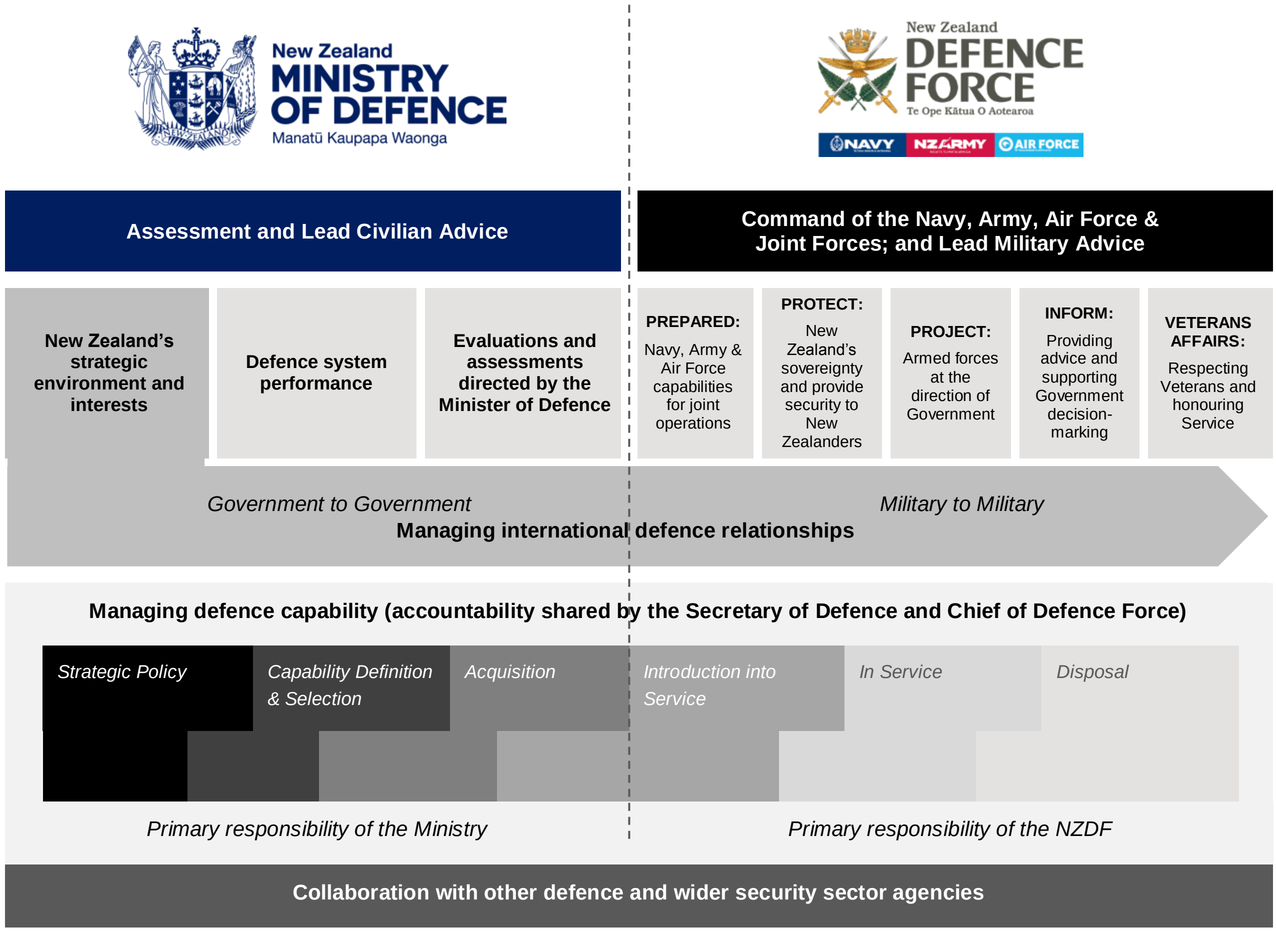
PART 2: THE MINISTRY'S PERFORMANCE AND OPERATIONS

THE MINISTRY OF DEFENCE

The Ministry of Defence is the government's lead civilian advisor on defence. Its purpose is to give civilian advice on defence matters to enhance the security and interests of New Zealand and its people. The Ministry also purchases major items of defence equipment which becomes a capability when it is used by the service men and women of the New Zealand Defence Force.

Defence is made up of two agencies: the Ministry of Defence and the New Zealand Defence Force. The agencies work very closely together; drawing on their strong, separate civilian and military perspectives. The separation between the two agencies is part of New Zealand's constitutional arrangements. Under the Defence Act 1990, the Secretary of Defence is the lead civilian advisor on defence matters and the Chief of Defence Force is the lead military advisor and senior military officer.

Figure 1: Respective roles of the Ministry of Defence and New Zealand Defence Force



The Ministry is responsible for the development of defence policy, international defence relationships and engagements, deployments, systemic reviews on behalf of the Minister of Defence, and the development and delivery of capability projects. In this context, capability means platforms, equipment systems, technologies and materiel with a whole of life capital and operating cost of more than $15 million.

To carry out these functions, the Ministry works closely with the Defence Force, the Ministry of Foreign Affairs and Trade and other agencies. The Ministry also builds and maintains strong defence connections with other governments, including our ally Australia, so New Zealand can contribute to the security of the Asia-Pacific region, as well as understand and respond to defence and security challenges internationally.

THE MINISTRY'S PRIORITIES AND OUTCOMES FRAMEWORK

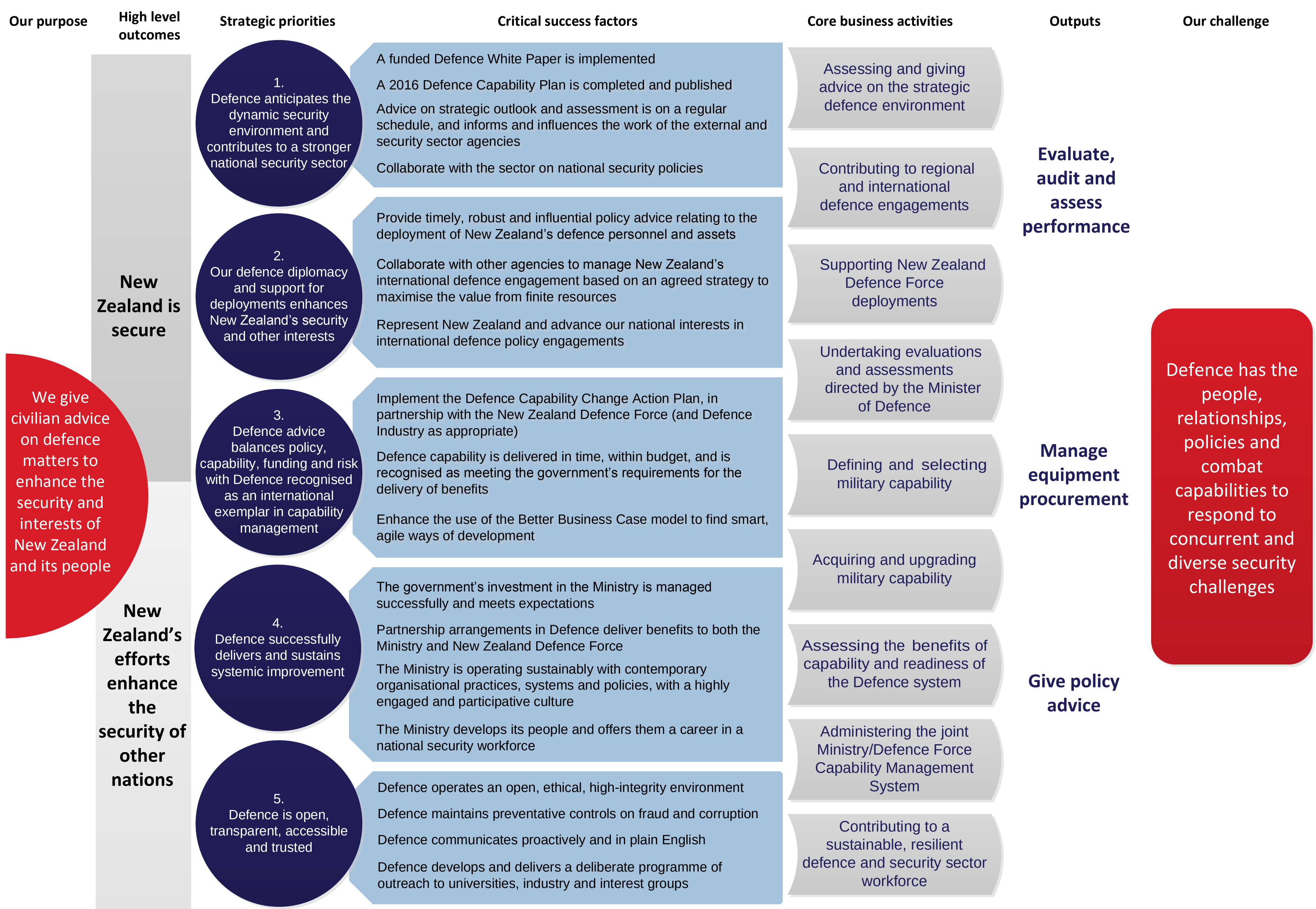
The Ministry's objectives and performance indicators are based on the Vote Defence *Estimates of Appropriations for 2016/17* and the Ministry's *Statement of Intent 1 July 2016 – 30 June 2020*.[1] Divisions regularly evaluate their performance against these during the year.

The Ministry's outcomes framework for this period is set out over the page, showing how the Ministry's outcomes, business activities and success factors reinforce each other.

The Government's primary direction for Defence during the period of this report was the *Defence White Paper 2016*, released in June 2016. The *Defence Capability Plan 2016* details when individual capabilities are planned to be purchased, which is further detailed in the updated *Defence Capital Plan 2016–2030*.[2] In addition, the Ministry's operating environment has changed as a result of the Government's Budget 2015 decision to invest $27.1 million of new operating funding into the Ministry.

[1] The Ministry's Statement of Intent is available from its website at www.defence.govt.nz/publications.
[2] The 2016 Defence White Paper and Defence Capability Plan are available from the Ministry's website at www.defence.govt.nz/publications. The Defence Capital Plan is not published externally.

Figure 2: The Ministry of Defence's Strategic Outcomes Framework



THE SECURITY ENVIRONMENT

The Ministry contributes to two high-level outcomes:

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

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

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

The Ministry contributes to the primary outcomes in three ways:

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

ASSESSING THE STATE OF THE SECURITY ENVIRONMENT

In an increasingly interconnected, uncertain and unstable world, assessing the state of a security environment requires complex judgements. A comprehensive assessment of the security environment was undertaken as part of the *Defence White Paper 2016*, which built upon the judgements in the *Defence Assessment 2014*. The Ministry has continued to monitor the strategic environment during the period of this report, over which a number of events globally have materially affected the state of the security environment.

CURRENT SECURITY STATE

Region	Recent events with substantial effect	Commentary on overall security state
New Zealand and its Exclusive Economic Zone	-	There have been no material changes to New Zealand's outlook during the period of this report. A direct security threat to New Zealand and its Exclusive Economic Zone remains unlikely.
Southern Ocean and Antarctica	Establishment of the Ross Sea Marine Protected Area	The security environment in the Southern Ocean and Antarctica remains stable, but increasing involvement by a range of state and non-state actors could impact New Zealand's interests into the future.
Australia	-	An armed attack on Australia is unlikely. Threats from terrorism and cyber security are an increasing concern.
South Pacific	-	There have been no material changes to New Zealand's outlook of the South Pacific during the period of this report. A direct military threat from outside the region remains unlikely, although an increasing number of external actors (both state and non-state) are becoming active in the South Pacific. Threats to security arise from many Pacific states' vulnerability to internal instability caused by chronic social, economic, demographic, environmental and governance stresses. Such stresses have the potential to develop into situations where nations' security could be compromised.

Region	Recent events with substantial effect	Commentary on overall security state
Asia-Pacific[3]	• Escalation of tensions on the Korean Peninsula due to North Korea's accelerated missile testing programme. • Increased intensity of insurgent activity in the southern Philippines, with connections to international terrorism.	Threat factors relate primarily to the risk of conflict on the Korean Peninsula, ongoing concerns around Weapons of Mass Destruction proliferation and terrorism, and maritime territorial disputes.
Global	• Positive progress made in the defeat of ISIL as a territorial entity, balanced against the uncertainty created by the consequent territorial transitions. • The increase in ISIL-inspired or initiated terrorist attacks in Europe. • Withdrawal by some nations from international agreements and institutions, raising questions about the future form of the rules-based international order.	The world continues to experience high levels of volatility and change. This includes a number of ongoing security challenges: • turmoil across the Middle East and North Africa • continued weakness in the global economy since the Global Financial Crisis • increasing challenges to the rules-based international order • constraints on the ability of international institutions to forge consensus on trans-boundary problems • the emergence of new centres of economic strength that are shifting the global balance of power • swiftly evolving technologies, including cyber and anti-space capabilities, resulting in the emergence of new threats • the risk of weapons proliferation, both conventional and chemical, biological and nuclear • terrorism continuing to challenge public safety and state authority • questioning by United States political leaders of the United States' role in contributing to global security • the uncertainty created by the United Kingdom's exit from the European Union.

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

DELIVERING ON THE MINISTRY'S STRATEGIC INTENTIONS

The Ministry set five strategic priorities in its *Statement of Intent 1 July 2016 – 30 June 2020*:

1. Defence anticipates the dynamic security environment and contributes to a stronger national security sector.
2. Our defence diplomacy and support for deployments enhances New Zealand's security and other interests.
3. Defence advice balances policy, capability, funding and risk with Defence recognised as an international exemplar in capability management.
4. Defence successfully delivers and sustains systemic improvement.
5. Defence is open, transparent, accessible and trusted.

Below is the progress made against each priority over the year to 30 June 2017, including the associated critical success factors.

HMNZS *Te Kaha* with an RNZAF P-3K2 Orion and the ship's Seasprite helicopter in the Indian Ocean

PRIORITY 1: DEFENCE ANTICIPATES THE DYNAMIC SECURITY ENVIRONMENT AND CONTRIBUTES TO A STRONGER NATIONAL SECURITY SECTOR

Over 2016–2020 this work will involve the following critical success factors:

- A funded Defence White Paper is implemented.
- A 2016 Defence Capability Plan is completed and published.
- Advice on strategic outlook and assessment is on a regular schedule, and informs and influences the work of the external and security sector agencies.
- Collaborate with the sector on national security policies.

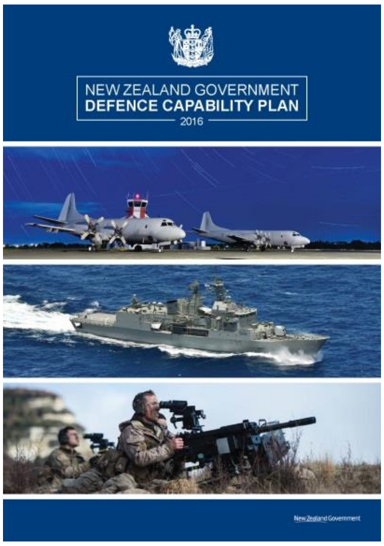
In June 2016, the Government released the *Defence White Paper 2016*. The White Paper describes:

- the international strategic environment
- the Government's defence policy objectives, and
- how the Defence Force will be structured and equipped to deliver on these objectives out to 2030 and beyond.

The Ministry produced the White Paper in collaboration with the Defence Force and other key government agencies.

The Defence Capability Plan 2016

The fully costed White Paper has enabled the Government to signal a commitment to a portfolio of planned defence capability investments valued at close to $20 billion over the next 15 years. In October 2016, Cabinet approved the *Defence Capability Plan 2016,* which articulates the detailed capability investment decisions arising out of the White Paper, out to 2030. The *Defence Capital Plan 2016–2030* was also updated to reflect the timing of this expenditure.



The Capability Plan was published and launched at the Defence Industry Association Conference in November 2016. It provides the detail of the 2030 force structure envisaged in the White Paper, at a greater level of detail than any previous edition. This force structure is a mix of present-day capabilities, updates to extant equipment, replacements of current platforms, and planned future capability enhancements.[4]

[4] The 2016 Defence White Paper and Defence Capability Plan are available from the Ministry's website at www.defence.govt.nz/publications.

More regular Defence Assessment activity

Following the direction set by the White Paper, work on major five-yearly Ministry-led Defence Assessments is being augmented by a cycle of smaller, more focused assessments on emerging issues. An annual assessment of significant changes to the overall international environment, including results of the more focussed work where they are relevant, will also be produced to inform decision makers.[5]

This approach ensures that Defence is better able to keep pace with changes in the international strategic environment and their possible implications for New Zealand's national security interests, Defence policy and the capabilities required by the Defence Force to fulfil its roles and tasks.

During 2016/17, the Ministry developed the framework to deliver on this programme of assessments, and began the first tranche of focussed work aimed at covering topics of current high interest. These in depth assessments will be delivered through the second half of calendar year 2017 and may provide policy recommendations if required. Alongside these will be the forward looking annual assessment of the international security environment. The first annual defence assessment will be delivered by the end of 2017. Details will be reflected in the Ministry's next annual report.

The Ministry has used the programme of assessments as a basis for enhancing its engagement with the New Zealand academic community, which holds expertise relevant and useful for defence policy development. To support this, the Ministry has joined the Massey University-led Multi-Agency Research Network and continues to build its relationship with the Centre for Strategic Studies at Victoria University of Wellington.

Working with the Defence Force, the Ministry began the preparation of defence planning scenarios, covering the range of defence force roles and tasks, to inform future capability acquisition and strategic policy making.

Across-government policy work

During 2016/17, the Ministry continued to work closely with other government agencies, particularly those in the wider national security sector, to develop defence policy and contribute to policy development across government. The Ministry has focused in particular on those new and emerging national security issues facing government – including cyber, space, maritime security and Antarctica – to ensure defence policy supports wider government objectives and that other agencies benefit from the expertise and information held by Defence.

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[5] See paragraph 10.5 of the *Defence White Paper 2016*.

PRIORITY 2: OUR DEFENCE DIPLOMACY AND SUPPORT FOR DEPLOYMENTS ENHANCES NEW ZEALAND'S SECURITY AND OTHER INTERESTS

Over 2016–2020 this work will involve the following critical success factors:

- Provide timely, robust and influential policy advice relating to the deployment of New Zealand's defence personnel and assets.
- Collaborate with other agencies to manage New Zealand's international defence engagement based on an agreed strategy to maximise the value from finite resources.
- Represent New Zealand and advance our national interests in international defence policy engagements.

The International Defence Engagement Strategy

In November 2016, Defence approved the *International Defence Engagement Strategy.* This was developed by the Ministry, with support from the New Zealand Defence Force and engagement with the Ministry of Foreign Affairs and Trade. It informs New Zealand agencies in the planning and conduct of international defence relations. The Strategy identifies and prioritises the international defence relationships that support broader defence, security and foreign policy objectives. It provides guidance on how the Ministry and Defence Force should focus resources, including senior visits, in order to contribute to international defence engagement that maximises the value to New Zealand.

The Strategy contains a set of broad, high level objectives that are delivered by specific initiatives Defence intends to track in the short term. These initiatives have been pursued with a significant number achieved over the period. Overall there is a high level of visibility and buy-in to the Strategy across Defence and key partner agencies. The Strategy will be reviewed and refreshed annually.

International defence policy engagements

During 2016/17 the Ministry supported travel by the Minister of Defence on bilateral visits to France, the United Arab Emirates and Indonesia, as well as participation in the Xiangshan Forum in China, Defeat-ISIS meetings in Paris and Washington, and the Shangri-La Dialogue in Singapore. The Ministry also supported the Minister's operational visit to Iraq, Exercise Rim of the Pacific, and commemorative visit to France for the Battle of the Somme.

Through such visits New Zealand develops familiarity with less established partners and deepens the trust of those partners to which it is already close. The Ministry also supports the Minister's engagement with international counterparts visiting New Zealand, including his participation in the Royal New Zealand Navy's 75th Anniversary Commemorations and International Naval Review.

In addition to the Minister's travel, the Ministry also supports the travel of the Secretary of Defence and Chief of the Defence Force and other senior officials, as well as travel by their counterparts visiting New Zealand.

Overall, in the last three years we have a seen significant increase in travel. The Ministry expects this high tempo to increase.

New Zealand continues to be an active participant in the region's security architecture and is a member of the East Asia Summit, the ASEAN Regional Forum, the ASEAN Defence Ministers' Meeting-Plus (ADMM-Plus), the Five Power Defence Arrangement, and the South Pacific Defence Ministers' Meeting (SPDMM). New Zealand hosted a successful SPDMM meeting that Fiji attended for the first time. New Zealand also successfully completed its term as co-chair of the ADMM-Plus Maritime Security Experts' Working Group, and continues to show its commitment to ADMM-Plus through co-chairing with the Philippines the new Experts' Working Group on Cyber Security.

The Ministry continued to lead the programme of bilateral defence consultations with a wide range of partner countries. Through such engagement New Zealand is able to increase its understanding of the international strategic environment and convey its views on international security matters. These consultations also provide an opportunity to advance specific defence initiatives with our partners, and contribute to whole of government relationship priorities.

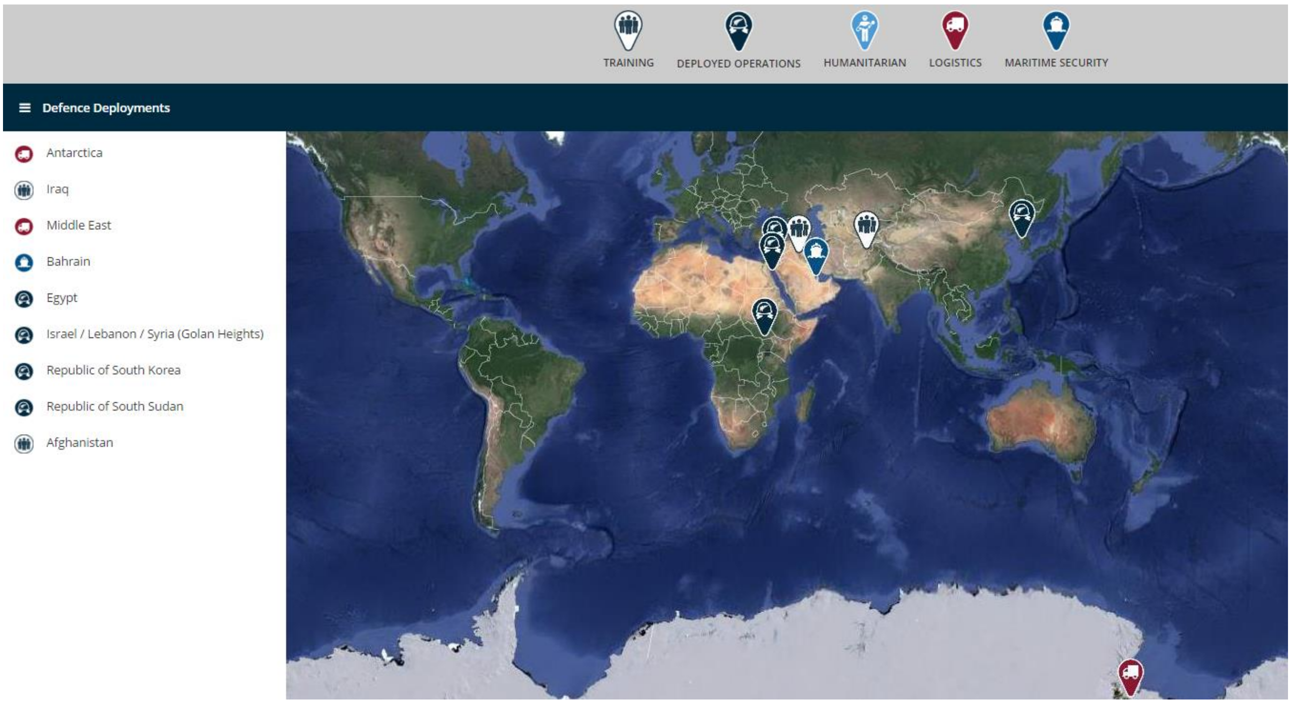
Policy advice on the deployment of New Zealand's defence personnel and assets

The Ministry provides advice to the government on the deployment of New Zealand's defence forces, in collaboration with the Defence Force and the Ministry of Foreign Affairs and Trade. This advice outlines the strategic rationale for New Zealand's participation in a deployment, including how it would contribute to New Zealand's security, national or international strategic intentions and foreign policy goals. The advice also sets out risks to the New Zealand Defence Force personnel and how these would be managed.

In 2016/17 deployment-related advice to the Government included Cabinet papers extending New Zealand's deployments to the following missions:

- United Nations Command in South Korea
- United Nations Truce Supervision Organisation in the Middle East
- Afghan National Army Officer Academy in Afghanistan
- Multinational Force and Observers in the Sinai
- Building Partner Capacity mission in Iraq
- United Nations Mission in South Sudan.

Figure 3: New Zealand Defence Force deployments



The Government also approved a series of commitments to Maritime Security and Support Operations in the Middle East, a Royal New Zealand Naval Task Group deployment to Asia, and an Inshore Patrol Vessel deployment to Fiji.

In addition to new deployments and mandate extensions, advice was provided on ongoing deployments, including:

- a New Zealand Defence Force Brigadier filling the influential role as Deputy Commanding General of the Combined Joint Forces Land Component Command, part of Operation Inherent Resolve in Iraq
- New Zealand Defence Force providing training at Besmaya and Al Taqaddum in Iraq
- a short-term deployment of engineers undertaking work securing South Camp in the Multinational Force and Observers deployment in the Sinai, and
- regular updates on a particular security situation or where a mission is evolving are also provided to ensure Ministers remain well informed.

PRIORITY 3: DEFENCE ADVICE BALANCES POLICY, CAPABILITY, FUNDING AND RISK WITH DEFENCE RECOGNISED AS AN INTERNATIONAL EXEMPLAR IN CAPABILITY MANAGEMENT

Over 2016–2020 this work will involve the following critical success factors:

- Implement the Defence Capability Change Action Programme, in partnership with the New Zealand Defence Force (and Defence Industry as appropriate).
- Defence capability is delivered on time, within budget, and is recognised as meeting the Government's requirements for the delivery of benefits.
- Enhance the use of the Better Business Case model to find smart, agile ways of development.

The Ministry defines and selects future military capability, and acquires or upgrades capabilities with whole of life costs of $15 million or more. It has $3-5 billion worth of capability projects active at any one time, and in the next 13 years will be responsible for the management of around $20 billion in allocated capital funding – over one-third of the government's capital spend.

By 2030, Defence will have replaced most of its current major military platforms.

In recognition of this responsibility, the Government approved an investment bid in Budget 2015 to allow the Ministry to grow its capability development and delivery functions, and to strengthen the Defence Capability Management System overall. As a result of the successful bid, the Government invested $27.1 million over four years in the Ministry to support increases in capacity and expertise.

This investment is enabling a significant change programme to deliver a challenging agenda of improvements across the Ministry and New Zealand Defence Force's joint Capability Management System.

Defence Capability Change Action Programme

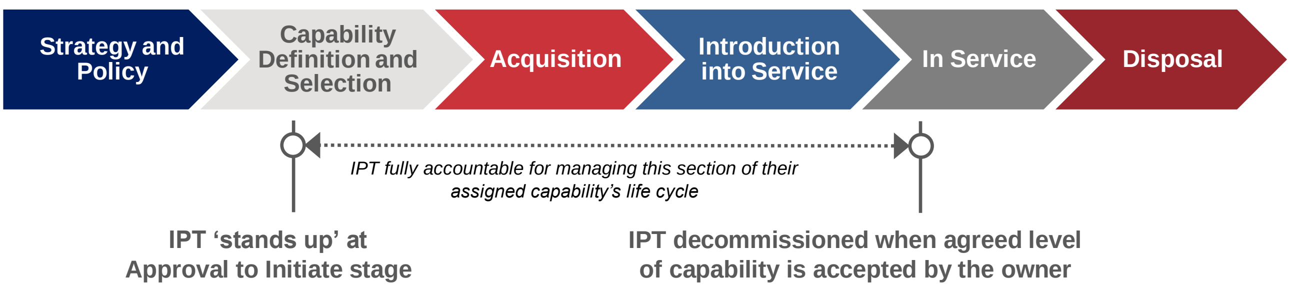
Changes to defence capability management are being delivered through the Defence Capability Change Action Programme. The Programme has now been in place for two years and is at a stage where the key activities needed to build the essential aspects of a contemporary capability management system are in place or in development.

At the core of the Programme is the enrichment of collaboration between the two agencies to draw on expertise from both. The Programme involves joint leads from both the Ministry and Defence Force.

> The Defence Capability Change Action Programme aims to ensure Defence delivers the right military capability at the right time for the right price and to the right specification.

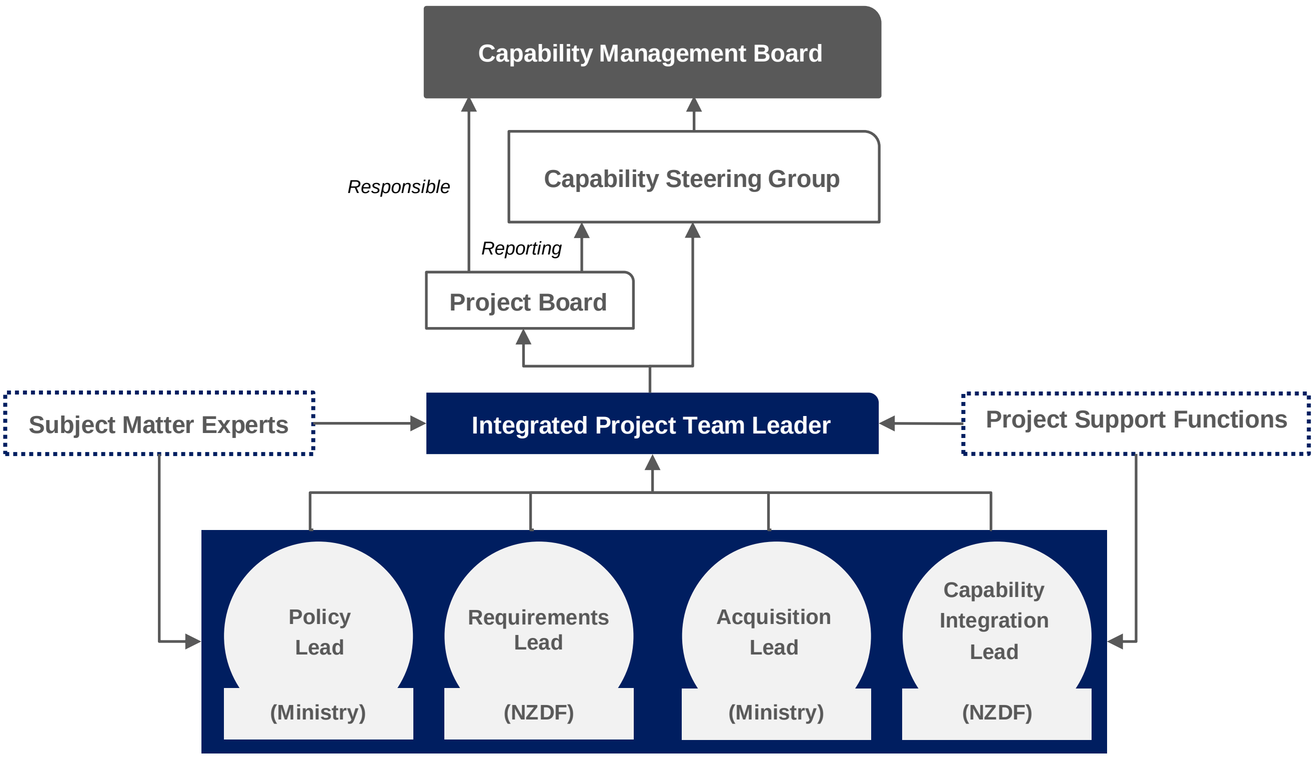
One of the key components of the changes to the Defence Capability Management Systems is the establishment of Integrated Project Teams (IPTs). In February 2017, the Defence agencies introduced six IPTs for major capability projects. IPTs bring Ministry and Defence Force staff together into a single team that spans capability definition and selection, and acquisition (for which the Secretary of Defence is primarily responsible) and Introduction into Service (for which the Chief of Defence Force is primarily responsible) phases of each capability project.

Figure 4: How Integrated Project Teams fit in the lifecycle of a defence capability



The six IPTs that have been established will deliver the following projects: Future Air Surveillance Capability, Future Air Mobility Capability, ANZAC Frigate System Upgrade/ANZAC Communications, Littoral Operations Support Capability/Littoral Warfare Systems, Maritime Sustainment Capability, and Network Enabled Army.

Figure 5: Roles and reporting lines for IPTs



In addition, we have established eight dedicated Project Boards to provide oversight of particularly large and complex capability projects and programmes: ANZAC Frigate Systems Upgrade, Network Enabled Army, Maritime Sustainment Capability, Individual Weapons Replacement, Underwater Intelligence, Surveillance and Reconnaissance, Littoral Operations Support Capability, Future Air Surveillance Capability, and the Consolidated Logistics Project. The role of these boards is to provide enhanced assurance that the project will successfully deliver expected outcomes and benefits.

The work of each IPT will be guided by a refreshed Capability Management Framework that is well underway. This Framework is owned by the Capability Management Board, which is co-chaired by the Secretary of Defence and the Chief of Defence Force. Enhancements to the Framework include clarification of roles, and policies, procedures and guidelines based on international best practice. It is being developed through a co-design process with staff from both organisations.

As part of the Programme, during 2016/17 Defence implemented a Whole of Life Costing model for major projects that strengthens costing advice for projects at each stage of their lifestyle. It has also implemented a Benefit Management Framework to ensure benefits expected from Defence's investments are agreed, understood, and ultimately realised. We have enhanced the planning process used to define the capability needed to meet policy goals, and have developed a collection of standard tools to support the definition and selection of military capability.

The next phase of the Programme is to embed the improvements that have been developed and introduced.

Defining and selecting military capability

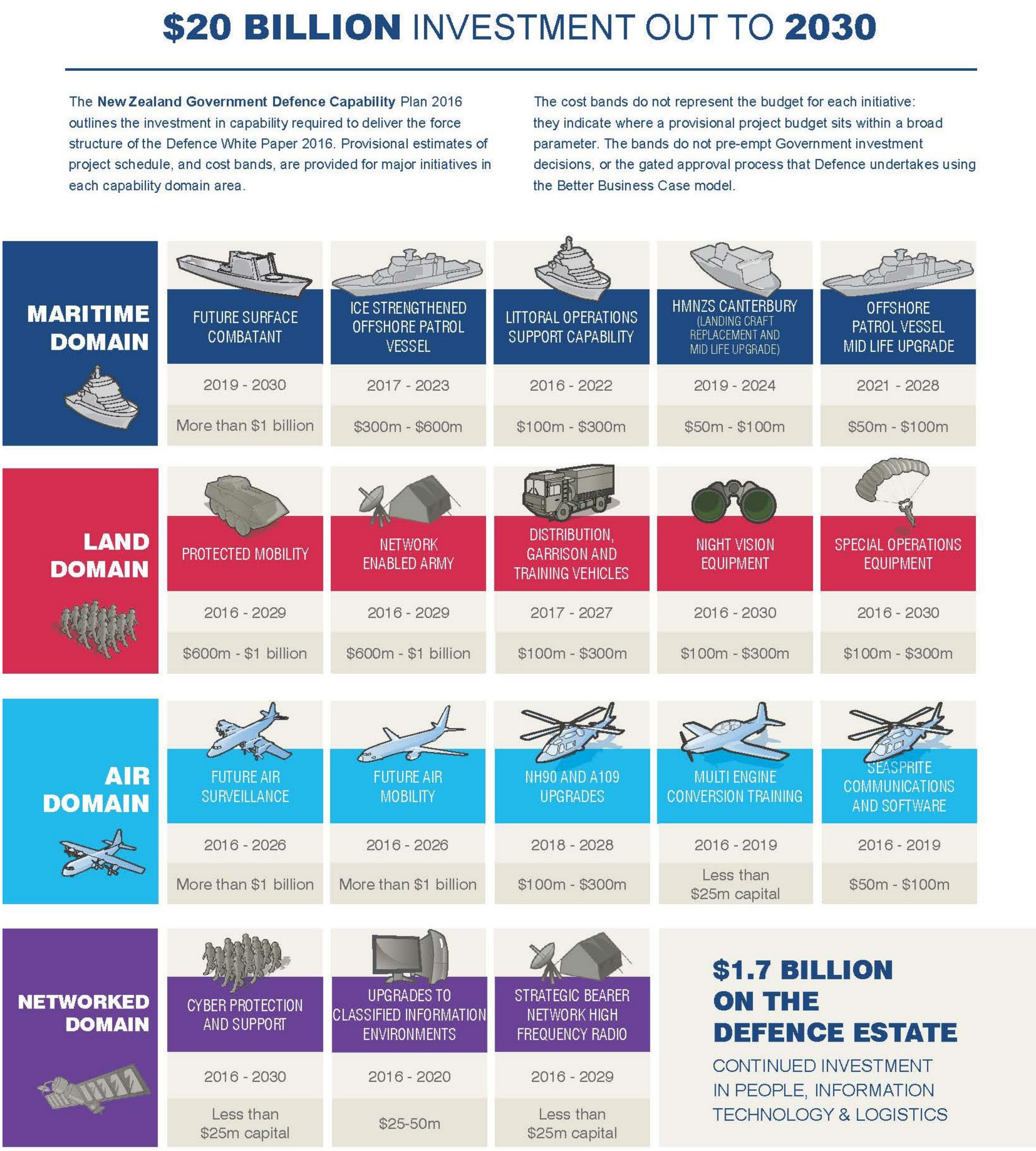
The Secretary of Defence is accountable for defining what military capability is needed to meet the Government priorities set out in the *Defence White Paper 2016*. The result of this process is recommendations to the Government on options for delivering the capability.

Prior to buying and taking delivery of new capability, the Ministry focuses on capturing requirements for each major project. Using an engagement framework that spans project team structures, management processes and events, we ensure:

- the Ministry and Defence Force work together closely so solutions meet the needs of those who will use the capability once it is delivered and deployed
- specialist advisers are engaged as needed to provide technical expertise during the definition and selection stages
- early and ongoing engagement with the defence industry is built into the process at appropriate points and levels, so industry has certainty about what the Ministry is seeking to achieve – particularly in areas such as whole-of-life cost and support models – and can plan their own business activities.

Details about the Ministry's work on engaging defence industry for major defence capability projects is provided under Priority 5 on page 35.

Figure 6: Upcoming defence capability decisions identified in the *Defence Capability Plan 2016*



Over the reporting period, business cases have been developed and submitted to Ministers for the following defence capabilities:

- Aircrew Training Capability Single Stage Business Case (agreed October 2016)
- Consolidated Logistics Project Detailed Business Case (agreed November 2016)
- Protected Mobility Indicative Business Case (agreed March 2017)
- 81mm Mortar Upgrade Project Single Stage Business Case (agreed March 2017)
- NH90 Simulator Single Stage Business Case (agreed July 2017)
- Future Air Mobility Capability Indicative Business Case (agreed July 2017).

Acquiring and upgrading military capability

Since publication of the *Defence White Paper 2016* and during the 2016/17 financial year, the Ministry has undertaken negotiations for military capability contracts worth over $650 million.

On 1 July 2016, Cabinet approved the Detailed Business Cases for a new Littoral Operations Support Capability to replace the Navy dive ship, HMNZS *Manawanui*, and the hydrographic ship, HMNZS *Resolution.* The Ministry has engaged Defence Industry on this project, with tenders closing in November 2016.

In relation to major equipment projects being acquired or introduced into service, highlights from the year include:

- completion of the upgrade project that has extended the life of the C-130 Hercules aircraft operated by the Royal New Zealand Air Force. The last of the five aircraft to be upgraded was completed in February 2017. This ensures these aircraft can continue to provide strategic and tactical air support while the search for replacement aircraft is undertaken as part of the Future Air Mobility Capability project.
- four contracts awarded under the Special Operations Vehicles project for Mobility Heavy, Protected Heavy, Low Profile Protected and Low Profile Utility vehicles, and for infrastructure that provides spares and ancillary equipment to maintain the vehicles.
- following approval of the Maritime Sustainment Capability project implementation business case by Cabinet, a contract with Hyundai Heavy Industries was signed in late July 2016.
- completion in October 2016 of the final configuration upgrade of the NH90 helicopter fleet that replaced the RNZAF Iroquois fleet.

Detailed summaries on major defence equipment currently being acquired or introduced into service are provided in the following section.

In addition, during 2016/17 the following major projects have been going through project closure:

- ANZAC Frigates Platform Systems Upgrade
- Defence Command and Control System
- Maritime Helicopter
- Medium-Heavy Operational Vehicles
- P-3K Orion Missions Systems Upgrade
- Pilot Training Capability
- Protector Remediation
- Replacement Helicopter Capability: Medium Utility Helicopter
- Replacement Helicopter Capability: Training/Light Utility Helicopter.

Project summaries for major defence equipment currently being acquired or introduced into service

This section summarises the background and 2016/17 performance of all significant defence projects that the Ministry is currently acquiring or supporting introduction into service by the New Zealand Defence Force.

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

The approval by Cabinet to commit to total project costs uses foreign exchange rates obtained through hedging. The subsequent recording of project expenditure uses exchange rates prevailing at the date of the transaction and creates a difference between the estimated costs included in the Cabinet approval and the amounts recorded in ledgers as project expenditure.

The project cost summaries show the financial effect of foreign exchange movements between Cabinet approval and recorded expenditure as at 30 June 2017: (favourable) / unfavourable.

Aircrew Training Capability

This project seeks to replace and provide a platform to conduct multi-engine pilot training, air warfare officer training, light transport operations, specialist support capabilities and support the development of a short-range maritime patrol capability. In October 2016, Cabinet authorised the release of a Request for Tender. In July 2017, Cabinet authorised the conclusion of a contract for an appropriate aircraft with the successful supplier.

Objectives	Performance
• Establish requirements and seek Cabinet approval	• In October 2016 Cabinet authorised the process for Chief of Defence Force to conclude a lease contract
• Release a Request For Tender	• Request for Tender released November 2016
• Select preferred bidder	• Acquisition Review Board approved preferred bidder in March 2017
• Begin contract negotiations	• Negotiations commenced and are ongoing

As this may involve a lease agreement, any capital costs are likely to be covered by Vote Defence Force.

81mm Mortar

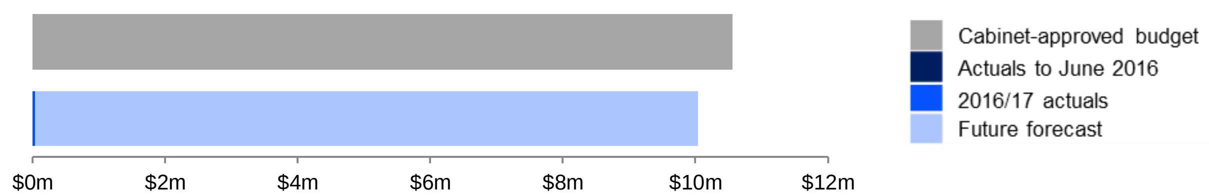
This project is to replace and enhance the Defence Force's 81mm medium mortar capability in order to improve its operational effectiveness, reliability and sustainability. There are three equipment components that form the mortar capability: the mortar weapon, the sighting system and the weapons locating radar. In March 2017 the Minister of Defence approved the Single Stage Business Case for the sole source acquisition of the following components:

- 81mm mortars and weapons locating radars – via separate United States Foreign Military Sales cases
- sighting systems – direct commercial sales contract with Hall & Watts, United Kingdom.

Objectives	Performance
• Submit Price and Availability requests for mortars and radars	• Price and Availability requests sent to US authorities in July 2016 (mortar) and September 2016 (radar) • Responses received October 2016
• Develop Single Stage Business Case for endorsement by Defence governance boards and approval by Minister of Defence	• Single Stage Business Case approved by Minister in March 2017 • Letter of request released to sights supplier in April 2017 with a response received in May 2017
• Develop letter of request for mortars and radars	• US authorities advised in May 2017 that, due to large orders ahead of NZ delivery of mortars would be 32 months – delivery potentially mid-late 2020 • US authorities advised in May 2017 that the radars will undergo a technical refresh with a potential delay in delivery until 2020
• Develop contract for sights	• A letter of request was released to the supplier in April 2017 with a response received in May 2017 • Offer includes buy back option of existing sights.

At 30 June 2017 actual and expected project costs were:

	Total costs to 30 June 2016 $000	Project costs in 2016/17 $000	Estimated remaining costs to complete $000	Estimated total project costs $000
Cabinet approved budget				10,560
Effect of foreign exchange movements				(517)
				10,043
Project expenditure	**-**	**35**	**10,008**	**10,043**
Estimated project variation				-



ANZAC Frigate Systems Upgrade

The primary objective of the ANZAC Frigate Systems Upgrade project is to upgrade the ANZAC frigates' combat capabilities. This is required to counter contemporary threats and to replace obsolescent systems.

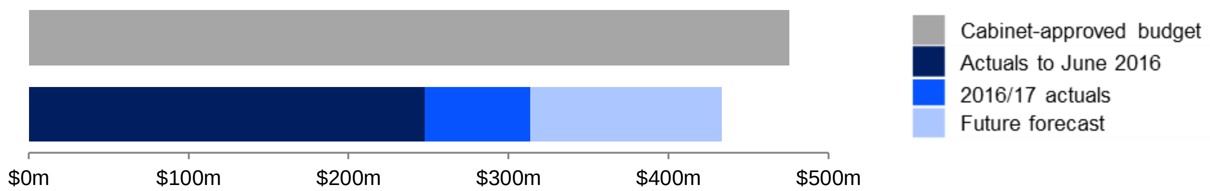
In April 2014, Cabinet approved the Project Implementation Business Case, including capital expenditure of up to $446.2 million between the Ministry and New Zealand Defence Force. Contracts have been awarded to Lockheed Martin Canada as the Prime System Integrator and 11 others for the provision of equipment and services.[6]

The systems to be installed on the ANZAC Frigates have been acquired. Due to the longer than planned preliminary design phase, and cost pressures, the planned refit start date has been deferred. As at 30 June 2017, the Detailed Design for installing those systems was being finalised and costed.

Objectives	Performance
• Conduct scheduled Platform Detailed Design Reviews	• Reviews were successfully completed in June 2016 and May 2017
• Complete installation and sea trials on the upgraded sonar and underwater telephone and conduct training	• Equipment installed. Trials for the first systems were successfully completed in June 2016 with the trials for the second ship completed in November 2016
• Award contract for the design of the Combat System Trainer layout at Devonport	• The system was delivered and successfully commissioned at the Devonport Naval Base in February 2017

At 30 June 2017 actual and expected project costs were:

	Total costs to 30 June 2016 $000	Project costs in 2016/17 $000	Estimated remaining costs to complete $000	Estimated total project costs $000
Cabinet approved budget				475,537
Effect of foreign exchange movements				(42,189)
				433,348
Project expenditure	**247,592**	**66,285**	**119,471**	**433,348**[7]
Estimated project variation				-



[6] The appropriation was subsequently increased through a non-cash technical adjustment to the approved budget, reflecting the effect of hedged foreign exchange movements.
[7] The first two phases of this project were completed to budget. In the case of the installation phase, while the Ministry anticipates cost estimate pressures, we are still negotiating the final contract.

C-130 Life Extension

This project has extended the life of the five Royal New Zealand Air Force C-130 Hercules aircraft by upgrading the fleet's mechanical and electrical equipment, undertaking comprehensive structural refurbishment work and extensively upgrading the communication and navigation systems.

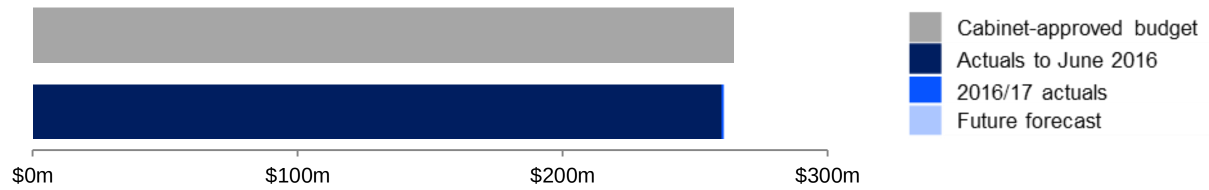
The first four completed aircraft had been delivered already and the fifth and final aircraft was delivered in February 2017, joining the rest of the fleet in service for the New Zealand Defence Force.

This project will be formally closed in the 2017/18 financial year, following completion of the final release of the Flight Management System software, which is expected to take place in September 2017.

Objectives	Performance
• Deliver the fifth aircraft by September 2016	• The final aircraft was delivered in February 2017 and commenced its first tasking in March 2017. Significant additional work had been required due to the need for a greater level of structural refurbishment of the airframe

At 30 June 2017 actual and expected project costs were:

	Total costs to 30 June 2016 $000	Project costs in 2016/17 $000	Estimated remaining costs to complete $000	Estimated total project costs $000
Cabinet approved budget				264,789
Effect of foreign exchange movements				(3,591)
				261,198
Project expenditure	**260,142**	**643**	**196**	**260,981**
Estimated project variation				217



Individual Weapons Replacement

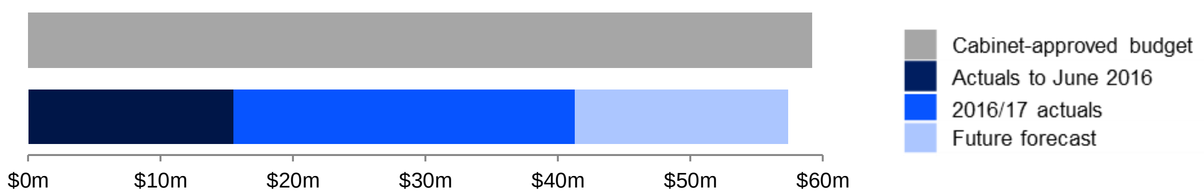
This project is replacing the existing Defence Force individual weapon (the Steyr rifle) with a new Modular Assault Rifle System – Light manufactured by Lewis Machine and Tools, along with necessary spares and ancillaries. Following Cabinet approval of the Project Implementation Business Case authorising the acquisition (in December 2015), the following contracts were signed:

- Individual Weapon and associated equipment – Lewis Machine and Tools USA
- Advanced Combat Optical Gunsights – Trijicon USA
- Combat Torches – Quality Imports NZ.

Objectives	Performance
• Monitor delivery of the Individual Weapons and associated equipment in accordance with the agreed milestone schedule (across four tranches)	• Tranches 1 to 3 factory acceptance test inspections were completed and tranches 1 and 2 were delivered and accepted. Tranche 3 was in the process of being shipped at the end of the financial year • Tranche 4 completed the factory acceptance test in July 2017 and will be delivered in the last quarter of calendar year 2017
• Deliver the Advanced Combat Optical Gunsights in accordance with the agreed milestone schedule (across 7 tranches)	• Tranches 1 to 7 were all delivered and accepted before 30 June 2017
• Delivery of Combat Torches	• All Combat Torches were delivered and accepted before 30 June 2017
• Complete the initial series of the train the trainer training	• Phase one was completed before 30 June 2017

At 30 June 2017 actual and expected project costs were:

	Total costs to 30 June 2016 $000	Project costs in 2016/17 $000	Estimated remaining costs to complete $000	Estimated total project costs $000
Cabinet approved budget				59,234
Effect of foreign exchange movements				(1,834)
				57,400
Project expenditure	**15,539**	**25,771**	**16,090**	**57,400**
Estimated project variation				-



Maritime Sustainment Capability

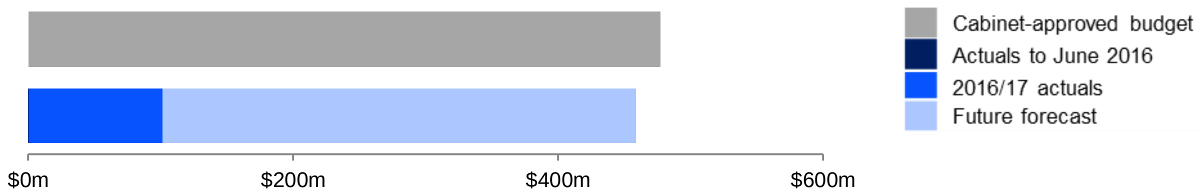
This project will replace the naval tanker HMNZS *Endeavour* with a vessel with capacity to maintain an afloat sustainment capability for the Defence Force and its partners, to support New Zealand's civilian presence at Scott Base in Antarctica and the nation's Southern Ocean interests.

This year saw the project move from a selection phase (2015/16) to a preliminary design phase. In July 2016, Cabinet approved of the Implementation Business Case and the contract was signed with Hyundai Heavy Industries.

Objectives	Performance
• Let the contract with Hyundai Heavy Industries	• Contract signed in July 2016
• Establish Acquisition Team in Ulsan, Republic of South Korea	• Team established in October 2016
• Completion of Preliminary Design Review	• Formal review conducted week ending 30 June 2017, working towards completion of the Preliminary Design Review

At 30 June 2017 actual and expected project costs were:

	Total costs to 30 June 2016 $000	Project costs in 2016/17 $000	Estimated remaining costs to complete $000	Estimated total project costs $000
Cabinet approved budget				477,130
Effect of foreign exchange movements				(18,320)
				458,810
Project expenditure	**204**	**101,248**	**357,306**	**458,758**
Estimated project variation				52



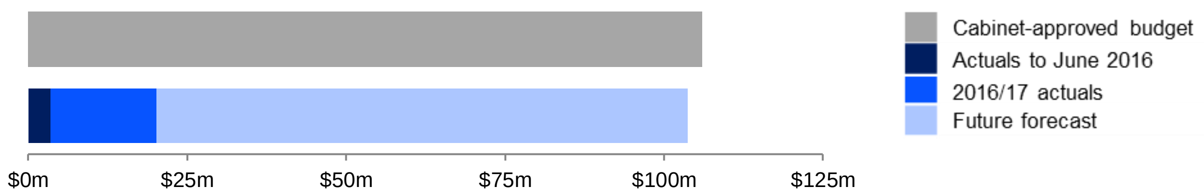
Network Enabled Army – Tranche 1

In April 2015, Cabinet approved Network Enabled Army – Tranche 1, including capital expenditure of up to $106 million. Tranche 1 will deliver modern communications to Special Operations Forces, and an Enhanced Infantry Task Group and its headquarters, comprised of around 200 personnel.

Objectives	Performance
• Request for Proposal for the provision of a Mobile Tactical Command System, for core radios, their ancillaries, network and engineering integration	• Contract signed in February 2017 with Industry Partner (System Designer) for the delivery of Tranche One capability and provision for future tranches. Delivery of some core radios and commencement of network design and radio integration
• Acquire specialist communication devices for Special Operations Forces	• Delivery for commencement of introduction into service
• Command Post combined capability realised	• Contract signed for equipment for commencement of introduction into service
• Communication Access Nodes, supporting common universal bearers designed and procured	• Bearer systems developed, tested and procured to enable the commencement of introduction into service
• Implementation of wide band communication devices	• Commencement of introduction into service
• Commence construction Test, Reference and Evaluation Capability Engineering Centre	• Tenders approved and commencement of Engineering Centre construction
• Commence construction Test, Reference and Evaluation Capability User Centre	• Design Consultant procured and tender documentation for tender and consents in place

At 30 June 2017 actual and expected project costs were:

	Total costs to 30 June 2016 $000	Project costs in 2016/17 $000	Estimated remaining costs to complete $000	Estimated total project costs $000
Cabinet approved budget				106,000
Effect of foreign exchange movements				(2,451)
				103,549
Project expenditure	**3,539**	**16,634**	**83,376**	**103,549**
Estimated project variation				-



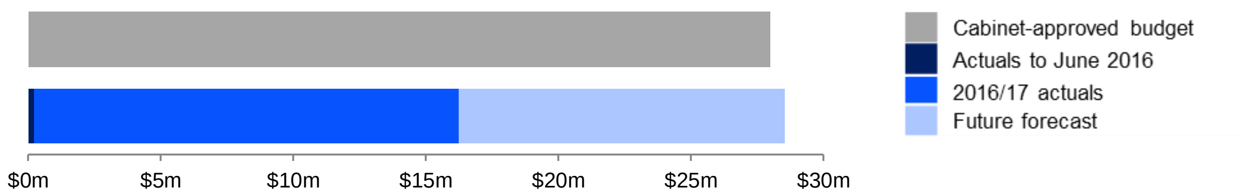
Special Operations Vehicles

In June 2015, Cabinet approved expenditure of up to $28 million on Special Operations Vehicles and associated support and infrastructure. Replacing the Pinzgauer Special Operations Vehicle, the project will acquire a mixed fleet, consisting of four vehicle types matched to the core requirements of the Special Operations Forces.

Objectives	Performance
• Award contracts for the supply of the Mobility Heavy, Protected Heavy, Low Profile Protected, and Low Profile Utility vehicles, and necessary spares and ancillary equipment	• Mobility Heavy contract awarded August 2016 • Protected Heavy contract signed May 2017 • Low Profile Protected and Utility combined contract awarded December 2016 • Infrastructure contract awarded June 2017
• Monitor contract deliveries in accordance with the contracted milestone delivery schedules	• All contracted milestones and deliveries up to 30 June 2017 have been met, including delivery of the Protected Heavy vehicles with their associated spares and ancillary equipment

At 30 June 2017 actual and expected project costs were:

	Total costs to 30 June 2016 $000	Project costs in 2016/17 $000	Estimated remaining costs to complete $000	Estimated total project costs $000
Cabinet approved budget				28,000
Effect of foreign exchange movements[8]				570
				28,570
Project expenditure	**217**	**16,024**	**12,294**	**28,535**
Estimated project variation				35



[8] The Ministry will seek a non-cash technical adjustment to the approved budget, reflecting the effect of foreign currency exchange movements on the reported value of project expenditure.

Strategic Bearer Network

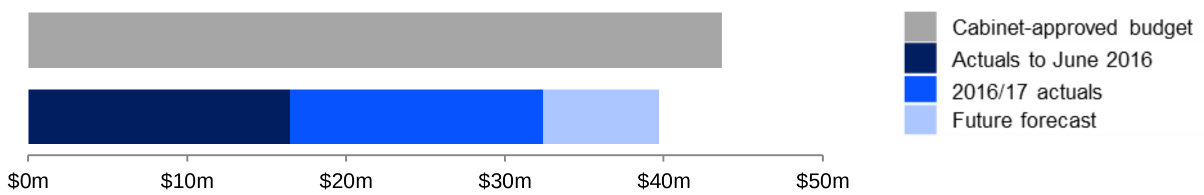
Strategic Bearer Network – Phase 1 will deliver global satellite communications services to the New Zealand Defence Force through the United States Department of Defense Wideband Global Satellite System. The Ministry is responsible for acquiring the infrastructure (mobile land based terminals, maritime terminals and fixed anchor stations) required to access the satellites. On 11 July 2016, Cabinet approved an increase in appropriation of $11.7 million to complete equipment acquisition.

Delivery of all capability is expected to be completed by the end of 2017 but the installation of some equipment may not occur until later in 2018.

Objectives	Performance
• Contract for five maritime terminals for installation on HMNZS *Te Mana*, *Te Kaha*, *Canterbury*, *Wellington* and *Otago*	• Foreign Military Sales contract delivering maritime terminals from July 2017
• Contract for second anchor station	• Contract for second anchor station signed. Hardware in country ready for installation at the end of calendar year 2017

At 30 June 2017 actual and expected project costs were:

	Total costs to 30 June 2016 $000	Project costs in 2016/17 $000	Estimated remaining costs to complete $000	Estimated total project costs $000
Cabinet approved budget				43,610
Effect of foreign exchange movements				(172)
				43,438
Project expenditure	**16,483**	**15,930**	**7,298**	**39,711**
Estimated project variation				3,727



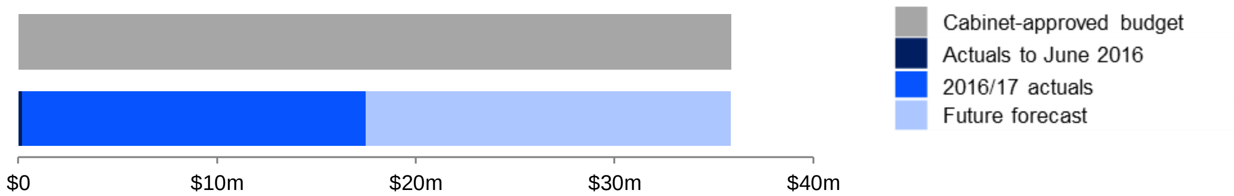
Underwater Intelligence, Surveillance and Reconnaissance

This project seeks to replace the underwater intelligence, surveillance and reconnaissance capability of the existing P-3K Orion fleet. In June 2014, Cabinet directed the Secretary of Defence to issue a Request for Tenders for the project. In June 2016 Cabinet approved the Project Implementation Business Case and issued an Approved to Commit Funds to the Secretary of Defence. In July 2016, a contract was signed with Boeing for the delivery of the upgrade.

Objectives	Performance
• Establish Project Board	• First Project Board meeting was held in July 2016
• Agree Acquisition Contract	• Acquisition Contract was signed in August 2016
• Agree Through Life Support Agreement	• Through Life Support Agreement was signed in August 2016
• Complete Final Design Review	• Final Design Review was successfully completed in March 2017

At 30 June 2017 actual and expected project costs were:

	Total costs to 30 June 2016 $000	**Project costs in 2016/17 $000**	**Estimated remaining costs to complete $000**	**Estimated total project costs $000**
Cabinet approved budget				35,872
Effect of foreign exchange movements				(39)
				35,833
Project expenditure	**200**	**17,256**	**18,377**	**35,833**
Estimated project variation				-



PRIORITY 4: DEFENCE SUCCESSFULLY DELIVERS AND SUSTAINS SYSTEMIC IMPROVEMENT

Over 2016–2020 this work will involve the following critical success factors:

- The Government's investment in the Ministry is managed successfully and meets expectations.
- Partnership arrangements in Defence deliver benefits to both the Ministry and New Zealand Defence Force.
- The Ministry is operating sustainably with contemporary organisational practices, systems and policies, with a highly engaged and participative culture.
- The Ministry develops its people and offers them a career in a national security workforce.

The Government's Budget 2015 investment is increasing the Ministry's annual baseline from $11.2 million in 2014/15 to $19.7 million in 2018/19. Most of this investment is for new staff positions to manage a period of significant activity in respect of major defence capability projects. This investment is also creating a larger Ministry that is more sustainable, resilient and fit for future purpose.

The Ministry and the Defence Force manage the Defence Capability Management System together. Improvements within the Ministry have involved partnering with the New Zealand Defence Force to make sure improvements benefit the whole system.

The Government's investment

The Defence Capability Change Action Programme is implementing the combined recommendations of various reviews of defence capability that go back 10 years. At 30 June 2017, 38 per cent of recommendations had been closed. The Programme is on track to close more than 90 per cent of recommendations by December 2017 and all recommendations by June 2018.

As the Programme enters its delivery phase, reviews of components are being undertaken at three, six and nine months to allow for feedback and adjustment.

Partnership arrangements in Defence

The Ministry's partnership with the Defence Force works formally through co-location and sharing of management and governance arrangements. It also works informally, through the way staff work together every day.

The Integrated Project Teams introduced through the Defence Capability Change Action Programme (discussed further on page 18) bring Ministry and Defence Force staff together into a single team that spans the responsibilities of both Defence Chief Executives for defence capability projects.

Partnered working between the agencies is further supported by IT infrastructure that supports teams across functional rather than agency lines. Both agencies are now operating a shared system for the programme and project management and reporting of capability projects (Planview).

In addition, a combined Defence document management system has been introduced that both agencies are implementing and using together. By the end of 2017/18, the system will have been rolled out to all Ministry teams – from those supporting capability projects to those supporting Defence's international engagement.

A sustainable, contemporary Ministry of Defence

The Ministry has grown from 70 people at the start of the Defence Capability Change Action Programme in July 2015 to 120 people at 30 June 2017. This has brought with it opportunities to enhance our capability delivery workforce with increased skills and expertise in portfolio and programme management; industry engagement; governance; and policy development for major capabilities. Most of these increases have been in the new structure for the Capability Delivery Division (previously Acquisition Division), which has increased from 15 to 50 people.

Through this growth, the Ministry has outgrown or started to outgrow many of its old organisational policies and systems. During 2015/16 the Ministry focused on a refresh of our human resources policy framework and introduced a new People Strategy. During 2016/17 it has introduced a modern delegations framework and new financial policies. This delegates more authority to managers in the organisation so they can plan and manage their functions in a similar way to other medium-size government departments.

During 2016/17 we also made further changes to human resources. Because we cater to several specialist workforces – including policy, evaluation and project management, we took a decision to move provision of human resource services in-house from 1 July 2017. This is so we can focus for the next few years on establishing the right professional support and career progression.

A Career in a National Security Workforce

We are committed to being part of a sector workforce approach for the external and security sector. We want people to be able to advance a career in the Ministry, or in our sector, and potentially to leave and return. During 2016/17 we agreed to co-invest in the delivery of a sector strategy, with this underway at the end of the year.

PRIORITY 5: DEFENCE IS OPEN, TRANSPARENT, ACCESSIBLE AND TRUSTED

Over 2016–2020 this work will involve the following critical success factors:

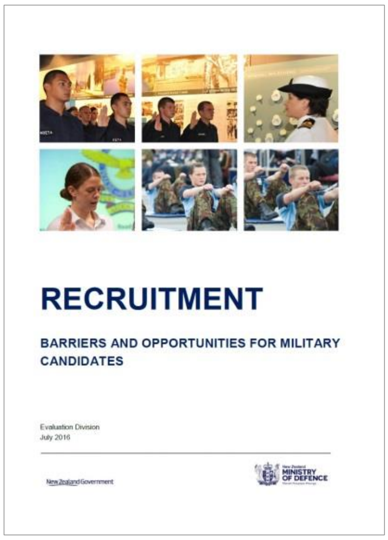
- The Ministry of Defence operates an open, ethical, high integrity environment.
- The Ministry of Defence maintains preventative controls on fraud and corruption.
- The Ministry of Defence communicates proactively and in plain English.
- The Ministry of Defence develops and delivers a deliberate programme of outreach to universities, industry and interest groups.

Evaluating Defence activities

The Ministry's multi-year Evaluation Work Programme assists Defence with assessing and evaluating risk across elements identified in the *Defence White Paper 2016* as most important for delivery:

- development of appropriate Defence Force capability
- generating and maintaining a skilled workforce
- fulfilling a series of varied roles and tasks
- partnering with other agencies and Defence Industry.

In July 2016 the Ministry released a report on recruitment: *Barriers and Opportunities for Military Candidates*. The report examined the recruitment experience of a cohort of Defence Force applicants as they passed through all phases of the process.



The report highlighted the challenges facing the Defence Force in its quest to recruit the right people for the right roles. It also identified a number of positive factors that show the organisation to be fair and equitable and an attractive employer with a lot to offer potential candidates. The review also enabled the Defence Force to isolate and confront some of the challenges the current system faced in 'filtering' a large pool of diverse applicants through the recruitment process. Measures are being undertaken to address recommendations in the report, including the reduction of wastage by automating and standardising methods of screening applicants and instituting standard operating procedures to maintain a consistency of approach by Candidate Coordinators.

The Ministry also undertook a substantive revision of its internal controls polices and procedures.

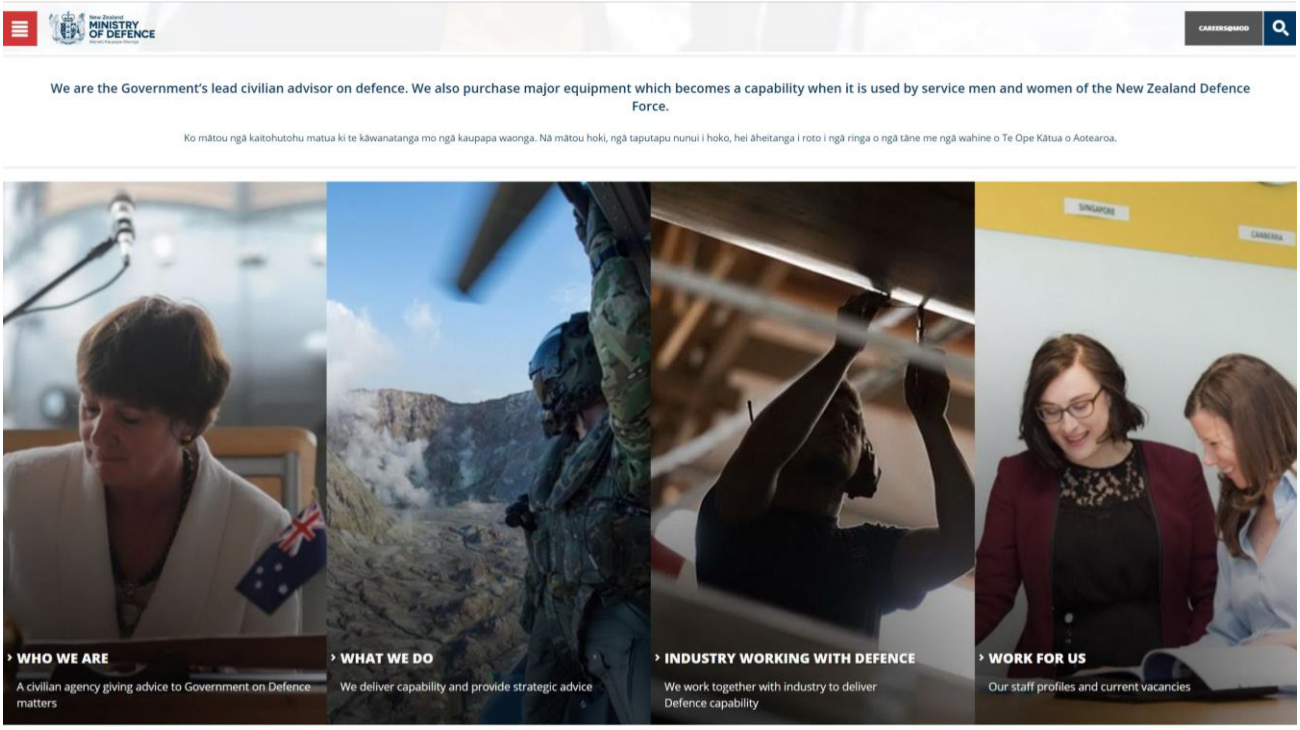
Fraud and corruption controls

The Ministry has built international networks to support anti-fraud and corruption work within Defence, and has established a network to improve alignment for Defence research. The Deputy Secretary, Evaluation and the Defence Force's Provost Marshal represent Defence as part of the Defence Fraud and Corruption Network alongside representatives from the United States, United Kingdom, Canada and Australia. The network aims to strengthen the capability of each participant to respond to serious and complex fraud, bribery and corruption, to enable a coordinated approach to sharing information and intelligence and to provide a platform for joint communications on efforts to defeat fraud and corruption.

Engaging Defence customers

In October 2016, the Ministry launched a significant refresh of its www.defence.govt.nz website. This provides enhanced information on New Zealand Defence activities, particularly providing expanded information on New Zealand's defence strategic policy framework, policy for defence deployments, and details of the Defence activities on international defence engagement.

Figure 7: A refreshed Ministry of Defence website was launched in October 2016



In 2016/17, the Ministry joined the Massey University-led Multi-Agency Research Network. This enables us to improve awareness of the Ministry's activities, including its research interests.

Working with industry

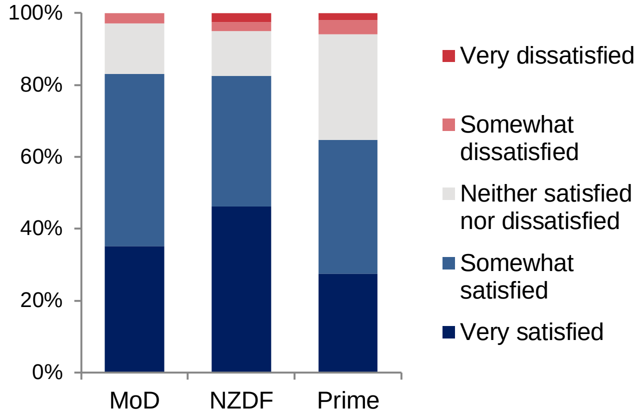
The Ministry's new website provides a first point of reference and source for information about capability delivery projects, along with clear points of contact for those seeking more information. Following the launch of the site, the Ministry has completed initial planning for additional functionality to increase industry access to information. Initial planning for this enhancement was completed over the second half of the reporting period and the release is planned to be completed by October 2017.

At the Defence Industry Association Conference in November 2016, the Defence agencies launched a shared strategy for enhanced engagement with industry: *Smart Customers and Smart Suppliers*.[9] The strategy sets out how Defence will communicate its future capability intentions more clearly and consistently. It also commits to greater engagement with industry as Defence develops policy and planning activities, to better draw on industry expertise and information. It commits to five enabling principles:

1. early engagement
2. effective two-way communication
3. a whole-of-life view of defence capabilities
4. collaboration and partnering
5. commercial good practice.

Following the Conference, the Ministry undertook an initial defence industry satisfaction survey on behalf of both Defence agencies. The 2016 survey set a baseline measurement of New Zealand defence industry's satisfaction with their engagements with the Ministry, the Defence Force and prime contractors.

Figure 8: Industry satisfaction with Defence's engagement



This first annual survey reported high levels of satisfaction with the Ministry's engagement with industry.[10] Establishing this baseline helps direct opportunities for domestic vendors and businesses to engage with prime contractors.

From 2016/17, all major Requests for Tender ask prime suppliers to submit a New Zealand Industry Engagement Plan, providing information on how they may be able to work with domestic suppliers as part of their proposal. This has created opportunities for New Zealand industry members to sub-contract with prime contractors in delivering military capability, and supporting it through life.

The Defence Capability Change Action Programme has seen a dedicated team appointed to more actively manage Defence's relationship with industry. Since September 2016, the Ministry has engaged industry through 10 meetings with the New Zealand Defence Industry Association, participation in five conferences and tradeshows, and 72 meetings and site visits with industry.

Information gathered through this industry engagement helps to inform the business cases presented to government.

[9] The *Smart Customers and Smart Suppliers* strategy is available from the Ministry's website at www.defence.govt.nz/publications/publication/Ministry-of-Defence-Strategy-for-Engaging-with-Industry.
[10] The survey is available from the Ministry's website at www.defence.govt.nz/publications/publication/2016-new-zealand-defence-industry-survey-results.

ORGANISATIONAL HEALTH AND CAPABILITY

In 2016/17 the Ministry managed dual challenges together – delivering on its change programme while also managing the serious impact of the November 2016 Kaikoura earthquake on the organisation and its people.

MANAGING GROWTH – FROM 70 PEOPLE TO 130

During 2016/17 the Ministry ran 71 recruitments – more than its total headcount of 70 in June 2015. Most of this recruitment is part of the Defence Capability Change Action Programme (see page 18) and for new Crown-funded major capability projects.

This growth in headcount has changed our staff profile. Over the year to 30 June 2017, the Ministry's average length of service reduced from 10 years to just two. Because of this, an important part of the change programme has been preserving the best aspects of the Ministry's culture, while acknowledging that our culture will change.

The Ministry has made sure every new staff member attends an induction programme that is focused on the Ministry's values. Each programme includes content on the Ministry's work and way of working, the perspectives of partners and key stakeholders, and is led by the Ministry's Leadership Team.

THE KAIKOURA EARTHQUAKE

The November 2016 Kaikoura earthquake had a major impact on the Ministry, damaging our head office building so badly that we are unable to return. This has left the Ministry in temporary premises while a long-term home is found.

The Ministry was operational six working days after the earthquake, and we have maintained delivery of our work programme. This includes the Defence Capability Change Action Programme and its recruitment programme.

We have worked with the New Zealand Defence Force to make sure Defence's temporary accommodation arrangements can accommodate a 20 per cent increase in headcount over the seven months following the earthquake. The earthquake has had a material impact on the Ministry's assets and an extra appropriation was established to meet these costs (see page 47).

We are working closely with the Defence Force on future accommodation for Defence. This includes looking at improvements that reflect what we have learned from working in the former Defence House, as well as in our temporary accommodation in Freyberg Building.

GENDER PAY

The Ministry pays men and women the same remuneration for the same work and at 30 June 2017 most (51 per cent) of staff were women. However, most senior roles are held by men, particularly in the Capability Delivery Division of the Ministry. This reflects the labour market from which these roles are hired. As a result, the Ministry has a higher gender pay gap than other agencies.

The Ministry has made a lot of progress on gender pay since 2013, when it started work to address gender disparities within the organisation. At 30 June 2017, women made up 51 per cent of staff (against 34 per cent in 2013) and 39 per cent of managers (against 17 per cent in 2013).

The Ministry has set goals to shift our performance further.

At each level in the Ministry, we have set a target of 40-40-20 – 40 per cent each of men and women, and 20 per cent of any gender.

The Ministry has taken a number of steps to support careers of all staff, particularly women:

- changes to human resources policies
- providing private sector secondments for high potential staff
- requiring shortlists for management roles to include at least one woman candidate
- progressive policies that include support with parental leave and flexible working arrangements
- reimbursing some childcare costs, including when staff have to travel
- being the first public service department to provide free flu vaccinations for dependent children, and
- making sure that, where people have to pause their career or change hours, we help them to maintain pay and career advancement.

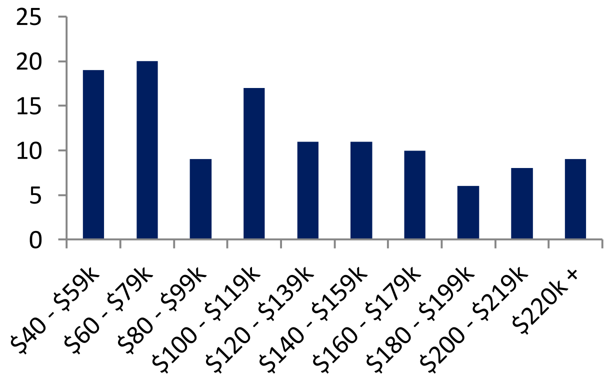
We have also set a goal of making 50 per cent of appointments each year women in our Capability Delivery Division, where the greatest change is needed.

Ministry staff working together

STAFF SALARY BANDS

The table to the right reflects a number of new senior project manager and specialist roles which lead multi-million dollar projects that acquire military equipment for the Defence Force. These people frequently have complex project management or engineering backgrounds as they are purchasing frigates, aircraft and the like.

Figure 9: Number of Ministry staff in each $20k salary band



PUBLIC SERVICE INTEGRITY

The Ministry advises on and leads major commercial activities for the government as well as key international relationships. Integrity is at the heart of what we do. In 2016, Transparency International rated New Zealand as having the least corrupt and most transparent defence system in the world.

In 2016/17 the Ministry took steps to make sure we look after our integrity culture. It introduced enhancements to the management of conflicts of interest, and made sure all new staff had multiple opportunities to understand the policy and declare any interests.

The Ministry also introduced a new 'Speaking Up' policy which encourages all staff to raise any integrity issue, big or small, and requires managers to respond positively to any issue that is raised with them in good faith. This sits alongside the existing Protected Disclosures Policy, and new training for managers that includes content on integrity, fraud and corruption.

QUALITY ASSURANCE

The Ministry believes in continuous improvement. We support this across Defence through the activities of our Evaluation Division, and it is also something we are embedding in our own organisation.

As part of the Defence Capability Change Action Programme, we are establishing an embedded focus on continuous improvement as part of a refreshed Capability Management System. Work on this was started in 2016/17.

Each part of the organisation has some mechanism to provide assurance or review. This includes an annual review of the quality of policy advice, external peer review of Evaluation reports, an annual audit programme, and mechanisms that ensure regular review of our internal controls framework and policies. In addition, the Capability Delivery Division holds accreditation to the ISO 9001 standard.

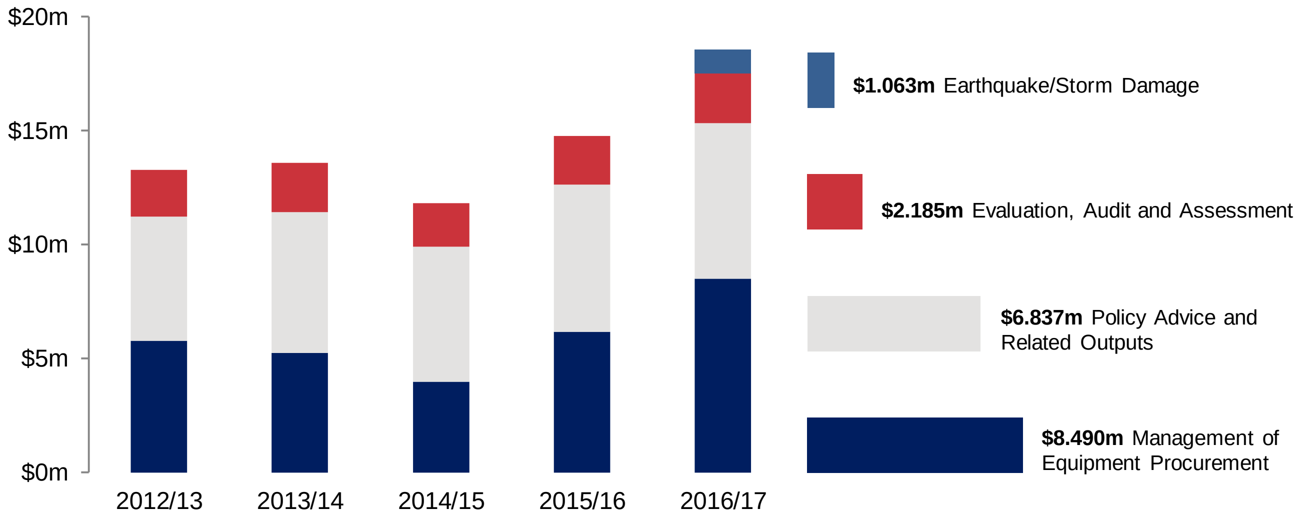
IMPLEMENTING THE NEW ZEALAND BUSINESS NUMBER

The Ministry has established an internal group working on the Ministry's adoption of the New Zealand Business Number (NZBN). Use of the NZBN for the Ministry's financial management and procurement will be rolled out in 2017/18.

SUMMARY FINANCIAL INFORMATION

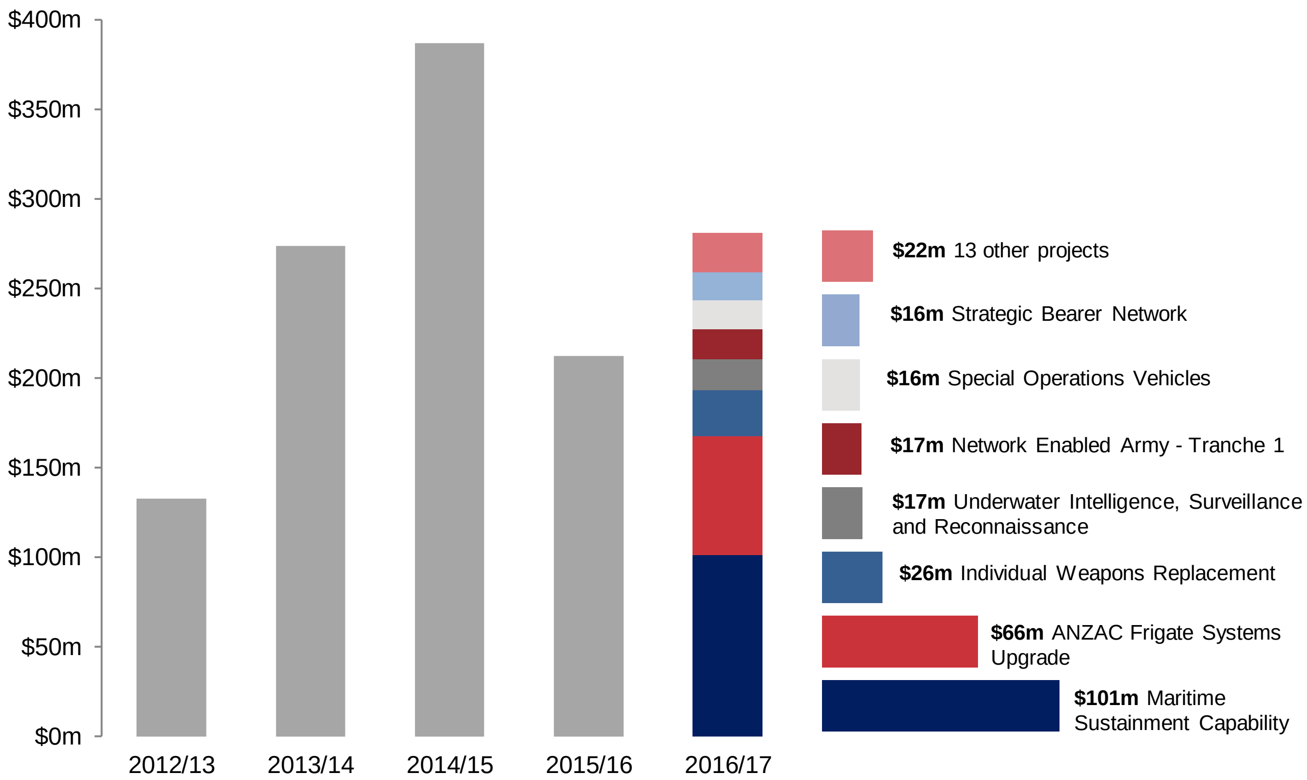
The Ministry's departmental expenditure

The Ministry meets expenses through three appropriations, with an Earthquake/Storm Damage appropriation established to meet costs associated with the November 2016 Kaikoura earthquake.



The Ministry's non-departmental expenditure on Defence equipment

The Defence Capability Plan sets out an intended timeline for upcoming major defence equipment procurement activities. Crown funding is allocated after Cabinet approval of business cases for the specific projects.



MULTI-CATEGORY APPROPRIATION: POLICY ADVICE AND RELATED OUTPUTS

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

Under this Multi-Category Appropriation (MCA), the Minister of Defence purchases:

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

	2015/16	2016/17	
Performance Measures	**Actual**	**Budget**	**Actual**
The performance of the MCA as a whole will be assessed by the average performance success of the below measures of the difference between actual results and the budget standard of all percentage based measures within the MCA categories	+6.6%	>0%	+6.8%
Ministerial Services			
This category is intended to achieve the provision of quality and timely Ministerial support to the Minister			
Quality, as assessed by the percentage of first draft of all correspondence accepted by the Minister	94%	≥90%	100%
Timeliness, as assessed by the percentage of papers that were submitted by the timeframe set in legislation, or otherwise agreed with the Minister	94%	≥95%	97%
Policy Advice			
This category is intended to achieve the provision of accurate, timely and responsive policy advice			
Total cost per output hour of Policy Advice	$87	$100	$71
Technical quality of policy advice, as assessed by an independent review of a sample of policy papers	75%	Mean ≥70%	76%

	2015/16	2016/17	
Performance Measures	**Actual**	**Budget**	**Actual**
Minister's satisfaction with the quality of policy advice, as assessed by survey	70%[1]	≥70%	75%[1]
Technical quality robustness, as assessed by the Common Indicator Set tool	100%	≥70%	87.5%
Policy Support			
This category is intended to achieve the provision of quality and timely policy support to the Minister			
Minister's satisfaction with the quality of policy support, as assessed by survey	70%[1]	≥70%	70%[1]

Note

1. These scores reflect a shared rating across both the Ministry of Defence and New Zealand Defence Force.

Further information

This output particularly relates to the Ministry's following core business activities:

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

Further detail about 2016/17 policy advice activities are addressed in the preceding section Delivering on the Ministry's Strategic Intentions, particularly in relation to the following strategic priorities:

- strategic priority 1: Defence anticipates the dynamic security environment and contributes to a stronger national security sector
- strategic priority 2: Our defence diplomacy and support for deployments enhances New Zealand's security and other interests
- strategic priority 3: Defence advice balances policy capability, funding and risk with Defence recognised as an international exemplar in capability management

Cost for the year ended 30 June 2017

	2015/16	2016/17		
	Actual **$000**	**Main estimates** **$000**	**Supp estimates** **$000**	**Actual** **$000**
Policy advice and related outputs multi-category appropriation	6,480	6,985	6,976	6,837

DEPARTMENTAL OUTPUT EXPENSE: EVALUATION, AUDIT AND ASSESSMENT OF PERFORMANCE

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

	2015/16	2016/17	
Performance Measures	**Actual**	**Budget**	**Actual**
Evaluations, audits and assessments are in accordance with work priorities identified and advised by the Minister of Defence. (Note 1)	Standard met	Standard met	Standard met
All evaluations, audits and assessments meet the Ministry's pre-determined quality criteria	New measure	100%	100%
All major evaluations, audits and assessments are externally quality assured. (Note 2)	New measure	100%	100%

Notes:

1. The standard for this measure is based on a continuum of standard not met, standard met and standard exceeded.
2. Small, simple reviews may be peer reviewed by qualified Ministry staff from outside the Evaluation Division. All medium, large and/or complex reviews are reviewed by qualified persons external to the Ministry.

Further information

This output particularly relates to the Ministry's core business activity of undertaking evaluations and assessments directed by the Minister of Defence.

Further detail about 2016/17 evaluation, audit and assessment activities are addressed in the preceding section Delivering on the Ministry's Strategic Intentions, particularly in relation to strategic priority 5: Defence is open, transparent, accessible and trusted.

Cost for the year ended 30 June 2017

	2015/16	2016/17		
	Actual **$000**	**Main estimates** **$000**	**Supp estimates** **$000**	**Actual** **$000**
Evaluation, audit and assessment of performance	2,128	2,393	2,387	2,185

DEPARTMENTAL OUTPUT EXPENSE: MANAGEMENT OF EQUIPMENT PROCUREMENT

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

'Major' means equipment that will have more than a $15 million whole-of-life cost. The Ministry is committed to providing competitive industries with the opportunity to support defence, and to ensuring that the Government and the taxpayer receive value for money.

This output class involves:

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

	2015/16	2016/17	
Performance Measures	**Actual**	**Budget**	**Actual**
Cost: Each procurement or refurbishment project will be managed within its approved budget, inclusive of approved variations to the contract price and project budget (see Note 1).	Restated measure	100%	100%
Quality of Deliverable: Each procurement or refurbishment project will achieve on delivery the agreed/contracted specifications that are critical to acceptance (see Note 2).	Restated measure	100%	100%
Schedule: Each procurement or refurbishment project will be managed to schedule, without avoidable schedule over-run (see Note 3).	Restated measure	85%	85% (11 of 13 projects)

Notes:

1. Measured by the percentage of all projects that have total project-related expenditure incurred in the year within the approved project expenditure budget.
2. Measured by the percentage of accepted projects that meet all specifications that are critical to acceptance.
3. Measured by the percentage of all projects where, during the year, the project delivery schedule is not extended by more than 10%.

Further information

This output particularly relates to the Ministry's following core business activities:

- acquiring and upgrading military capability

- administering the joint Ministry/Defence Force Capability Management System.

Further detail about 2016/17 equipment procurement operations are addressed in the preceding section Delivering on the Ministry's Strategic Intentions, particularly in relation to the following strategic priorities:

- strategic priority 3: Defence advice balances policy capability, funding and risk with Defence recognised as an international exemplar in capability management
- strategic priority 5: Defence is open, transparent, accessible and trusted.

Cost for the year ended 30 June 2017

	2015/16	2016/17		
	Actual $000	Main estimates $000	Supp estimates $000	Actual $000
Management of equipment procurement	6,165	8,637	8,931	8,490

MINISTRY OF DEFENCE – CAPITAL EXPENDITURE PERMANENT LEGISLATIVE AUTHORITY

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

	2015/16	2016/17	
Performance Measures	**Actual**	**Budget**	**Actual**
Capital expenditure is within Capital Plan	New measure (previously 'within budget')	Within Capital Plan	Within Capital Plan

Note

1. The Defence Capital Plan was updated during the reporting year to reflect the impact of the November 2016 Kaikoura earthquake.

Cost for the year ended 30 June 2017

	2015/16	2016/17		
	Actual **$000**	**Main estimates** **$000**	**Supp estimates** **$000**	**Actual** **$000**
Capital expenditure permanent legislative authority	301	350	650	373

DEPARTMENTAL OTHER EXPENSES – EARTHQUAKE/STORM DAMAGES

This appropriation is intended to achieve the recognition of costs incurred by the Ministry of Defence resulting from the November 2016 Kaikoura earthquake. (Refer to note 15 of the Departmental Financial Statements for further information.)

	2015/16	2016/17	
Performance Measures	**Actual**	**Budget**	**Actual**
Recognised expenses are within appropriation	Temporary appropriation	Within appropriation	Within appropriation

Cost for the year ended 30 June 2017

	2015/16	2016/17		
	Actual **$000**	**Main estimates** **$000**	**Supp estimates** **$000**	**Actual** **$000**
Departmental other expenses	-	-	1,167	1,063

NON-DEPARTMENTAL CAPITAL EXPENDITURE: PURCHASE OF DEFENCE EQUIPMENT

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

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

	2015/16	2016/17	
Performance Measures	**Actual**	**Budget**	**Actual**
Performance measures are the same as used for the departmental appropriation Management of Equipment Procurement and are reported under the appropriation on page 45.			

Further information

This output particularly relates to the Ministry's following core business activities:

- acquiring and upgrading military capability
- administering the joint Ministry/Defence Force Capability Management System.

Further detail about 2016/17 equipment procurement operations are addressed in the preceding section Delivering on the Ministry's Strategic Intentions, particularly in relation to the following strategic priorities:

- strategic priority 3: Defence advice balances policy capability, funding and risk with Defence recognised as an international exemplar in capability management
- strategic priority 5: Defence is open, transparent, accessible and trusted.

Cost for the year ended 30 June 2017

	2015/16	2016/17		
	Actual **$000**	**Main estimates** **$000**	**Supp estimates** **$000**	**Actual** **$000**
Purchase of defence equipment	212,412	260,529	329,469	280,658

PART 3: STATEMENT OF RESPONSIBILITY AND AUDIT REPORT

STATEMENT OF RESPONSIBILITY

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

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

In my opinion:

- the financial statements fairly reflect the financial position of the Ministry as at 30 June 2017 and its operations for the year ended on that date and
- the forecast financial statements fairly reflect the forecast financial position of the Ministry as at 30 June 2018 and its operations for the year ending on that date.

Signed by:

Helene Quilter
Secretary of Defence

27 September 2017

Countersigned by:

Pasanka Wickremasinghe
Chief Financial Officer

27 September 2017

INDEPENDENT AUDITOR'S REPORT

TO THE READERS OF MINISTRY OF DEFENCE'S ANNUAL REPORT FOR THE YEAR ENDED 30 JUNE 2017

AUDIT NEW ZEALAND
Mana Arotake Aotearoa

The Auditor-General is the auditor of the Ministry of Defence (the Ministry). The Auditor-General has appointed me, Karen Young, using the staff and resources of Audit New Zealand, to carry out, on his behalf, the audit of:

- the financial statements of the Ministry on pages 56 to 76 that comprise the statement of financial position, statement of commitments, statement of contingent liabilities and contingent assets as at 30 June 2017, the statement of comprehensive revenue and expense, statement of changes in equity, and statement of cash flows for the year ended on that date and the notes to the financial statements that include accounting policies and other explanatory information;
- the performance information prepared by the Ministry for the year ended 30 June 2017 on pages 12 to 37 and 42 to 48;
- the statements of expenses and capital expenditure of the Ministry for the year ended 30 June 2017 on pages 54 and 55; and
- the schedules of non-departmental activities which are managed by the Ministry on behalf of the Crown on pages 77 to 90 that comprise:
    - the schedules of assets; liabilities; capital commitments; and contingent liabilities and assets as at 30 June 2017;
    - the schedules of expenses; revenue, capital receipts and capital expenditure for the year ended 30 June 2017; and
    - the notes to the schedules that include accounting policies and other explanatory information.

OPINION

In our opinion:

- the financial statements of the Ministry on pages 56 to 76:
    - present fairly, in all material respects:
        - its financial position as at 30 June 2017; and
        - its financial performance and cash flows for the year ended on that date; and
    - comply with generally accepted accounting practice in New Zealand in accordance with Public Benefit Entity Standards Reduced Disclosure Regime; and
- the performance information of the Ministry on pages 12 to 37 and 42 to 48:
    - presents fairly, in all material respects, for the year ended 30 June 2017:
        - what has been achieved with the appropriation; and
        - the actual expenses or capital expenditure incurred compared with the appropriated or forecast expenses or capital expenditure; and
    - complies with generally accepted accounting practice in New Zealand; and

- the statements of expenses and capital expenditure of the Ministry on pages 54 and 55 and are presented fairly, in all material respects, in accordance with the requirements of section 45A of the Public Finance Act 1989; and
- the schedules of non-departmental activities which are managed by the Ministry on behalf of the Crown on pages 77 to 90 present fairly, in all material respects, in accordance with the Treasury Instructions:
  - the assets; liabilities; capital commitments; and contingent liabilities and assets as at 30 June 2017; and
  - expenses; revenue, capital receipts and capital expenditure for the year ended 30 June 2017.

Our audit was completed on 27 September 2017. This is the date at which our opinion is expressed.

The basis for our opinion is explained below. In addition, we outline the responsibilities of the Secretary of Defence and our responsibilities relating to the information to be audited, we comment on other information, and we explain our independence.

BASIS FOR OUR OPINION

We carried out our audit in accordance with the Auditor-General's Auditing Standards, which incorporate the Professional and Ethical Standards and the International Standards on Auditing (New Zealand) issued by the New Zealand Auditing and Assurance Standards Board. Our responsibilities under those standards are further described in the Responsibilities of the auditor section of our report.

We have fulfilled our responsibilities in accordance with the Auditor-General's Auditing Standards.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

RESPONSIBILITIES OF THE SECRETARY OF DEFENCE FOR THE INFORMATION TO BE AUDITED

The Secretary of Defence is responsible on behalf of the Ministry for preparing:

- financial statements that present fairly the Ministry's financial position, financial performance, and its cash flows, and that comply with generally accepted accounting practice in New Zealand;
- performance information that presents fairly what has been achieved with each appropriation, the expenditure incurred as compared with expenditure expected to be incurred, and that complies with generally accepted accounting practice in New Zealand;
- statements of expenses and capital expenditure of the Ministry, that are presented fairly, in accordance with the requirements of the Public Finance Act 1989; and
- schedules of non-departmental activities, in accordance with the Treasury Instructions, that present fairly those activities managed by the Ministry on behalf of the Crown.

The Secretary of Defence is responsible for such internal control as is determined is necessary to enable the preparation of the information to be audited that is free from material misstatement, whether due to fraud or error.

In preparing the information to be audited, the Secretary of Defence is responsible on behalf of the Ministry for assessing the Ministry's ability to continue as a going concern. The Secretary of Defence is also responsible for disclosing, as applicable, matters related to going concern and using the going concern basis of accounting, unless there is an intention to merge or to terminate the activities of the Ministry, or there is no realistic alternative but to do so.

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

RESPONSIBILITIES OF THE AUDITOR FOR THE INFORMATION TO BE AUDITED

Our objectives are to obtain reasonable assurance about whether the information we audited, as a whole, is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit carried out in accordance with the Auditor-General's Auditing Standards will always detect a material misstatement when it exists. Misstatements are differences or omissions of amounts or disclosures, and can arise from fraud or error. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decisions of readers, taken on the basis of the information we audited.

For the budget information reported in the information we audited, our procedures were limited to checking that the information agreed to the Ministry's statement of intent.

For the budget information reported in the information we audited, our procedures were limited to checking that the information agreed to the Ministry's 2016-2020 Statement of Intent, Estimates and Supplementary Estimates of Appropriations 2016/17 for Vote Defence, and the 2016/17 forecast financial figures included in the Ministry's 2015/16 Annual Report.

We did not evaluate the security and controls over the electronic publication of the information we audited.

As part of an audit in accordance with the Auditor-General's Auditing Standards, we exercise professional judgement and maintain professional scepticism throughout the audit. Also:

- We identify and assess the risks of material misstatement of the information we audited, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- We obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Ministry's internal control.
- We evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Secretary of Defence.
- We evaluate the appropriateness of the reported performance information within the Ministry's framework for reporting its performance.
- We conclude on the appropriateness of the use of the going concern basis of accounting by the Secretary of Defence and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Ministry's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the information we audited or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Ministry to cease to continue as a going concern.
- We evaluate the overall presentation, structure and content of the information we audited, including the disclosures, and whether the information we audited represents the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Secretary of Defence, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Our responsibilities arise from the Public Audit Act 2001.

OTHER INFORMATION

The Secretary of Defence is responsible for the other information. The other information comprises the information included on pages 5 to 90, but does not include the information we audited, and our auditor's report thereon.

Our opinion on the information we audited does not cover the other information and we do not express any form of audit opinion or assurance conclusion thereon.

Our responsibility is to read the other information. In doing so, we consider whether the other information is materially inconsistent with the information we audited or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on our work, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

INDEPENDENCE

We are independent of the Ministry in accordance with the independence requirements of the Auditor-General's Auditing Standards, which incorporate the independence requirements of Professional and Ethical Standard 1 (Revised): Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board.

In addition to this audit, the Auditor-General has carried out an assurance review of the *Major Projects Report 2016* prepared by the Ministry and the New Zealand Defence Force. Other than the audit and the Auditor-General's assurance review, we have no relationship with or interests in the Ministry.

Karen Young

Karen Young
Audit New Zealand
On behalf of the Auditor-General
Wellington, New Zealand

PART 4: APPROPRIATION STATEMENTS

STATEMENT OF EXPENSES AND CAPITAL EXPENDITURE AGAINST APPROPRIATIONS

For the year ended 30 June 2017

Actual 2016 $000		Forecast not audited 2017 $000	Main estimates 2017 $000	Supp estimates 2017 $000	Actual 2017 $000	Forecast not audited 2018 $000
	Vote: Defence					
	Departmental Appropriations					
	Appropriations for output expenses					
2,128	Evaluation, audit and assessment of performance	2,393	2,393	2,387	2,185	2,384
6,165	Management of equipment procurement	8,637	8,637	8,931	8,490	11,008
8,293	**Total appropriations for output expenses**	**11,030**	**11,030**	**11,318**	**10,675**	**13,392**
	Multi-category appropriations (MCA)					
	Policy advice and related outputs MCA					
3,901	Policy advice	4,204	4,204	4,198	4,116	4,316
778	Ministerial services	839	839	838	820	861
1,801	Policy support	1,942	1,942	1,940	1,901	1,993
6,480	**Total multi-category appropriations**	**6,985**	**6,985**	**6,976**	**6,837**	**7,170**
	Departmental Other Expenses					
-	Earthquake/storm damages	-	-	1,167	1,063	-
	Departmental capital expenditure *					
301	Ministry of Defence – capital expenditure	350	350	650	373	350
15,074	**Total Departmental appropriations**	**18,365**	**18,365**	**20,111**	**18,948**	**20,912**
	Non-Departmental Appropriations					
	Capital expenditure					
212,412	Defence equipment	260,529	260,529	329,469	280,658	265,585
212,412	**Total Non-Departmental appropriations**	**260,529**	**260,529**	**329,469**	**280,658**	**265,585**
227,486	**Total appropriations administered by the Ministry of Defence**	**278,894**	**278,894**	**349,580**	**299,606**	**286,497**

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

STATEMENT OF EXPENSES AND CAPITAL EXPENDITURE INCURRED WITHOUT, OR IN EXCESS OF, APPROPRIATION OR OTHER AUTHORITY

For the year ended 30 June 2017

The Ministry has no instances of departmental or non-departmental unappropriated expenditure or capital expenditure (2016 – Nil).

STATEMENT OF DEPARTMENTAL CAPITAL INJECTIONS WITHOUT, OR IN EXCESSS OF, AUTHORITY

For the year ended 30 June 2017

The Ministry has not received any capital injections during the year without, or in excess of, authority (2016 – Nil).

TRANSFERS UNDER SECTION 26A OF THE PUBLIC FINANCE ACT 1989

For the year ended 30 June 2017

The Ministry has not made any transfers under Section 26A of the Public Finance Act 1989 (2016 – $0.260m).

PERFORMANCE INFORMATION

Performance information for all departmental appropriations are reported in this Annual Report.

Performance information for non-departmental capital expenditure is reported on page 48 in this Annual Report.

Performance information for departmental appropriations and non-departmental capital expenditure is reported in Part 2 of this Annual Report.

PART 5: DEPARTMENTAL FINANCIAL STATEMENTS

STATEMENT OF COMPREHENSIVE REVENUE AND EXPENSE

For the year ended 30 June 2017

Actual 2016 $000		Note	Forecast not audited 2017 $000	Main estimates 2017 $000	Supp estimates 2017 $000	Actual 2017 $000	Forecast not audited 2018 $000
	Revenue						
14,223	Revenue Crown	**2**	18,015	18,015	17,130	17,130	20,462
588	Other revenue	**2**	-	-	1,164	921	100
14,811	Total revenue		18,015	18,015	18,294	18,051	20,562
	Expenses						
8,212	Personnel expenses	**3**	10,114	10,114	11,507	11,553	12,841
6,144	Operating expenses	**5**	7,268	7,268	6,194	5,585	7,266
223	Depreciation and amortisation expense	**7,8**	360	360	371	212	250
-	Earthquake costs	**15**	-	-	1,167	1,063	-
194	Capital charge	**4**	273	273	222	162	205
14,773	Total expenses		18,015	18,015	19,461	18,575	20,562
38	**Surplus/(deficit)**		**-**	**-**	**(1,167)**	**(524)**	**-**
-	Other comprehensive revenue and expense		**-**	**-**	**-**	**-**	**-**
38	**Total comprehensive revenue and expense**		**-**	**-**	**(1,167)**	**(524)**	**-**

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 16.

STATEMENT OF FINANCIAL POSITION

As at 30 June 2017

Actual 2016 $000		Note	Forecast not audited 2017 $000	Main estimates 2017 $000	Supp estimates 2017 $000	Actual 2017 $000	Forecast not audited 2018 $000
	Assets						
	Current assets						
4,643	Cash and cash equivalents		2,708	2,708	3,084	4,970	3,019
-	Receivables from exchange transactions	**6**	494	494	472	164	472
13	Prepayments		15	15	8	3	8
4,656	Total current assets		3,217	3,217	3,564	5,137	3,499
	Non-current assets						
1,479	Property, plant and equipment	**7**	1,486	1,486	669	629	741
4	Intangible assets	**8**	34	34	126	30	154
1,483	Total non-current assets		1,520	1,520	795	659	895
6,139	**Total assets**		**4,737**	**4,737**	**4,359**	**5,796**	**4,394**
	Liabilities						
	Current liabilities						
1,753	Creditors and other payables	**9**	479	479	1,215	1,984	1,215
38	Return of surplus to the Crown	**10**	-	-	-	539	-
741	Employee entitlements	**11**	510	510	653	784	653
2,532	Total current liabilities		989	989	1,868	3,307	1,868
	Non-current liabilities						
191	Employee entitlements	**11**	332	332	242	136	242
191	Total non-current liabilities		332	332	242	136	242
2,723	**Total liabilities**		**1,321**	**1,321**	**2,110**	**3,443**	**2,110**
3,416	**Net assets**		**3,416**	**3,416**	**2,249**	**2,353**	**2,284**
	Equity						
3,416	Taxpayers' funds	**12**	3,416	3,416	2,249	2,353	2,284
3,416	**Total equity**		**3,416**	**3,416**	**2,249**	**2,353**	**2,284**

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 16.

STATEMENT OF CHANGES IN EQUITY

For the year ended 30 June 2017

Actual 2016 $000		Note	Forecast not audited 2017 $000	Main estimates 2017 $000	Supp estimates 2017 $000	Actual 2017 $000	Forecast not audited 2018 $000
3,416	**Balance at 1 July**		3,416	3,416	3,416	3,416	2,284
38	Total comprehensive revenue and expense		-	-	(1,167)	(524)	-
(38)	Return of operating surplus to the Crown	**10**	-	-	-	(539)	-
3,416	**Balance at 30 June**	**12**	**3,416**	**3,416**	**2,249**	**2,353**	**2,284**

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 16.

STATEMENT OF CASH FLOWS

For the year ended 30 June 2017

Actual 2016 $000		Forecast not audited 2017 $000	Main estimates 2017 $000	Supp estimates 2017 $000	Actual 2017 $000	Forecast not audited 2018 $000
	Cash flows from operating activities					
14,223	Receipts from Revenue Crown	18,015	18,015	17,130	17,130	20,562
935	Receipts from other revenue	-	-	697	778	-
(8,172)	Payments to employees	(10,037)	(10,037)	(11,562)	(11,500)	(12,566)
(6,015)	Payments to suppliers	(7,345)	(7,345)	(6,674)	(4,948)	(7,541)
(194)	Payments for capital charge	(273)	(273)	(222)	(162)	(205)
638	Goods and services tax (net)	-	-	(240)	(482)	-
1,415	Net cash flow from operating activities	360	360	(871)	816	250
	Cash flows from investing activities					
-	Receipts from sale of property, plant and equipment	-	-	-	-	-
(301)	Purchase of property, plant and equipment	(300)	(300)	(511)	(418)	(300)
-	Purchase of intangible assets	(50)	(50)	(139)	(33)	(50)
(301)	Net cash flow from investing activities	(350)	(350)	(650)	(451)	(350)
	Cash flows from financing activities					
(46)	Return of operating surplus	-	-	(38)	(38)	-
(46)	Net cash flow from financing activities	-	-	(38)	(38)	-
1,068	**Net increase/(decrease) in cash**	**10**	**10**	**(1,559)**	**327**	**(100)**
3,575	Cash at the beginning of the year	2,698	2,698	4,643	4,643	3,119
4,643	**Cash at the end of the year**	**2,708**	**2,708**	**3,084**	**4,970**	**3,019**

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 16.

STATEMENT OF COMMITMENTS

As at 30 June 2017

CAPITAL COMMITMENTS

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

The Ministry has no capital commitments (2016 – Nil).

NON-CANCELLABLE OPERATING LEASE COMMITMENTS

The Ministry leases property, plant and equipment in the normal course of its business. The lease of premises in Defence House was terminated as a result of the November 2016 Kaikoura Earthquake (refer note 15). The Ministry no longer has any non-cancellable operating lease commitments.

Actual 2016 $000		Actual 2017 $000
	Non-cancellable operating lease commitments	
494	Not later than one year	-
494	Later than one year and not later than two years	-
1,483	Later than two years and not later than five years	-
1,813	Later than five years	-
4,284	Total non-cancellable operating lease commitments	-
4,284	**Total commitments**	**-**

STATEMENT OF CONTINGENT LIABILITIES AND CONTINGENT ASSETS

As at 30 June 2017

CONTINGENT LIABILITIES

The Ministry has no quantifiable or unquantifiable contingent liabilities (2016 – Nil).

LEGAL PROCEEDINGS AND DISPUTES

The Ministry has no pending legal proceedings and disputes (2016 – Nil).

CONTINGENT ASSETS

The Ministry has a contingent asset for an insurance claim for the damage and other costs incurred due to the November 2016 Kaikoura Earthquake (refer note 15). Specialist advice is being provided in preparing this claim which is currently not quantifiable. The Ministry expects to proceed with this claim during the 2017/18 financial year but has no known resolution date (2016 – Nil).

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 16.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2017

NOTE 1: STATEMENT OF ACCOUNTING POLICIES

REPORTING ENTITY

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

The relevant legislation governing the Ministry's operations includes the Public Finance Act 1989 and the Defence Act 1990. The Ministry's ultimate parent is the New Zealand Crown. In addition, the Ministry has reported on Crown activities that it administers in the non-departmental statements and schedules on pages 77 to 90.

The Ministry's primary objective is to provide services to the New Zealand public. The Ministry does not operate to make a financial return. The Ministry has designated itself as a public benefit entity (PBE) for the purposes of complying with generally accepted accounting practice.

The financial statements of the Ministry are for the year ended 30 June 2017 and were approved for issue by the Chief Executive of the Ministry on 27 September 2017.

BASIS OF PREPARATION

The financial statements have been prepared on a going-concern basis, and the accounting policies have been applied consistently throughout the year.

Statement of compliance

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

The financial statements have been prepared in accordance and comply with Tier 2 PBE accounting standards. The Ministry meets the requirements of Tier 2 and is eligible for reduced disclosure reporting as its expenses are less than $30 million and does not have publicly traded debt.

Forecast financial statements have been prepared in accordance with PBE accounting standards, as described in the Forecast section below. The forecast financial statements have not been audited.

Presentation currency and rounding

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

Changes in accounting policies

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

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Significant accounting policies are included in the notes to which they relate.

Significant accounting policies that do not relate to a specific note are outlined below.

Foreign currency transactions

Foreign currency transactions (including those for which forward foreign exchange contracts are held) are translated into New Zealand dollars using the exchange rates prevailing at the dates of the transactions.

Goods and Services Tax (GST)

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

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

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

Commitments and contingencies are disclosed exclusive of GST.

Income tax

The Ministry is a public authority and consequently is exempt from income tax. Accordingly, no provision has been made for income tax.

Budget figures

The budget figures ("Main estimates") are those included in the Information Supporting the Estimates of Appropriations for the Government of New Zealand for the year ending 30 June 2017, which are consistent with the financial information in the Main Estimates.

In addition, the financial statements also present the updated budget information from the Supplementary Estimates ("Supp estimates").

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

Forecast figures

The Ministry is required by the Public Finance Act to present forecast financial statements for the financial year following the financial year to which the Annual Report relates. The forecast financial statements ("Forecast") are prepared in accordance with PBE FRS 42 Prospective Financial Statements.

The 2018 forecast financial statements are based on the Ministry's budget for 2017/18 as approved in the Estimates of Appropriations for 2017/18.

The forecast financial statements have been prepared as required by the Public Finance Act 1989 to communicate forecast financial information for accountability purposes.

The significant assumptions underlying the forecast financial statements are:

- the functions performed and the appropriations administered by the Ministry will not change over the forecast period
- the Ministry will not receive any additional funding beyond that voted in the Estimates of Appropriations during the forecast period.

The forecast financial statements were authorised for issue by the Chief Executive of the Ministry on 25 May 2017.

While the Ministry regularly updates its forecasts, updated forecast financial statements for the year ended 30 June 2018 will not be published. Actual financial results for the forecast period are likely to vary, and may be materially different, from the forecasts presented.

The 2017 forecast financial statements were reported in the Ministry's 2016 Annual Report and were prepared on the basis presented in that Annual Report.

The forecast financial statements have not been audited.

Provisions

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

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

COST ALLOCATION POLICIES

The Ministry has determined the cost of outputs using an allocation system comprising:

Direct costs

Direct costs are those costs directly attributable to an output.

For the year ended 30 June 2017, direct costs accounted for 77% of the Ministry's costs (2016 - 73%).

Indirect costs

Indirect costs are those costs that cannot be identified in an economically feasible manner with a specific output. Indirect costs are allocated across outputs based on a predetermined ratio. This ratio is assessed annually based on the services expected to be provided for each output over the ensuing year.

For the year ended 30 June 2017, indirect costs accounted for 23% of the Ministry's costs (2016 - 27%).

CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS

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

CRITICAL JUDGEMENTS IN APPLYING THE MINISTRY'S ACCOUNTING POLICIES

The Ministry had to exercise its judgement in determining the condition and value of property, plant and equipment recovered following the November 2016 Kaikoura earthquake (refer note 15).

EVENTS AFTER BALANCE DATE

There have been no significant events after balance date.

NOTE 2: REVENUE

Accounting policy

Revenue Crown

Revenue from the Crown is measured based on the Ministry's funding entitlement for the reporting period. The funding entitlement is established by Parliament when it passes the Appropriation Acts for the financial year. The amount of revenue recognised takes into account any amendments to appropriations approved in the Appropriation (Supplementary Estimates) Act for the year and certain other unconditional funding adjustments formally approved prior to balance date. There are no conditions attached to the funding from the Crown. However, the Ministry may only incur expenses within the scope and limits of its appropriations. The fair value of Revenue Crown has been determined to be equivalent to the funding entitlement.

Other Revenue

Costs incurred by the Ministry in the pre-acquisition stages of acquisition projects are recovered from the New Zealand Defence Force. This is classified as an exchange transaction.

Breakdown of other revenue and further information

Actual 2016 $000		Forecast not audited 2017 $000	Main estimates 2017 $000	Actual 2017 $000	Forecast not audited 2018 $000
588	Pre-acquisition project costs from New Zealand Defence Force	-	-	921	-
588	**Total other revenue**	**-**	**-**	**921**	**-**

NOTE 3: PERSONNEL EXPENSES

Accounting policy

Salaries and wages

Employees of the Ministry provide their services for salaries and wages under full time, fixed term and part time employment contracts. Remuneration for services provided incudes wages, superannuation contributions, leave and other Ministry entitlements.

Superannuation schemes

Employee contributions to the State Sector Retirement Savings Scheme, KiwiSaver, and the Government Superannuation Fund are accounted for as defined contribution superannuation schemes and are expensed in the surplus or deficit as incurred.

Actual 2016 $000		Forecast not audited 2017 $000	Main estimates 2017 $000	Actual 2017 $000	Forecast not audited 2018 $000
7,907	Salaries and wages	9,766	9,766	11,087	12,279
286	Employer contributions to defined contribution plans	271	271	385	444
19	Increase/(decrease) in employee entitlements	77	77	81	118
8,212	**Total personnel expenses**	**10,114**	**10,114**	**11,553**	**12,841**

NOTE 4: CAPITAL CHARGE

Accounting policy

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

Further information

The Ministry pays a capital charge to the Crown on its equity as at 30 June and 31 December each year. The capital charge rate for the year ended 30 June 2017 was 7.0% from 1 July 2016 to 31 December 2016 and 6.0% from 1 January 2017 to 30 June 2017 (2016 – 8.0% for the full year).

NOTE 5: OPERATING EXPENSES

Accounting policy

Operating expenses are recognised when goods and services are received.

Actual 2016 $000		Forecast not audited 2017 $000	Main estimates 2017 $000	Actual 2017 $000	Forecast not audited 2018 $000
103	Audit fees for financial statements	100	100	105	105
14	Fees paid to Audit New Zealand for other services	-	-	-	-
1,967	Consultancy	1,880	1,880	1,785	2,378
485	Professional services	867	867	881	978
837	Travel and related costs	807	807	871	824
187	Courses, conferences and exhibitions	325	325	262	217
683	Rental of premises	572	572	449	475
167	Legal	228	228	230	402
236	Grants and contributions	90	90	88	73
1,465	Other operating costs	2,399	2,399	914	1,814
6,144	**Total operating expenses**	**7,268**	**7,268**	**5,585**	**7,266**

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

NOTE 6: RECEIVABLES

Accounting policy

Short-term receivables are recorded at the amount due, less any provision for uncollectability.

A receivable is considered to be uncollectable when there is evidence that the amount will not be fully collectable. The amount that is uncollectable is the difference between the carrying amount due and the present value of the amount expected to be collected.

Actual 2016 $000		Actual 2017 $000
-	Debtors	164
-	Less provision for impairment	-
-	Net debtors	164
-	GST receivable	-
-	**Total receivables from exchange transactions**	**164**

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

NOTE 7: PROPERTY, PLANT AND EQUIPMENT

Accounting policy

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

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

Additions

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

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

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

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

Disposals

Gains and losses on disposals are determined by comparing the net disposal proceeds with the carrying amount of the asset. Gains and losses on disposals are included in the surplus/deficit.

Subsequent costs

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

Depreciation

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

Leasehold improvements	2 ½ years	(2016 – 5-18 years)
Furniture	2 ½-10 years	(2016 – 3-10 years)
Office equipment	5-10 years	(2016 – 5-10 years)
Computer equipment	3-5 years	(2016 – 3-5 years)

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

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

Impairment

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

Property, plant and equipment and intangible assets that have a finite useful life are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

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

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

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

	Note	Main estimates 2017	Actual 2017			
		Total	Leasehold improvements	Office furniture	Office and computer equipment	Total
		$000	$000	$000	$000	$000
Cost or valuation						
Balance at 1 July 2015		3,951	2,774	342	835	3,951
Additions		376	167	134	-	301
Disposals		-	-	-	-	-
Balance at 30 June 2016		**4,327**	**2,941**	**476**	**835**	**4,252**
Balance at 1 July 2016		4,327	2,941	476	835	4,252
Additions		300	152	59	129	340
Disposals	**15**	-	(2,625)	-	(21)	(2,646)
Balance at 30 June 2017		**4,627**	**468**	**535**	**943**	**1,946**
Accumulated depreciation and impairment losses						
Balance at 1 July 2015		2,562	1,722	81	759	2,562
Depreciation expense		235	161	38	12	211
Eliminate on disposal		-	-	-	-	-
Balance at 30 June 2016		**2,797**	**1,883**	**119**	**771**	**2,773**
Balance at 1 July 2016		2,797	1,883	119	771	2,773
Depreciation expense		344	121	56	28	205
Eliminate on disposal	**15**	-	(1,656)	-	(5)	(1,661)
Balance at 30 June 2017		**3,141**	**348**	**175**	**794**	**1,317**
Carrying amounts						
At 30 June and 1 July 2016		1,530	1,058	357	64	1,479
At 30 June 2017		1,486	120	360	149	629

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

NOTE 8: INTANGIBLE ASSETS

Accounting policy

Additions

Software developing costs, including website and licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software.

Staff training costs are recognised as an expense when incurred.

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

Amortisation

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

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

Computer software	3-5 years

Impairment

Refer to the policy for impairment of property, plant, and equipment in Note 7. The same policy applies to the impairment of intangible assets.

Critical accounting estimates and assumptions

Useful lives of software

The useful life of software is determined at the time the software is acquired and brought into use and is reviewed at each reporting date for appropriateness. For computer software licences, the useful life represents management's view of the expected period over which the Ministry will receive benefits from the software, but not exceeding the licence term.

	Main estimates 2017	Actual 2017	
	Total $000	Software $000	Total $000
Cost			
Balance at 1 July 2015	958	958	958
Additions	-	-	-
Disposals	-	-	-
Balance at 30 June 2016	**958**	**958**	**958**
Balance at 1 July 2016	958	958	958
Additions	48	33	33
Disposals	-	-	-
Balance at 30 June 2017	**1,006**	**991**	**991**
Accumulated amortisation and impairment losses			
Balance at 1 July 2015	942	942	942
Amortisation expense	14	12	12
Disposals	-	-	-
Balance at 30 June 2016	**956**	**954**	**954**
Balance at 1 July 2016	956	954	954
Amortisation expense	16	7	7
Disposals	-	-	-
Balance at 30 June 2017	**972**	**961**	**961**
Carrying amounts			
At 30 June and 1 July 2016	2	4	4
At 30 June 2017	34	30	30

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

NOTE 9: CREDITORS AND OTHER PAYABLES

Accounting policy

Short-term creditors are recorded at the amount payable.

Actual 2016 $000		Actual 2017 $000
588	Creditors	500
456	Accrued expenses	1,224
709	GST payable	260
1,753	**Total creditors and other payables**	**1,984**

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

NOTE 10: RETURN OF OPERATING SURPLUS

Actual 2016 $000		Actual 2017 $000
38	Net surplus/(deficit)	(524)
	Add back Other Expense appropriations:	
-	Earthquake/storm damages	1,063
38	**Total return of operating surplus**	**539**

The return of operating surplus to the Crown is required to be paid by 31 October of each year.

NOTE 11: EMPLOYEE ENTITLEMENTS

Accounting policy

Presentation of employee entitlements

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

Short-term employee entitlements

Entitlements expected to be settled within twelve months of balance date are measured at nominal values based on accrued entitlements at current rates of pay.

These include salaries and wages accrued up to balance date, annual leave earned but not yet taken at balance date, retiring and long service leave entitlements expected to be settled within twelve months, and sick leave.

Long-term employee entitlements

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

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

Critical accounting estimates and assumptions

Long service leave and retirement gratuities

The measurement of the long service leave and retirement gratuities obligations depend on a number of factors that are determined on an actuarial basis using a number of assumptions. Two key assumptions used in calculating this liability include the discount rate and the salary inflation factor. Any changes in these assumptions will affect the carrying amount of the liability.

Expected future payments are discounted using a weighted average discount rate of 2.84% (2016 3.13%) and an inflation factor of 3.0% (2016 3.0%) based on Treasury discount rates.

If either the discount rate or the salary inflation factor were to change by 1% from the Treasury's discount rates, with all other factors held constant, the carrying amount of the liability and the surplus/deficit would change by less than $7,000.

Actual 2016 $000		Actual 2017 $000
	Current provisions are represented by:	
562	Annual leave	710
16	Sick leave	22
163	Retirement and long service leave	52
741	Total current provision	784
	Non-current employee entitlements are represented by:	
191	Retirement and long service leave	136
932	**Total employee entitlements**	**920**

NOTE 12: EQUITY

Actual 2016 $000		Actual 2017 $000
	Taxpayers' funds	
3,416	Balance at 1 July	3,416
38	Net surplus/(deficit)	(524)
-	Capital contribution from the Crown	-
(38)	Provision for repayment of surplus to the Crown	(539)
3,416	**Taxpayers' funds at 30 June**	**2,353**

NOTE 13: RELATED PARTY TRANSACTIONS AND KEY MANAGEMENT PERSONNEL

Accounting policy

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

All transactions with related parties have been undertaken either:

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

Key management personnel compensation

Actual 2016 $000		Actual 2017 $000
	Leadership Team, including the Chief Executive	
1,857	Remuneration	1,790
6	Full-time equivalent staff	6

Key management personnel include the Chief Executive and the five members (2016 – five) of the Leadership Team.

The above key management personnel compensation excludes the remuneration and other benefits received by the Minister of Defence. The Minister's remuneration and other benefits are not received only for his role as a member of key management personnel of the Ministry. The Minister's remuneration and other benefits are set by the Remuneration Authority under the Members of Parliament (Remuneration and Services) Act 2013 and are paid under Permanent Legislative Authority, and not paid by the Ministry of Defence.

NOTE 14: FINANCIAL INSTRUMENTS

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

Actual 2016 $000		Actual 2017 $000
	Loans and receivables	
4,643	Cash and cash equivalents	4,970
-	Debtors and other receivables	164
13	Prepayments	3
4,656	Total loans and receivables	5,137
	Financial liabilities measured at amortised cost	
1,753	Creditors and other payables	1,984

NOTE 15: KAIKOURA EARTHQUAKE

The November 2016 Kaikoura earthquake caused significant damage to the Ministry's leased premises in Defence House. The Ministry was operational six working days after the earthquake with Ministry staff located at several alternate sites across the greater Wellington area.

In early-2017 the landlord advised that the damage to Defence House was too severe to repair and it would be demolished. Until a long-term home is found the Ministry has established temporary premises in Freyberg Building in central Wellington, co-located with the New Zealand Defence Force.

Earthquake costs

The major costs to the Ministry from the earthquake are the cost of assets destroyed and the capital cost associated with establishing the new office in Freyberg Building.

None of the Ministry's leasehold improvements in Defence House were recoverable and have been written off. Some audio-visual and electronic equipment was damaged beyond repair and has also been written off. The majority of the Ministry's other assets, predominantly furniture, have been recovered in a usable state.

Due to the state of the damaged Defence House specialist personnel were required for the recovery of the Ministry's assets, files and other items.

Expenses recognised in the surplus/deficit are:

	Actual 2017 $000
Write-off of leasehold improvements	969
Write-off of electronic equipment	16
Recovery costs	78
Earthquake costs	**1,063**

Capital expenditure due to the earthquake primarily involved fitting out the temporary premises in Freyberg Building, including the purchase of office furniture to re-establish operations while the Ministry's existing furniture was unavailable in the damaged Defence House. The capitalised fit-out of Freyberg Building and the substitute furniture are being depreciated over the expected period of occupation of Freyberg Building. Other assets that are expected to be transferred to the Ministry's eventual long-term home are depreciated over their expected useful life.

Capital expenditure due to the earthquake was:

	Actual 2017 $000
Office fit-out (leasehold improvements)	145
Computer equipment	98
Office furniture	76
Earthquake related capital expenditure	**319**

Appropriations

The Ministry received a new expense appropriation, Earthquake/Storm Damages, in the Supplementary Estimates to cover the cost of writing off departmental assets and re-establishing departmental operations.

This expense appropriation did not have any associated revenue. Consequently the Ministry's equity at 30 June 2017 is reduced by the amount of this expense. It is the Ministry's intent to apply to retain insurance proceeds (see below) to the amount that re-establishes the Ministry's previous equity level.

The Ministry's departmental capital expenditure appropriation was increased from $350,000 to $650,000 to allow for the additional capital expenditure required to re-establish operations after the earthquake.

Insurance claim

The Ministry is preparing insurance claims for damage and other costs incurred due to the earthquake. Specialist advice is being obtained in the preparation of the claims which are currently not quantifiable. The Ministry expects to proceed with the claims during the 2017/18 financial year but has no known resolution date.

The amount claimed under insurance policies is likely to differ from the amounts reported as earthquake costs in these financial statements. These differences are largely due to valuation methods for damaged assets and categorisation of costs differing between those used under insurance policies and used in the financial statements.

NOTE 16: EXPLANATION OF MAJOR VARIANCES AGAINST BUDGET

Explanations for major variances from the Actuals to the Main and Supplementary Estimates are as follows:

Statement of comprehensive revenue and expense

Revenue Crown

Revenue Crown decreased during the year as some of the costs relating to the implementation of the Enhancements to Defence Capability Development and Acquisition initiative were deferred to 2017/18 along with the related funding.

Other revenue

The pre-acquisition stage of two acquisition projects were approved by Cabinet during the year, increasing the Supplementary Estimates revenue. Actual costs were lower than the Supplementary Estimates as cost assumptions from the original budgets did not fully eventuate with resultant impact on revenue.

Personnel expenses

Personnel expenses were higher than Forecast and Main Estimates as identified savings in other expense categories were utilised to recruit new positions earlier than originally budgeted.

Operating expenses

The decrease in operating expenses from the Main and Supplementary Estimates reflects the deferral of the initiative implementation costs to 2017/18 and reduced pre-acquisition costs as described above.

Depreciation and amortisation expense

The decrease in depreciation and amortisation reflects the Ministry's lower asset base following the write off of property, plant and equipment due to the November 2016 Kaikoura earthquake (refer note 15).

Earthquake costs

These are predominantly the costs of writing off destroyed property, plant and equipment following the November 2016 Kaikoura earthquake (refer note 15).

Capital charge

The reduced capital charge cost from both Estimates reflects reductions in the capital charge rate during the year, coupled with a lower capital base at mid-year due to the deferral of Crown funding to the second half of the year.

Statement of financial position

Cash and cash equivalents

The higher balance at year-end compared to both Estimates reflects lower than forecast expenditure during the year and a higher creditors balance at year-end.

Property, plant and equipment

The value of property, plant and equipment reduced from the Main to the Supplementary Estimates due to the write-off of assets destroyed in the November 2016 Kaikoura earthquake (refer note 15).

Equity

The Ministry's equity is reduced at year-end as the Earthquake/storm damage appropriation was unfunded during 2016/17. It is the Ministry's intent to apply to retain proceeds from any insurance claim to the amount that re-establishes the Ministry's previous equity level (refer note 15).

Statement of cash flows

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

PART 6: NON-DEPARTMENTAL STATEMENTS AND SCHEDULES

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

SCHEDULE OF NON-DEPARTMENTAL REVENUE

For the year ended 30 June 2017

Actual 2016 $000		Note	Main estimates 2017 $000	Supp estimates 2017 $000	Actual 2017 $000
869	Realised foreign exchange gains		-	2,809	2,821
2,646	Realised gains on derivatives		-	1,142	1,142
-	Unrealised gains on derivatives		-	1,254	290
22	Unrealised foreign exchange gains		-	-	65
225	Interest		-	218	843
3,762	**Total non-departmental revenue**	**4**	**-**	**5,423**	**5,161**

SCHEDULE OF NON-DEPARTMENTAL EXPENSES

For the year ended 30 June 2017

Actual 2016 $000		Main estimates 2017 $000	Supp estimates 2017 $000	Actual 2017 $000
14,174	Realised foreign exchange losses	-	6	7,656
4,528	Realised losses on derivatives	-	695	362
3,870	Unrealised losses on derivatives	-	3,952	14,697
-	Unrealised foreign exchange losses	-	-	-
16,246	GST input expense	8,968	16,348	7,688
38,818	**Total non-departmental expenses**	**8,968**	**21,001**	**30,403**

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 4. For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated Financial Statements of the Government for the year ended 30 June 2017.

SCHEDULE OF NON-DEPARTMENTAL ASSETS

As at 30 June 2017

Actual 2016 $000		Note	Main estimates 2017 $000	Supp estimates 2017 $000	Actual 2017 $000
	Current assets				
235,754	Cash and cash equivalents	**4**	92,417	66,016	207,942
156,250	Receivables from exchange transactions	**2,4**	111,777	243,135	191,364
-	Derivative financial instruments		-	1,158	290
392,004	Total current assets		204,194	310,309	399,596
	Non-current assets				
-	Derivative financial instruments		-	-	-
-	Total non-current assets		-	-	-
392,004	**Total non-departmental assets**		**204,194**	**310,309**	**399,596**

SCHEDULE OF NON-DEPARTMENTAL LIABILITIES

As at 30 June 2017

Actual 2016 $000		Note	Main estimates 2017 $000	Supp estimates 2017 $000	Actual 2017 $000
	Current liabilities				
41,055	Creditors and other payables	**3**	14,580	31,713	131,958
2,248	Derivative financial instruments		225	273	8,760
43,303	Total current liabilities		14,805	31,986	140,718
	Non-current liabilities				
201	Derivative financial instruments		-	-	6,139
201	Total non-current liabilities		-	-	6,139
43,504	**Total non-departmental liabilities**		**14,805**	**31,986**	**146,857**

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 4. For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated Financial Statements of the Government for the year ended 30 June 2017.

SCHEDULE OF NON-DEPARTMENTAL CAPITAL RECEIPTS

For the year ended 30 June 2017

Actual 2016 $000		Note	Main estimates 2017 $000	Supp estimates 2017 $000	Actual 2017 $000
11,585	ANZAC Frigate Platform Systems Upgrade		6,346	3,628	3,629
103,402	ANZAC Frigate Systems Upgrade		119,450	78,440	66,285
1,810	C-130 Hercules Life Extension		-	(87)	643
6,958	Defence Command and Control System		661	1,758	1,697
15,539	Individual Weapons Replacement		43,607	26,701	25,771
-	Littoral Operations Support Capability		-	470	-
28,675	Maritime Helicopter		25,822	14,007	10,125
204	Maritime Sustainment Capability		-	108,746	101,248
2,950	Medium-Heavy Operational Vehicles		5,328	1,921	1,517
12,214	Medium Utility Helicopter		-	1,837	1,838
3,507	Network Enabled Army		35,508	39,330	16,634
2,168	P-3K Orion Missions Systems Upgrade		-	135	135
13,858	Pilot Training Capability		3,911	86	88
2	Project Protector Vessels		-	-	-
4,677	Protector Remediation		2,278	1,141	1,135
217	Special Operations Vehicles		10,248	17,432	16,024
1,351	Strategic Bearer Network		4,989	18,997	15,930
3,095	Training/Light Utility Helicopter		2,381	667	668
200	Underwater Intelligence, Surveillance and Reconnaissance		-	14,160	17,256
-	81mm Mortar Replacement		-	100	35
212,412	**Total non-departmental capital receipts**	**4**	**260,529**	**329,469**	**280,658**

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 4. For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated Financial Statements of the Government for the year ended 30 June 2017.

SCHEDULE OF NON-DEPARTMENTAL CAPITAL EXPENDITURE

For the year ended 30 June 2017

Actual 2016 $000		Note	Main estimates 2017 $000	Supp estimates 2017 $000	Actual 2017 $000
11,585	ANZAC Frigate Platform Systems Upgrade		6,346	3,628	3,629
103,402	ANZAC Frigate Systems Upgrade		119,450	78,440	66,285
1,810	C-130 Hercules Life Extension		-	(87)	643
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The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 4. For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated Financial Statements of the Government for the year ended 30 June 2017.

SCHEDULE OF NON-DEPARTMENTAL CAPITAL COMMITMENTS

As at 30 June 2017

Actual 2016 $000		Actual 2017 $000
	Non-cancellable capital commitments	
140,420	Not later than one year	138,237
36,234	Later than one year and not later than two years	133,648
4,767	Later than two years and not later than five years	57,386
-	Later than five years	-
181,421	**Total non-cancellable capital commitments**	**329,271**

SCHEDULE OF NON-DEPARTMENTAL CONTINGENT LIABILITIES AND CONTINGENT ASSETS

As at 30 June 2017

CONTINGENT LIABILITIES

The Ministry on behalf of the Crown has no contingent liabilities (2016 – Nil).

CONTINGENT ASSETS

The Ministry on behalf of the Crown has no contingent assets (2016 – Nil).

The accompanying notes form part of these financial statements. Explanations of major variances against the Main and Supplementary Estimates are shown in note 4. For a full understanding of the Crown's financial position and the results of its operations for the period, reference should be made to the consolidated Financial Statements of the Government for the year ended 30 June 2017.

NOTES TO THE NON-DEPARTMENTAL SCHEDULES

NOTE 1: STATEMENT OF ACCOUNTING POLICIES

Reporting entity

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

These non-departmental balances are consolidated into the Financial Statements of the Government for the year ended 30 June 2017. For a full understanding of the Crown's financial position, results of operations and cash flows for the year, reference should also be made to the Financial Statements of the Government for the year ended 30 June 2017.

Basis of preparation

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

Measurement and recognition rules applied in the preparation of these non-departmental statements and schedules are consistent with New Zealand generally accepted accounting practice (Tier 1 Public Sector Public Benefit Entity Accounting Standards) as appropriate for public benefit entities.

Changes in accounting policies

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

Budget figures

The budget figures ("Main estimates") are those included in the Information Supporting the Estimates of Appropriations for the Government of New Zealand for the year ending 30 June 2017, which are consistent with the financial information in the Main Estimates.

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

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

Summary of significant accounting policies

Significant accounting policies are included in the notes to which they relate.

Significant accounting policies that do not relate to a specific note are outlined below.

Revenue

Interest income is recognised using the effective interest method.

Foreign currency transactions

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

Goods and Services Tax

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

Derivative financial instruments

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

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

The full fair value of a foreign exchange derivative is classified as current if the contract is due for settlement within 12 months of balance date. Otherwise, foreign exchange derivatives are classified as non-current.

Commitments

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

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

Comparative information

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

NOTE 2: RECEIVABLES FROM EXCHANGE TRANSACTIONS

Accounting policy

Receivables are initially measured at the amount due and subsequently measured at amortised cost using the effective interest method, less any provision for uncollectability.

Impairment of a receivable is established when there is objective evidence that the Ministry will not be able to collect amounts due according to the original terms of the receivable. Significant financial difficulties of the debtor, probability that the debtor will enter into insolvency, bankruptcy, receivership, or liquidation, and default in payments are considered indicators that the receivable is impaired. For receivables not individually impaired, a collective assessment of impairment is also carried out. This considers past practice of collection history across the receivables portfolio. The amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted using the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in the schedule of non-departmental expenses. When a debt is uncollectible, it is written off against the allowance account for debtors. Overdue receivables that are renegotiated are reclassified as current (that is, not past due).

Actual 2016 $000		Actual 2017 $000
156,250	Debtors	191,364
-	Less provision for impairment	-
156,250	Net debtors	191,364
-	Receivables written off during period	-
156,250	**Balance at 30 June**	**191,364**

The carrying value of receivables from exchange transactions approximates their fair value.

	2016			2017		
	Gross $000	Impairment $000	Net $000	Gross $000	Impairment $000	Net $000
Not past due	156,250	-	156,250	191,364	-	191,364
Past due	-	-	-	-	-	-
Total	**156,250**	**-**	**156,250**	**191,364**	**-**	**191,364**

NOTE 3: CREDITORS AND OTHER PAYABLES

Actual 2016 $000		Actual 2017 $000
25,180	Creditors	34,372
15,875	Accrued expenses	97,586
41,055	**Total creditors and other payables**	**131,958**

NOTE 4: EXPLANATION OF MAJOR VARIANCES AGAINST BUDGET

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

Non-departmental income and expenses

Gains and losses

Future gains or losses from movements in both foreign exchange rates and derivative values are not budgeted. Gains and losses shown in the Supplementary Estimates are the gains or losses incurred by the Ministry at the time of preparation of the Supplementary Estimates.

GST input expense

GST input expense was lower than the Supplementary Estimates due changes in the timing and assessed value of the importation of military equipment into New Zealand.

Non-departmental assets and liabilities

Cash and cash equivalents

The cash holdings are higher than both Estimates due to the requirement to purchase foreign currency in advance for capital expenditure contracted in 2017/18 plus lower than budgeted project capital expenditure during 2016/17.

Receivables from exchange transactions

The Ministry invoices NZDF on a six-monthly basis for non-departmental capital expenditure. The variance in the year-end debtors balance reflects the timing of project expenditure across the year and the resultant timing of invoicing to NZDF.

Derivatives financial instruments

Future changes in derivatives values are not budgeted, as described above.

Creditors and other payables

The higher creditors balance at 30 June 2017 from that presented in both Estimates reflects the effect of accrued work in progress by suppliers at year-end plus an increased GST liability resulting from invoicing of capital expenditure to NZDF as described in the debtors section above.

Non-departmental capital receipts

Non-departmental capital receipts are the on-charge to the New Zealand Defence Force of all capital project expenditure incurred in the financial year. Variances in capital receipts reflect variances in non-departmental capital expenditure.

Non-departmental capital expenditure

The increase in non-departmental capital expenditure from Main Estimates to Supplementary Estimates was mainly due to two new projects being approved during the year. The variance between actual expenditure and the Supplementary Estimates was largely the result of changing part of the Network Enabled Army project from sole-source supply to open-tender which extended the contracting process into 2017/18, and delays commencing the installation phase of the ANZAC Frigate Systems Upgrade project.

NOTE 5: FINANCIAL INSTRUMENTS

Financial instrument categories

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

Actual 2016 $000		Actual 2017 $000
	Loans and receivables	
235,754	Cash and cash equivalents	207,942
156,250	Debtors and other receivables	191,364
392,004	Total loans and receivables	399,306
	Fair value through profit and loss – designated as such upon initial recognition	
-	Derivative financial instrument assets	290
2,449	Derivative financial instrument liabilities	14,899
	Financial liabilities measured at amortised cost	
41,055	Creditors and other payables	131,958

The notional principal amount of outstanding forward exchange contract derivatives at 30 June 2017 is NZD 265.6 million (2016 – NZD 40.2 million). The contracts consist of the purchase of (amounts in foreign currency):

Actual 2016 fx 000		Actual 2017 fx 000
1,500	British pounds	325
16,000	Canadian dollars	2,800
-	Euros	3,790
12,161	United States dollars	187,600

Fair value hierarchy disclosures

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

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

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

		Valuation technique		
	Total $000	Quoted market price $000	Observable inputs $000	Significant non-observable inputs $000
2016				
Financial assets				
Derivative financial instruments	-	-	-	-
Financial liabilities				
Derivative financial instruments	2,449	-	2,449	-
2017				
Financial assets				
Derivative financial instruments	290	-	290	-
Financial liabilities				
Derivative financial instruments	14,899	-	14,899	-

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

Financial instrument risks

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

Market risk

Currency risk

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

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

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

Interest rate risk

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

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

Liquidity risk

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

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

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

At 30 June 2017	Less than 6 months $000	6-12 months $000	1-5 years $000	Over 5 years $000	Total $000
Assets					
Current assets					
Cash and cash equivalents	207,942	-	-	-	207,942
Debtors and other receivables	191,364	-	-	-	191,364
Derivative financial instruments	149	73	-	-	222
Total current assets	399,455	73	-	-	399,528
Non-current assets					
Derivative financial instruments	-	-	-	-	-
Total non-current assets	-	-	-	-	-
Total assets	**399,455**	**73**	**-**	**-**	**399,528**
Liabilities					
Current liabilities					
Creditors and other payables	131,958	-	-	-	131,958
Derivative financial instruments	4,465	5,212	-	-	9,677
Total current liabilities	136,423	5,212	-	-	141,635
Non-current liabilities					
Derivative financial instruments	-	-	7,846	-	7,846
Total non-current liabilities	-	-	7,846	-	7,846
Total liabilities	**136,423**	**5,212**	**7,846**	**-**	**149,481**
Net liquidity of continuing operations	**263,032**	**(5,139)**	**(7,846)**	**-**	**250,047**

At 30 June 2016	Less than 6 months $000	6-12 months $000	1-5 years $000	Over 5 years $000	Total $000
Assets					
Current assets					
Cash and cash equivalents	235,754	-	-	-	235,754
Debtors and other receivables	156,250	-	-	-	156,250
Derivative financial instruments	-	-	-	-	-
Total current assets	392,004	-	-	-	392,004
Non-current assets					
Derivative financial instruments	-	-	-	-	-
Total non-current assets	-	-	-	-	-
Total assets	**392,004**	**-**	**-**	**-**	**392,004**
Liabilities					
Current liabilities					
Creditors and other payables	41,055	-	-	-	41,055
Derivative financial instruments	-	2,589	-	-	2,589
Total current liabilities	41,055	2,589	-	-	43,644
Non-current liabilities					
Derivative financial instruments	-	-	288	-	288
Total non-current liabilities	-	-	288	-	288
Total liabilities	**41,055**	**2,589**	**288**	**-**	**43,932**
Net liquidity of continuing operations	**350,949**	**(2,589)**	**(288)**	**-**	**348,072**

Credit risk

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

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

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

Contractual maturity analysis of derivative financial instrument liabilities

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

	Liability carrying amount $000	Asset carrying amount $000	Contractual cash flows NZ $000	Less than 6 months NZ $000	6-12 months NZ $000	1-2 years NZ $000	2-5 years NZ $000
Gross settled forward foreign exchange contracts:							
2016	2,449	-					
- outflow			40,208	18,381	18,496	3,331	-
- inflow			37,332	17,108	17,181	3,043	-
2017	14,899	290					
- outflow			282,943	87,225	85,447	110,271	-
- inflow			265,642	82,910	80,308	102,424	-

Sensitivity analysis

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

	2016			2017		
	Cash and cash equivalents $000	Derivatives $000	Net gain/(loss) $000	Cash and cash equivalents $000	Derivatives $000	Net gain/(loss) $000
Effect on surplus if NZ dollar strengthened by 5%						
AUD	(198)	-	(198)	(41)	-	(41)
CAD	(2,030)	(828)	(2,858)	(1,984)	(139)	(2,123)
EUR	(956)	-	(956)	(529)	(283)	(812)
GBP	(1,788)	(135)	(1,923)	(1,609)	(28)	(1,637)
NOK	(10)	-	(10)	(6)	-	(6)
SEK	(11)	-	(11)	(4)	-	(4)
USD	(1,301)	(815)	(2,116)	(5,095)	(12,006)	(17,101)
Total	**(6,294)**	**(1,778)**	**(8,072)**	**(9,268)**	**(12,456)**	**(21,724)**
Effect on surplus if NZ dollar weakened by 5%						
AUD	219	-	219	46	-	46
CAD	2,244	915	3,159	2,193	154	2,347
EUR	1,057	-	1,057	585	312	897
GBP	1,976	149	2,125	1,778	30	1,808
NOK	11	-	11	7	-	7
SEK	13	-	13	5	-	5
USD	1,438	900	2,338	5,632	13,270	18,902
Total	**6,958**	**1,964**	**8,922**	**10,246**	**13,766**	**24,012**