



ARMSCOR
Armaments Corporation of South Africa Ltd



Gateway to Defence Solutions

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Our expertise and service is your best line of defence in maintaining peace

Vision

ARMSCOR's vision is to be a truly South African organisation that is valued locally and globally as a centre of technical excellence for defence acquisition and support services.

Mission

ARMSCOR's mission is to meet the acquisition, maintenance and disposal needs of the South African Department of Defence and other clients in terms of defence matériel, related products and services. ARMSCOR maintains strategic capabilities and technologies and promotes the local defence-related industry.



Values

ARMSCOR believes that its values constitute the building blocks of the manner in which it conducts its business. We believe in the highest standards and are committed to equal opportunities, transparency and accountability. We pledge commitment to the following values: Leading by example, results driven, customer focus, care and respect for others, excellence, teamwork and integrity.



ARMSCOR is a statutory body. The Minister of Defence is the executive authority responsible for ARMSCOR. The management and control of ARMSCOR resides with a Board of Directors, whilst its day-to-day management vests in the hands of the Management Board.

In the execution of its functions ARMSCOR has established and maintains capabilities and technologies that are required to fulfil its mandate, such as appropriate programme management systems, Defence Industrial Participation (DIP) programme, the management of technology projects and strategic facilities.

ARMSCOR as acquisition agent

ARMSCOR acquires defence *matériel* for the Department of Defence (DOD) and for any organ of State that may require such services, such as the South African Police Services (SAPS).

The acquisition role of ARMSCOR pertains to all the actions that need to be taken to satisfy the need for *matériel*, facilities or services intended for client use or in support of client requirements. These actions include long-term operational research, requirement planning, establishment and development of technology, design and development of products and systems aimed at industrialisation and manufacturing of mature products and systems that fully meet the stated user requirements. The acquisition role can broadly be divided into the following four categories: System Acquisition Management, Procurement

Management, Product Systems Management and Technology Acquisition Management.

ARMSCOR, in addition also performs the following functions: Government quality assurance, analytical decision support in the acquisition of defence *matériel*, Logistic Support, Defence Industrial Participation (DIP) and Arms Control Compliance.

Quality

ARMSCOR provides for a quality assurance capability in support of acquisition and technology projects as well as for any other service required by the DOD. To enhance this capability, ARMSCOR is a certified ISO 9001:2000 company.

Armscor Business (Pty) Limited

This company offers defence support services of exceptional standard to the DOD. The core of these services includes defence research and development, test and evaluation, logistic support services and defence *matériel* disposal.

To fulfil this mandate, Armscor Business is structured in three groups, namely the:

- Defence Science and Technology Institute that houses the research and development facilities;
- Test and Evaluation Centre that is responsible for rendering comprehensive test and evaluation services in both the military and civilian environment; and
- Defence Support that is responsible for defence *matériel* disposal, configuration management and data management.



Acquisition of defence *matériel* on behalf of the Department of Defence is the core function of ARMSCOR

Introduction

I assumed the chairmanship of ARMSCOR on 1 October 2004, having taken over from Mr Fani Titi. I thank Mr Titi for wishing me well in this challenging position. As chairman, and as member of the Board of Directors of ARMSCOR, it is my role to steer ARMSCOR in the direction proposed by the shareholder, which is the State. ARMSCOR is owned by the State and it has to align its activities with the policies of the State. The Minister of Defence exercises ownership control over the Corporation on behalf of the State.



Dr PS Molefe
Chairman – ARMSCOR

The mandate of ARMSCOR

ARMSCOR derives its mandate from the ARMSCOR Act (Act 51 of 2003) which clearly states that ARMSCOR's objectives are to meet the defence *matériel*/requirements of the Department of Defence effectively, efficiently and economically and to meet the defence technology, research and development, analysis, and test and evaluation requirements of the Department of Defence effectively, efficiently and economically. Thus, ARMSCOR has no jurisdiction outside this mandate.

Funding of ARMSCOR

ARMSCOR is funded to a large extent by means of a transfer payment via the Department of Defence. This has been insufficient to meet ARMSCOR's operating budget and poses a challenge. Appropriate strategies have been implemented to alleviate this problem.

In addition to the results from these strategies, the good working relationship with the Department of Defence resulted in the ARMSCOR transfer payment being increased by 14% for the financial year under review.

Armscor Business operates strategic facilities for the Department of Defence. The portion of the transfer payment allocated for this is not sufficient for the operation, capital renewal and maintenance of the facilities, and additional funds are sought via commercial business. The income generated from such commercial business has not been sufficient to meet the shortfall as the demand for



these services is low, and this is reflected in the financial results of Armscor Business.

Corporate governance issues

The Board observes the principles of Corporate Governance as outlined in various legislative prescripts, such as the Public Finance Management Act, the King II Report, and the protocol on Corporate Governance in the Public Sector. The Board further developed a Board Charter which contains guidelines on how the Board, the Chairman and the individual directors are to perform their roles and responsibilities.

The Institute of Directors conducted a course on Risk Management and Corporate Governance as part of training for directors.

It is the responsibility of the Board of Directors to see to it that ARMSCOR adheres to corporate governance policies when conducting its business. On 23 February the Board of Directors was made aware of serious allegations against the Defence *Matériel* Disposal division (DMD). In view of the seriousness of the allegations, the Board decided to suspend the CEO, Mr Sipho Thomo, the General Manager Armscor Business, Dr Jan de Necker, and the Executive Manager DMD, Mr Boet van Staden.

This was done to allow the Board to commission an independent investigation into the allegations. As an interim arrangement, the Board decided to co-opt me to act as the CEO. On 9 June 2005, Gobodo Forensic Accounting

presented its final report to the Board of Directors at a special sitting. Its chief findings and recommendations were as follows:

- The Chief Executive Officer, Mr Sipho Thomo, should be absolved of any irregularity in this entire matter and his suspension should be lifted with immediate effect.
- The suspension of the General Manager: Armscor Business, Dr Jan de Necker, should be lifted with immediate effect.
- The suspension of the Executive Manager: Defence *Matériel* Disposal, Mr Boet van Staden, should be lifted with immediate effect.

The Board of Directors accepted the above findings and recommendations.

Risk management and fraud prevention

The risk management and fraud prevention processes have been established and formalised in ARMSCOR for the past three years. ARMSCOR adheres to the prescriptions of the Public Finance Management Act (Act 1 of 1999), and of the Prevention and Combating of Corrupt Activities Act (Act 12 of 2004).

Progress reports on a corporate level are submitted biannually to the Board of Directors, via the Audit and Risk Management Committee, in October and at the end of the financial year, for evaluation of the progress made in respect of the management of the identified risks to acceptable levels.

Chairman's report continued

Compliance with legislative requirements

ARMSCOR is a statutory body and derives its mandate from the ARMSCOR Act (Act 51 of 2003). This Act was assented to and signed by the President on 20 April 2004 and will become effective on the date to be announced by the President in the *Government Gazette*. In the performance of its functions ARMSCOR acts within legislative parameters, such as the Public Finance Management Act, the Promotion of Access to Information Act, and the Public Audit Act. In compliance with the Public Finance Management Act (Act 1 of 1999), a Shareholders' Compact was signed by the Minister and the Chairman of the Board on 17 March 2004, which contains the agreement between the Minister of Defence as the executive authority and the ARMSCOR Board of Directors.

Transformation process

Transformation remains high on ARMSCOR's agenda. While some progress has been made, there are still a lot of challenges. Compared to 1996 when black employees constituted just 19,7% of the total workforce, black employees now make up 36% of ARMSCOR's workforce. This still falls far short of the target of reflecting the national demographic profile.

Efforts have continued, primarily by appointing newly graduated technical trainees from tertiary institutions for development, with mentorship, through the structured Talent Development Programme (TDP). The organisation also continues with its bursary scheme, which provides a useful feeder for the TDP.

The setting of targets for black appointments has also played a major positive role in ensuring some of the progress that has been made. However, our legacy from the past is a major constraint. ARMSCOR will need to review its existing policies on new appointments since that gives impetus to transformation.

As skills development forms a critical element of transformation, the organisation was assessed for the Investors in People programme. Nine of the twelve standards were met. The recommendations made by the assessor will be implemented in order to ensure maximum effectiveness in the development of employees.

HIV/Aids and Employee Wellness

The organisation also takes a keen interest in the general wellness of its employees and has an active HIV/Aids management programme that has been focusing mainly on creating awareness. Although the prevalence level has been found to be low within ARMSCOR, the organisation continues with its awareness campaign, placing more emphasis on ensuring that employees know their status.

Shows

A number of international defence shows took place during the year under review. ARMSCOR participated in the following shows on varying scales: Fidae 2004 in Chile, DSA 2004 in Malaysia, Sofex 2004 in Jordan, Eurosatory 2004 in France, Milipol Qatar 2004 in Doha Qatar, AAD 2004 in South Africa, and Idex 2005 in Abu Dhabi, UAE.

These shows provide good networking opportunities with key decision-makers from across the world. It is a unique opportunity for the South African defence-related industries to show their capabilities and hopefully make their mark in the competitive international defence environment.

Acquisition programmes

Acquisition of defence *materiel* on behalf of the Department of Defence is the core function of ARMSCOR. The CEO's report and the acquisition report elaborate on the Strategic Defence Packages (SDPs). The defence packages are progressing well, despite the declining defence budget and limited human resources.

Cabinet took a decision to acquire A400M military transport aircraft for the South African National Defence Force (SANDF). The SANDF is expected to assist in peace-keeping missions throughout the rest of Africa, and these transport aircraft will be put to good use to serve this purpose.

The implementation of the A400M programme affords ARMSCOR the opportunity to engage with the DOD on the critical benefits of the programme, such as design, engineering, technical support and operational planning. This initiative will also give ARMSCOR the opportunity to



select young black engineers and scientists for skills transfer and technology exchange, thus empowering our internal leadership and technical capacity.

The negotiations with Airbus Military for the A400M aircraft were concluded by the chief negotiator of the DOD. A draft contract and letter of understanding have been concluded, and approval was obtained from the Board of Directors to sign this contract.

Transfer of the Dockyard

The process of transferring the Dockyard from the Department of Defence to ARMSCOR continued to gain momentum during the period under review. A number of management and operational plans have been developed, with a number of others scheduled for the 2005/2006 financial period once ARMSCOR has assumed management control of the Dockyard.

One of the key milestones achieved in 2004/2005 was the signing of the Dockyard Transfer Agreement (DTA) and the Service Delivery Agreement (SDA) between ARMSCOR and the Department of Defence. The DTA focuses primarily on the legislative and strategic framework, whilst the SDA covers service delivery aspects.

The key outstanding issue is Ministerial approval for the final functional transfer of the Dockyard.

Acknowledgements

I wish to extend my gratitude to the Minister, Mr MPG Lekota, and his Deputy Minister, Mr ME George, for having

the confidence in me to give strategic direction to ARMSCOR.

The Board of Directors and the Management Board have been very supportive in helping me to come up to speed with how ARMSCOR operates and how it relates to the defence-related industry.

My heartfelt thanks go to the employees of ARMSCOR, who have worked tirelessly during the year under review. The activities reported on in this annual report attest to their commitment and dedication towards the success of ARMSCOR.

I wish to single out General Siphiwe Nyanda for the enormous contribution he made in the Board of Directors. I thank him on behalf of the Board of Directors, the Management Board and ARMSCOR employees. We wish him well in his new endeavours.

General Siphiwe Nyanda hands over the baton to General Nhlanhla Ngwenya who I wish to welcome as the new Chief of the SANDF from 1 June 2005. We look forward to a good working relationship.



Dr PS Molefe
Chairman

Board of Directors



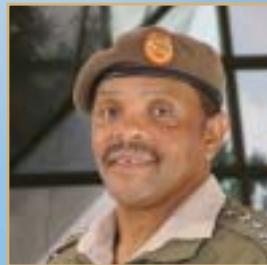
HS Thomo
Chief Executive Officer



JB Masilela
Secretary for Defence



CV Gamede



Gen S Nyanda SSA, DGM,
MMS, MMM
Chief of the SANDF



RP Meyer



CWN Molope



Dr PS Molefe
Chairman – ARMSCOR



PL Zim

Resigned: 31 October 2004



Gen (Ret) CL Viljoen

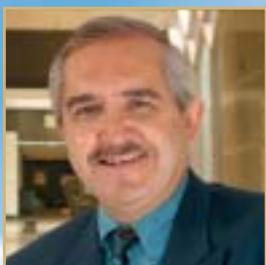
Resigned: 31 August 2004



Col (Ret) GN Ramaremiswa



P Riba



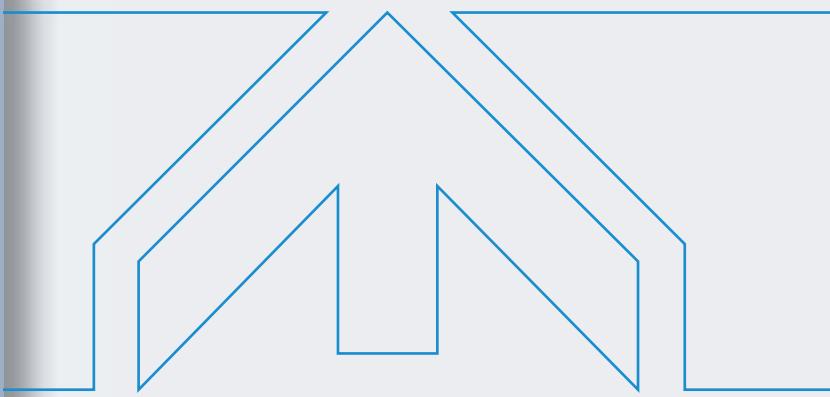
CJ Hoffmann



Adv CVV Ramphele



AS Human



It is the responsibility of
the Board of Directors
to see to it that
ARMSCOR adheres
to corporate
governance policies
when conducting its
business

The tendering and contracting processes of ARMSCOR are robust, transparent and accountable

Introduction

It is that time of the year again when ARMSCOR communicates the remarkable progress made in addressing the challenges of the previous financial year. The defence environment the world over has its unique challenges. ARMSCOR, being in that environment, had to confront these challenges plus those unique to our own domestic environment and came out victorious.



Mr HS Thomo
CEO - ARMSCOR

Review of the previous financial year

The primary objectives that ARMSCOR set for itself for the financial year 2004/2005 were the following:

- Benchmarking the ARMSCOR acquisition process.
- Advancing black economic empowerment.
- Taking over the Simon's Town Naval Dockyard.
- Commercialisation of ARMSCOR facilities.

Benchmarking the ARMSCOR acquisition process

One of the ARMSCOR Management Board's initiatives for the reporting period was to benchmark ARMSCOR's tendering and contracting processes. The tendering and contracting processes of ARMSCOR are robust, transparent and accountable. However, the benchmarking process was undertaken as part of ARMSCOR's strategy of continuous improvement to ensure that the tendering and contracting processes remain cost-effective and timeous while maintaining their integrity and accountability.

Benchmarking South Africa (BENSA) was contracted in August 2004 to facilitate the benchmarking process. A team of seven ARMSCOR senior managers from the acquisition department worked very closely with BENSA to scope and execute the study. The study was completed in November 2004 and made very useful recommendations, including the following:

- The use of workflow for routing electronic documents to improve organisation, standardisation and



digitisation of documents and to further improve various subprocesses.

- Automation of the value system, used in deciding on the winning tender during procurement, to allow for greater consistency and objectivity. This would be done by embedding decision-making rules in a computerised system.
- Separation and demarcation of the programme management and the contract management roles and responsibilities. This recommendation implies a shift in the way ARMSCOR has run its business previously, resulting in improved efficiencies and optimal utilisation of a scarce resource – manpower.

Black economic empowerment

The black economic empowerment policy of ARMSCOR was completed in March 2004. The policy is based on the Broad-Based Black Economic Empowerment Act (Act 53 of 2003) and seeks to achieve the following ARMSCOR objectives:

- To facilitate a substantial increase in the number of black-owned and controlled existing and new enterprises in the defence industry.
- To promote increased BEE spending in all ARMSCOR acquisition and procurement divisions through target setting.
- To substantially improve the racial composition of management structures and skilled employees of existing and new enterprises in the defence industry.

ARMSCOR placed orders to the value of approximately R2 500 million on local suppliers/contractors for acquisition and procurement of defence *matériel/services*. This amount includes contracts placed with public and parastatal companies (eg Denel and CSIR).

Of the abovementioned amount of R2 500 million, the black economic involvement amounted to approximately R200 million, that is about 8%. This exceeds the target of 7,5% set for the 2004/2005 financial year.

Note: No black equity ownership is attributed to public or parastatal companies in determination of the above figures.

An amount of R34 million was spent on purchases from ARMSCOR's operational budget of which R15 million (45%) was paid to BEE suppliers. The target of 30% was therefore far exceeded.

Simon's Town Naval Dockyard

The transfer of the Simon's Town Naval Dockyard from the SA Navy to ARMSCOR could not take place in March 2005 as planned mainly due to two reasons. Firstly, Dockyard staff transfer negotiations with unions were still ongoing by the target date. Secondly, permission to transfer Dockyard staff to ARMSCOR was still awaited from the Minister of Public Service and Administration by the target date. It is hoped that these two issues will be completed in the following financial year.

Gateway to defence solutions

Commercialisation of ARMSCOR facilities

Pursuant to the strategy of commercialisation of ARMSCOR's test and evaluation facilities, ARMSCOR has generated R10 million in sales during the year under review, primarily in service to markets abroad. This consists mainly of allowing our test and evaluation facilities to be used by private companies and governments from the following countries: USA, Singapore, Germany, Netherlands and Russia.

We foresee income from these foreign countries increasing in future as we open more of ARMSCOR's facilities to their use. This growing relationship between ARMSCOR and its foreign clients will go a long way in future to alleviating ARMSCOR's budgetary constraints in future.

New ARMSCOR Act

The new ARMSCOR Act (Act 51 of 2003) was approved by the National Assembly and the National Council of Provinces in November 2003. The President signed it into law in April 2004.

However, the Minister of Defence delayed the implementation of the Act because he wanted to bring about changes to the Act. The Minister wanted the Secretary for Defence and the Chief of the SANDF, both of which are Ex-Officio ARMSCOR Board members to be removed from the ARMSCOR Board because of a possible conflict of interest. This amendment has now been

approved by the Portfolio Committee on Defence and the Joint Standing Committee on Defence. After the July 2005 recess it is expected that the National Assembly and the National Council of Provinces will ratify the amendment.

Strategic Defence Packages

The Strategic Defence Packages (SDP), continue to form a significant part of the acquisition portfolio of ARMSCOR. Activities relating to these packages are progressing very well. Of the six foreign offices opened by ARMSCOR in the respective countries from which military hardware was purchased, only four now remain. The corvettes office in Germany and the Hawk office in the UK have both been closed due to work having been successfully completed.

The year under review has seen the delivery of the fourth and last corvette to South Africa. All these corvettes are currently being fitted with combat suites by South African contractors. Two of the submarines are almost complete and are currently undergoing sea trials in Germany.

The first South African version of the Hawk Lead-in Fighter Trainer has been built and is currently undergoing flight tests at the SA Air Force Test Flight and Development Centre. Airframes for the rest of the aircraft fleet are being assembled by Denel Aviation and also progressing according to schedule. The assembly and fitting of the first Gripen Advance Light Fighter Aircraft is also progressing according to plan.



The manufacturing and qualification of the South African configuration of the Augusta A109 Light Utility Helicopter (LUH) has progressed so well that the European Civil Aviation Authority (EASA) has issued a new type certificate for this helicopter. The first three of these helicopters, including one that was assembled locally by Denel Aviation, were unveiled at the Africa Aerospace and Defence (AAD) 2004 show. The remaining 23 are being assembled by Denel Aviation in South Africa.

Objectives for 2005/2006

The objectives that ARMSCOR set for itself last year were reported on earlier in this report. For a number of reasons not all these objectives were fully achieved. In the coming year, therefore, ARMSCOR will concentrate on finalising the objectives, namely:

- Implementing the benchmarking study recommendations;
- Implementing BEE further;
- Finalising the transfer of the Simon's Town Naval Dockyard to ARMSCOR; and
- Further commercialisation of ARMSCOR facilities.

In addition, ARMSCOR wishes to improve on its risk management system and to improve its relationship with its stakeholders. Previously, I made a case for ARMSCOR to become the acquisition agent of Africa. Although the argument is still valid, we have found the timing of this

move to be inappropriate and decided to leave it for later consideration.

Acknowledgments

Once more I would like to express my heartfelt gratitude to the Minister of Defence, Mr MGP Lekota, and his deputy Mr ME George, for their most valuable support and guidance during the year under review. A word of thanks is directed to the officials of the Department of Defence who were at all times available and willing to assist in matters of departmental procedure.

My congratulations go to the South African defence industry for delivering quality defence equipment to the SA National Defence Force and their other customers.

I am greatly indebted to the Board of Directors and Management together with their staff for their contribution to ARMSCOR's successes during the year.

We look forward to a challenging new year. I am confident that, under the competent guidance of the Board of Directors and Management Board, these challenges will be turned into opportunities.



HS Thomo

Chief Executive Officer



Management Board



01 HS Thomo
Chief Executive Officer

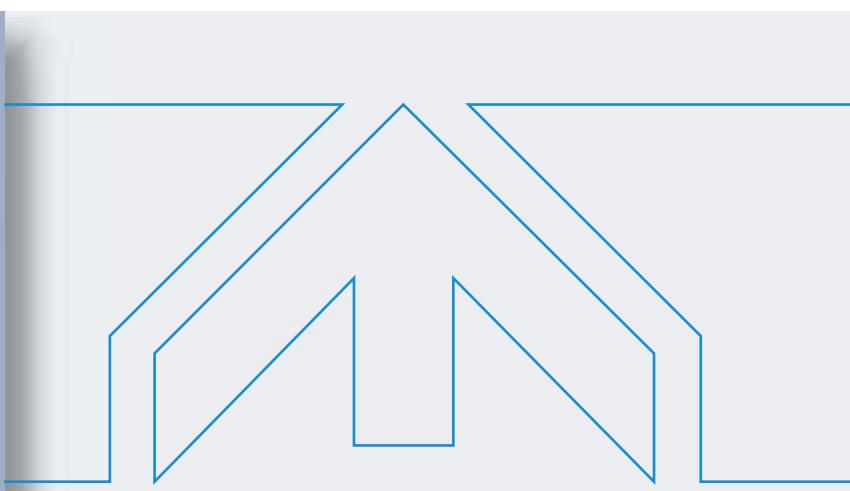
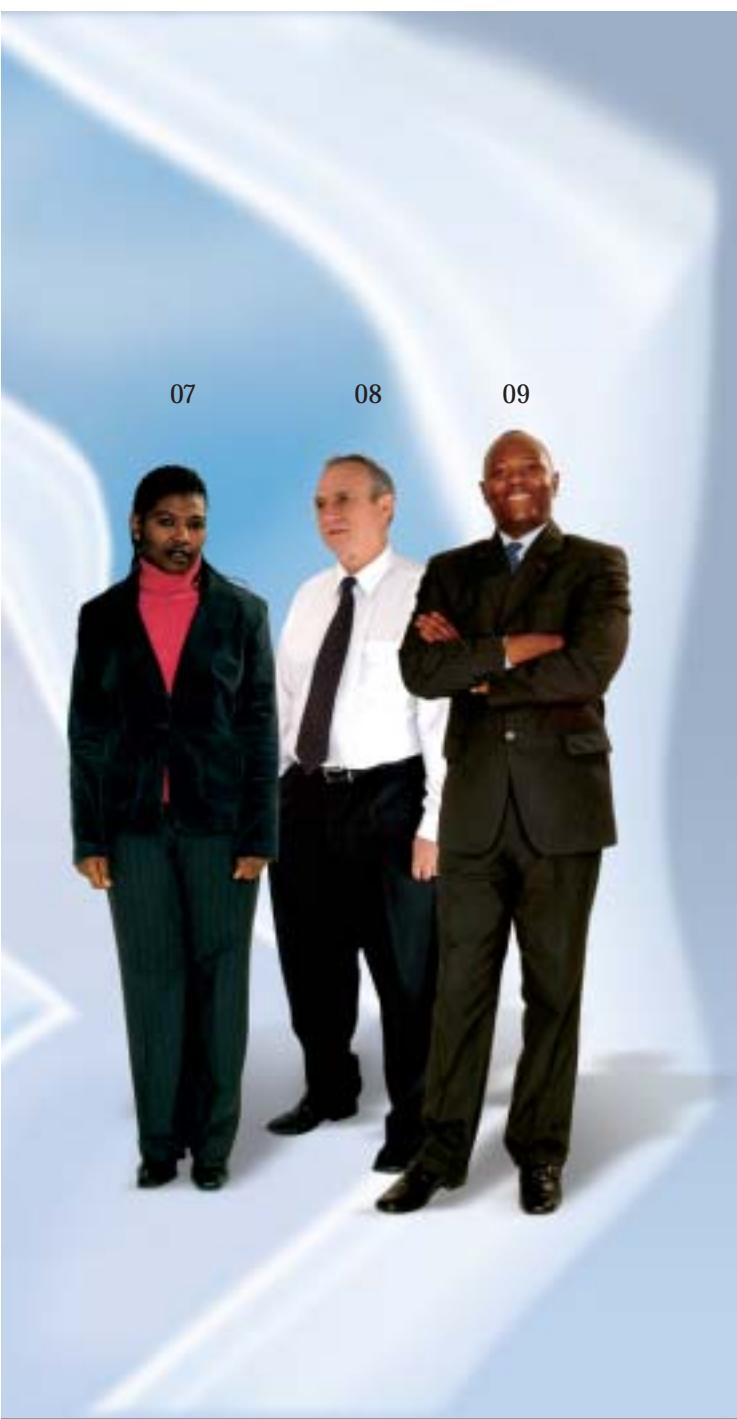
02 GJ Smith
**Acquisition
General Manager**

03 CJ Hoffmann
**Finance
General Manager**

04 TT Goduka
**Dockyard
General Manager**

05 NRM Borotho
**Corporate Affairs
General Manager**

06 Dr JAJ de Necker
**Armscor Business
(Pty) Limited
General Manager**



07 Adv CVV Ramphela
Board Secretariat and
Legal Services
General Manager

09 X Magojo
Human Resources
General Manager

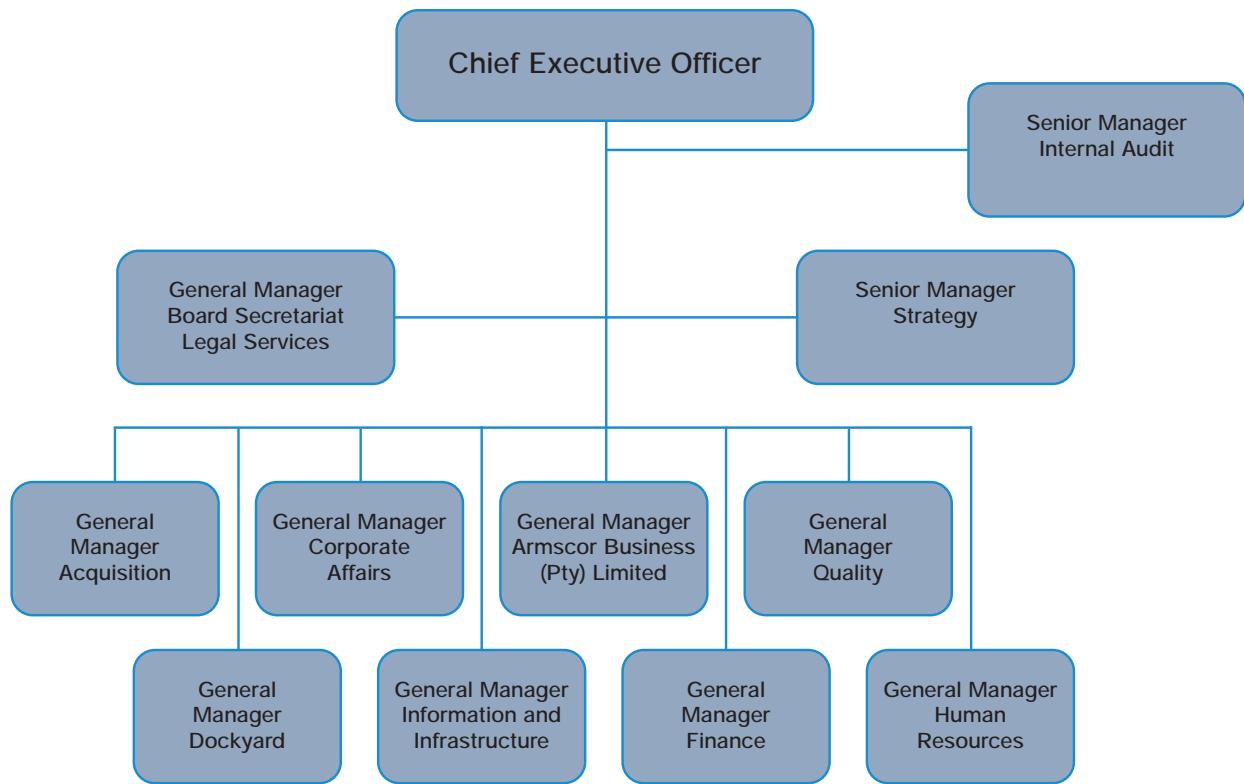
08 JC Oosthuizen
Quality
General Manager

JC Oosthuizen
Information and Infrastructure
Acting General Manager

Review of operations

ARMSCOR's acquisition involvement traditionally starts with the receipt of an approved user requirement from its client

Organisational structure



Background

The core function of ARMSCOR is the acquisition of defence *materiel*, primarily for the SANDF and other state departments such as the SAPS and the Department of Correctional Services.

Acquisition role

The acquisition role of ARMSCOR entails all the actions needed to satisfy the requirements for defence *materiel*, facilities or services intended for use by or in support of clients. This includes long-term operational research,

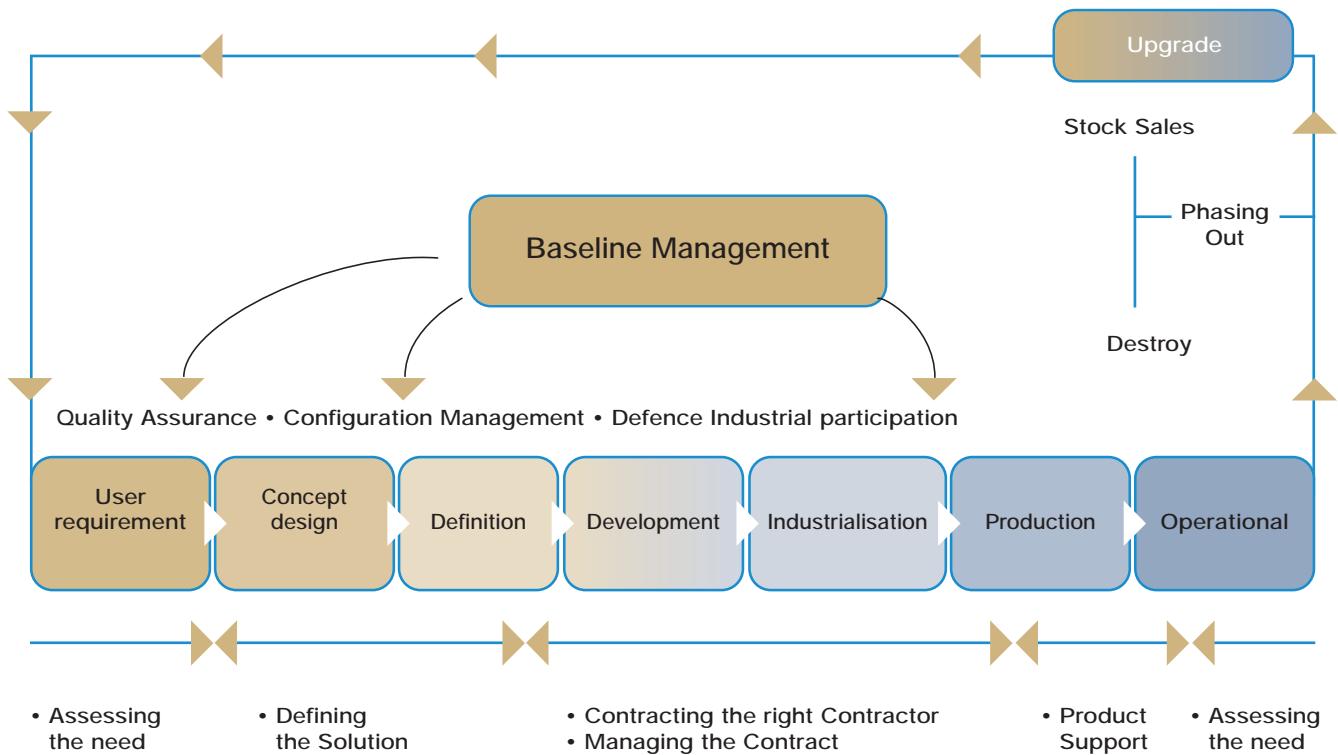


requirement planning, establishment and development of technology, design and development of products and systems, and the industrialisation and manufacturing of

mature products and systems that fully meet the stated user requirements.

Acquisition management through the life cycle of the product

The aforementioned services are best reflected in the following flow diagram:



Review of operations continued

Providing logistic support for SANDF equipment forms a significant part of ARMSCOR's acquisition activity

The acquisition role can broadly be divided into the following four categories: System Acquisition Management, Procurement Management, Product Systems Management and Technology Acquisition Management.

- *System Acquisition Management* represents the bulk of ARMSCOR's acquisition function and involves all the activities from the translation of mission and related needs, to operationally effective, suitable, survivable and supportable products and systems in accordance with the stated requirements of the clients.
- *Procurement Management* entails the procurement of existing Commercially-Off-The-Shelf (COTS) or Military-Off-The-Shelf (MOTS) equipment.
- *Products System Management* entails the support provided to the clients during the operating phase of products and systems, and involves, amongst others, the maintenance and logistic support of such products and systems.
- *Technology Acquisition Management* entails the contracting for and development of technology in support of future acquisition programmes.

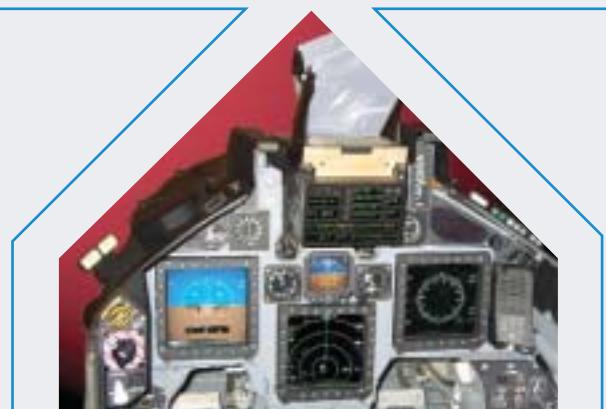
System Acquisition Management

A significant portion of the programme management function within ARMSCOR is focused on the acquisition of complex systems which entails the execution of the System Acquisition Management role. ARMSCOR's acquisition involvement traditionally starts with the receipt of an approved user requirement from its client. A formalised process of risk reduction is followed which

eventually leads to the contracting of suitable suppliers to develop and manufacture the required equipment or systems. A formalised source selection process, entailing the development and application of value systems, is followed to identify preferred suppliers to be contracted to meet specific user requirements. The selected suppliers develop the required product systems and deliver successive development models. These models range from experimental development models through advanced development and engineering development models up to pre-production models. After successful qualification of the designs and related production processes, production of the required products and systems commences.

The management of acquisition programmes demands the management of many diverse technical, financial and other disciplines such as systems and logistics engineering, resource management, contracting, quality and design assurance. In order to properly and adequately meet all the programme management requirements on acquisition programmes, project teams are usually formed with members from ARMSCOR, DOD and the industry. The project teams are led by ARMSCOR programme managers and, depending on the extent and complexity of a programme, various domain specialists are added to the teams to perform specific roles.

ARMSCOR has established a training division to identify and develop appropriate training modules for programme managers and administrative personnel. These training



modules will serve both to fast track new programme managers and as refresher courses for current programme managers.

The technical expertise vested in ARMSCOR covers all disciplines required to provide technical guidance to the diverse range of acquisition programmes presently being executed. ARMSCOR is, however, suffering from a lack of capacity to manage all the current programmes to the required depth as required by the DOD. This problem is being addressed by appointing suitable personnel within the constraints of a very limited operating budget.

Defence acquisition policy

During the review period, the combined ARMSCOR and DOD acquisition policy and procedure have been reviewed, approved and implemented. This policy serves to regulate and provide guidance to project teams executing acquisition programmes and incorporates all the applicable recommendations emanating from the report of the joint investigation into the Strategic Defence Package (SDP) programmes. The policy also provides a very clear definition of the respective responsibilities of the parties involved in the acquisition process.

Logistic support

Providing logistic support for SANDF equipment forms a significant part of ARMSCOR's acquisition activity. In this regard, the concept of Product Support Service (PSS) contracts, whereby a predetermined level of availability of

equipment is provided to the user, has been successfully developed and refined. The extent of this activity is steadily increasing on an annual basis.

New technology

The utilisation of new technology in the design and development of equipment is important in order to optimise the cost efficiency and effectiveness of new equipment. To ensure that the development of new equipment and capabilities for the SANDF is based on the utilisation of suitable modern and mature technologies, ARMSCOR and the DOD identify and manage a number of technology development programmes within local industry, aimed at supporting identified future system development programmes. ARMSCOR programme managers, utilising their specialist knowledge in the various applicable technological domains, have been very successful in identifying technology building blocks that needed to be matured for eventual implementation in planned development projects. The research into and development of identified critical technologies that are subsequently utilised in the development of new products systems, have in the past contributed greatly towards providing the SANDF with competitive advantages in their weapon systems. Involvement with the initiation of new technology development projects still remains a very important part of the responsibilities of ARMSCOR programme managers.



Review of operations continued

New initiatives

Changes in the environment within which the acquisition function is executed, necessitated a number of new initiatives to be launched to ensure that the acquisition processes and focus remain relevant and in harmony with the external requirements. These initiatives include, *inter alia*, the development of a business structuring and positioning strategy, the development of a capability management process, establishment of an acquisition knowledge management system and knowledge base, establishment of an acquisition training and skills development system and enhanced formalisation of baseline management on acquisition programmes.

Systems and logistics engineering capabilities

ARMSCOR endeavours to enhance its systems and logistics engineering capabilities. In this regard, two new divisions were created to specifically focus on systems and logistics engineering respectively. The two divisions are manned by systems and logistics engineering specialists and will have an overarching responsibility to further enhance the integrity of programmes being executed for the DOD.

Service level agreement (SLA)

In order to ensure that the acquisition function performed for the DOD is executed in a properly structured, transparent and accountable manner, the annual SLA between ARMSCOR and the DOD was extended to cover the past year. A new and more comprehensive three-year service level agreement has also been developed for implementation during the 2005/2006 financial year.

Technical disciplines

The acquisition activities are functionally structured with various divisions focusing on specific technical disciplines. These technical divisions provide a home base to programme managers specialising in those specific domains. In order to improve liaison and interaction with the DOD, divisions within ARMSCOR have been grouped together in units that mirror the structure of the Departmental Acquisition and Procurement Division (DAPD). This grouping provides single points of entry to the

respective DAPD directorates which resulted in a dramatic improvement in communication with the DOD.

Maritime systems

a Type MEKO® A-200 patrol corvette

During the past financial year, the corvette joint project office in Hamburg, Germany, was closed down subsequent to the completion of the fourth corvette in the German dockyard and the focus shifting to the completion of the integration of the combat suites of the vessels in the Republic of South Africa.

The acquisition of the Type MEKO® A-200 patrol corvettes from the European South African Corvette Consortium has made considerable progress during the review period. All four corvettes have arrived in Simon's Town for the integration of their combat suites by the appointed South African contractor, the first (SAS Amatola) has been virtually completed. The integration of the combat suites on the remaining three corvettes is in various stages of completion. The sea trial programme of the SAS Amatola in South African waters is expected to be completed by August 2005 and the ship is scheduled to be commissioned and handed over to the SA Navy for operational deployment during January 2006. All four corvettes are expected to be commissioned by the third quarter of 2006.

b Type 209 Mod 1400 submarine

The acquisition of three Type 209 submarines from the German Submarine Consortium encountered unexpected delays during the harbour acceptance trial programme of the first submarine. This resulted in a programme delay of three months. The first submarine was launched during June 2004 and should be commissioned in Germany during September 2005, upon successful completion of the scheduled sea trials. The submarine is planned to commence its homeward voyage to the Republic of South Africa during January 2006, upon completion of the training of the crew. The submarine should arrive in Simon's Town during February 2006. The production of the remaining two submarines is continuing according to schedule, and they are due to arrive in South Africa during October 2006 and



October 2007 respectively. Valuable support and cooperation was received from the German Navy with regard to the training of the South African submarine crew members.

Airborne systems

Rooivalk attack helicopter

The production of 12 Rooivalk attack helicopters has been completed. The last aircraft was delivered to the squadron at AFB Bloemfontein during March 2004. Contracting for the execution of the commissioning programme continued during 2004. A delay of approximately two years has been incurred on achieving the originally planned deployment date of July 2005. Every effort is being made to minimise the delay and measures are being put in place to ensure that deployment occurs at the latest by July 2007.

Maritime patrol helicopter

The acquisition of four Super Lynx maritime patrol helicopters from Westland Helicopters in the United Kingdom is still on track for delivery by mid-2007. These helicopters will be operated from the newly acquired corvettes and are specifically equipped to support the operational roles of the corvettes. Subsystems for the helicopters, provided by South African subcontractors, are performing very well. Westland Helicopters is now offering the same South African subsystems to other customers for future helicopter upgrades and newly built helicopters.

Lead-in fighter trainer aircraft (LIFT)

The development test phase of the South African Hawk Mk 120 lead-in fighter trainer aircraft that is being acquired from British Aerospace Systems in the UK, was concluded during March 2005. Approximately 95 flights, with the first South African aircraft, were flown by test pilots from BAE Systems. The South African Air Force has also started its evaluation flights with the aircraft.

A total of 21 fuselage and wing-sets have been shipped to South Africa and by the end of March 2005 four Denel assembled aircrafts had completed their production factory acceptance test flights.

The first aircraft will be ready for acceptance during July 2005 and will be fitted with an interim engine and avionics

that are suitably certified to meet the South African Air Force requirements for instructor conversion training scheduled to commence during September 2005.

Advanced light fighter aircraft (ALFA)

Development of the South African version of the JAS39 Gripen advanced light fighter aircraft is on schedule. The airframe of the first dual seat aircraft has been assembled and further fitting of the aircraft is progressing as planned. This first aircraft will arrive in South Africa during June 2006 to start an intensive development flight test and evaluation period at the SA Air Force's (SAAF) test flight and development centre. Upon successful completion of flight testing, this aircraft will be delivered to the SAAF, planned for the first quarter of 2008. Delivery of the remaining eight dual seat aircraft will continue to the third quarter of 2009, followed by delivery of the 19 single seat aircraft up to the first quarter of 2012.

Light utility helicopter (LUH)

Good progress has been made with the qualification of the final configuration of the A109 LUH being acquired from Augusta in Italy, to the extent that the European Civil Aviation Authority (EASA) issued a type certificate for the A109 LUH.

The first three South African A109 LUH helicopters, including the first helicopter assembled locally by Denel Aviation, were unveiled at the AAD 2004 show. They then successfully participated in the initial factory conversion flying programme for four South African Air Force pilots and 20 technicians.

Landward systems

New Generation Infantry Combat Vehicle (ICV)

During February 2004, requests for offer (RFO) for the supply of the New Generation Infantry Combat Vehicle to replace the ageing Ratel Infantry Combat Vehicle, were issued to 27 companies around the world. A single offer was received from an alliance headed by the South African arms manufacturing company, Denel (Pty) Limited, as prime contractor. A prototype vehicle was delivered during March 2005 for evaluation by ARMSCOR and the DOD. Various tests to evaluate compliance of the offered



Review of operations continued

prototype to predetermined criteria such as mobility, fire power, mine protection and ergonomics will be performed over a three-month period.

e Ground-based air defence system (GBADS) for the SA Army

The GBADS programme for the air defence formation of the SA Army is structured in a phased acquisition approach. Denel Aerospace Systems was appointed as the prime contractor for the first phase, which will provide for delivery of the local warning segment (LWS).

During 2004/2005, a large number of the LWS subsystems and products were delivered for the next level system integration and testing which is scheduled for completion during 2005/2006. Delivery of the man portable missile system has been completed and represents the most significant subsystem of the present phase.

f Quality

Acquisition quality assurance

Quality personnel continue to be actively involved throughout the acquisition process, both locally and overseas, to ensure that product and system quality standards are met during design, development, production and logistic support.

Overseas: Project quality assurance representatives utilise quality support services available under existing government quality assurance agreements with the host countries concerned, to support the various monitoring, inspection, auditing and verification tasks required during the process to assure quality.

Locally: Manufacturing, systems installation, reassembly and test activities are covered at the main subcontractors. Involvement in the procurement process of certain aircraft-related products via black economic empowerment (BEE) contractors has been initiated, with positive results. The progress, training and upliftment of BEE contractors in the defence industry to meet quality standards requires a significant part of available specialised quality assurance resources.

ARMSCOR quality

Owing to the strategic focus of many of the improvement opportunities identified in the feedback report of the South African Excellence Foundation (SAEF), it was decided to constitute a high-level corporate improvement forum with representatives of all functions in ARMSCOR, including Armscor Business and the dockyard.

The objectives of the forum are:

- to coordinate and oversee all improvement projects in order to ensure that the projects are based on sound business principles and that they are in line with ARMSCOR's strategy;
- to promote and facilitate the identification and implementation of improvement opportunities and to communicate the advantages of improvement projects; and
- to ensure that the maximum benefits of improvement projects are realised.

Since the forum has been established, 25 improvement suggestions – over and above those identified by the SAEF – have been registered and allocated to project managers.

Since the external customer satisfaction survey in 2002, areas for improvement have also been identified and corrective action implemented. A survey was again conducted in 2004 and a satisfaction level of 81,83% was achieved, compared with 64,75% for 2002.

Defence Industrial Participation

Government has initiated two offset programmes in South Africa, namely the Defence Industrial Participation (DIP) programme and the National Industrial Participation (NIP) programme. The DIP programme applies to all defence purchases with an imported content exceeding US\$10 million and attracts a DIP obligation of at least 50% of the imported content. The NIP programme applies to all government purchases (thus including defence) with an imported content exceeding USD10 million and attracts an NIP obligation of at least 30% of the imported content. Defence contracts with an imported content exceeding USD10 million thus attract an offset obligation of at least 80% of the imported content (50% DIP + 30% NIP).



ARMSCOR is responsible for the management and monitoring of the DIP programme on behalf of the DOD. The Department of Trade and Industry (the dti) manages the NIP programme.

DIP obligations are contracted in either USD, or the currency of the country of the foreign supplier. For reporting purposes, the obligations are converted to South African rand (ZAR) at the rates applicable at contract signature date. All performances are therefore also reflected in ZAR at this fixed "contract rate" for reporting purposes. It is, however, important to note that the obligations are based in a foreign currency and as the exchange rate devalues against these foreign currencies, more work needs to be done in the RSA to fulfil this obligation.

DIP status of the Strategic Defence Packages as at 31 March 2005

Project	Obligation	Planned performance	Actual performance	Actual vs planned	Actual vs obligation	Sales (local and export)	Technology transfer	Investments
	Rm	Rm	Rm	%	%	Rm	Rm	Rm
Corvettes	2 941	1 632	1 595	97	54	1 241	348	6
Submarine	1 121	703	609	86	54	576	34	0
Light utility helicopter	1 194	943	710	75	59	356	324	30
Hawk	4 252	2 358	2 221	94	52	1 922	292	7
Gripen	5 050	1 864	2 459	131	48	932	1 385	141
Maritime helicopter	550	80	93	116	16	93	0	0
Total	15 108	7 580	7 687	101	51	5 120	2 383	184

At first glance some of the projects may appear to be behind schedule, but sufficient claims have been submitted to address the shortfall.

The foreign suppliers on the SDP programme have placed contracts with the SA defence industry resulting in local or export sales, and have made investments and transferred technology resulting in approved DIP credits to the value of R7 700 million to date, at an exchange rate of R6,25 to the USD, R6,4 to the EUR and R10 to the GBP. The imported content of all contracts placed with the SA defence industry

When the Strategic Defence Packages programmes were signed on 3 December 1999, the NIP obligations amounted to approximately R85 000 million and the DIP obligations to approximately R15 000 million. These obligations have to be discharged (fulfilled) over a period of seven years, except for BAE Systems/SAAB, which has been allowed a period of eleven years.

The DIP obligations on the Strategic Defence Packages further represent approximately 73% of all the DIP obligations managed by ARMSCOR.

has further been excluded in the awarding of DIP credits, which means the DIP credits only represent the local added value. The result is the fulfilment of approximately 51% of their total DIP obligations, which is 101,42% of the planned fulfilment at the end of the fifth year.

A condition contained in the DIP obligations of foreign suppliers is that they must identify companies owned and managed by people from historically disadvantaged backgrounds, which have the ability to become part of the defence supply chain. Approximately 25 companies have



Review of operations continued

been identified so far and are at different stages of being evaluated to establish their requirements regarding technology and capabilities for entering the marketplace. Orders to the value of ±R20 million have already been placed with some of these BEE companies, for which DIP credits have been awarded.

Highlights of some of the DIP activities credited during the period under review:

Corvettes

- Project management, engineering services and hardware production for delivery of electrical plant system for the South African corvettes and for the export market.
- Supply of automatic vehicle transmission systems and components to foreign customers.
- Supply of large calibre ordnance systems to the export market.
- Supply, installation and associated logistic support for the combat suites on the South African corvettes.

Submarines

- Design and manufacturing of high-precision periscope systems in partnership with Zeo Zeiss, not only for the South African submarines, but also for other foreign clients.
- Export orders in cooperation with a foreign company for the delivery of forward-looking infrared systems.
- Development of customer-specific software for the South African submarine combat suite.

Maritime helicopters

- Orders placed for the local supply of IFF (Identification: Friend or Foe), electro-optic sight systems and the direction finder for the four South African maritime helicopters.
- Delivery of engineering services, supply of the infrared suppression system and the armoured crew seat for a foreign customer.
- Export of electronic warfare systems, threat warning systems and counter-measure systems.

Light utility helicopters

- Although major orders were placed on the industry during this financial year, very few credits have been awarded, due to the fact that Augusta only claims credits once delivery has taken place and an invoice has been paid.
- Some highlights of these orders placed, for which delivery is mainly scheduled in the 2005/2006 financial year, are armoured vehicles for the Italian government and electronic equipment for the UAE government.

Hawk

- The assistance of BAE Systems has led to a South African company winning an export order for Bahrain, and additional orders from the Royal Air Force (UK), India and Australia.
- A wider range of defence-related companies are in the process of being certified to aeronautical standards by BAE Systems, which will benefit the country in the future. As a result of this certification, companies that were not initially identified as possible beneficiaries under the DIP programme have already received major orders which are currently under review for DIP credits.
- BAE Systems identified a further opportunity to place Airbus-related work with Aerosud and is currently in the process to transfer the necessary technology to Aerosud to enable them to execute Airbus-related export orders.

Gripen

- Various technology transfer activities to the local defence-related industry took place during this financial year, which will enable these companies to become part of the SAAB supply chain – in some instances, the sole supplier, especially to Denel (Pty) Limited.
- Through the efforts of SAAB, one of the beneficiaries under the DIP programme became the sole supplier of highly sophisticated electronic equipment to a European country.
- Major work packages have been placed on the South African defence industry for the supply of electronic equipment.

Arms control compliance

The purpose of the arms control compliance function is to ensure the implementation of ARMSCOR's policy that all its business processes be executed in compliance with arms control requirements. This is a prerequisite for international recognition of ARMSCOR as a responsible and trustworthy trade partner, enabling it to optimally satisfy the needs of the SANDF and other clients regarding defence equipment. ARMSCOR also has the responsibility to create awareness of the importance and necessity of arms control compliance, and to cooperate with and support its contractors and clients in this regard.

As a result of the successful implementation of arms control measures over the past number of years, the United States government in July 2004 announced that defence trade relations between the two countries had been normalised. This brought to an end a period (since 1994) during which ARMSCOR, Denel and Fuchs Electronics could not do normal business with USA entities because of the violation of USA export control laws when a UN arms embargo against South Africa was in force.

Naval Dockyard Simon's Town

The Naval Dockyard Simon's Town (NDS) transformation process has continued to gain momentum during 2004/2005. One of the key milestones achieved during the period under review was the signing of the Dockyard Transfer Agreement, which focuses on the strategic partnership arrangements and the service delivery agreement, which deals with the service delivery aspects. This was coupled with the finalisation of the human resources transfer plan, which focuses on the personnel transfer option, associated conditions and service benefits. A number of activities have been completed and await implementation and rollout once the transfer of the dockyard has been fully transferred to ARMSCOR and include interim service level agreements with the SA Navy, the management information system plan, the master production schedule and the infrastructure upkeep plans.

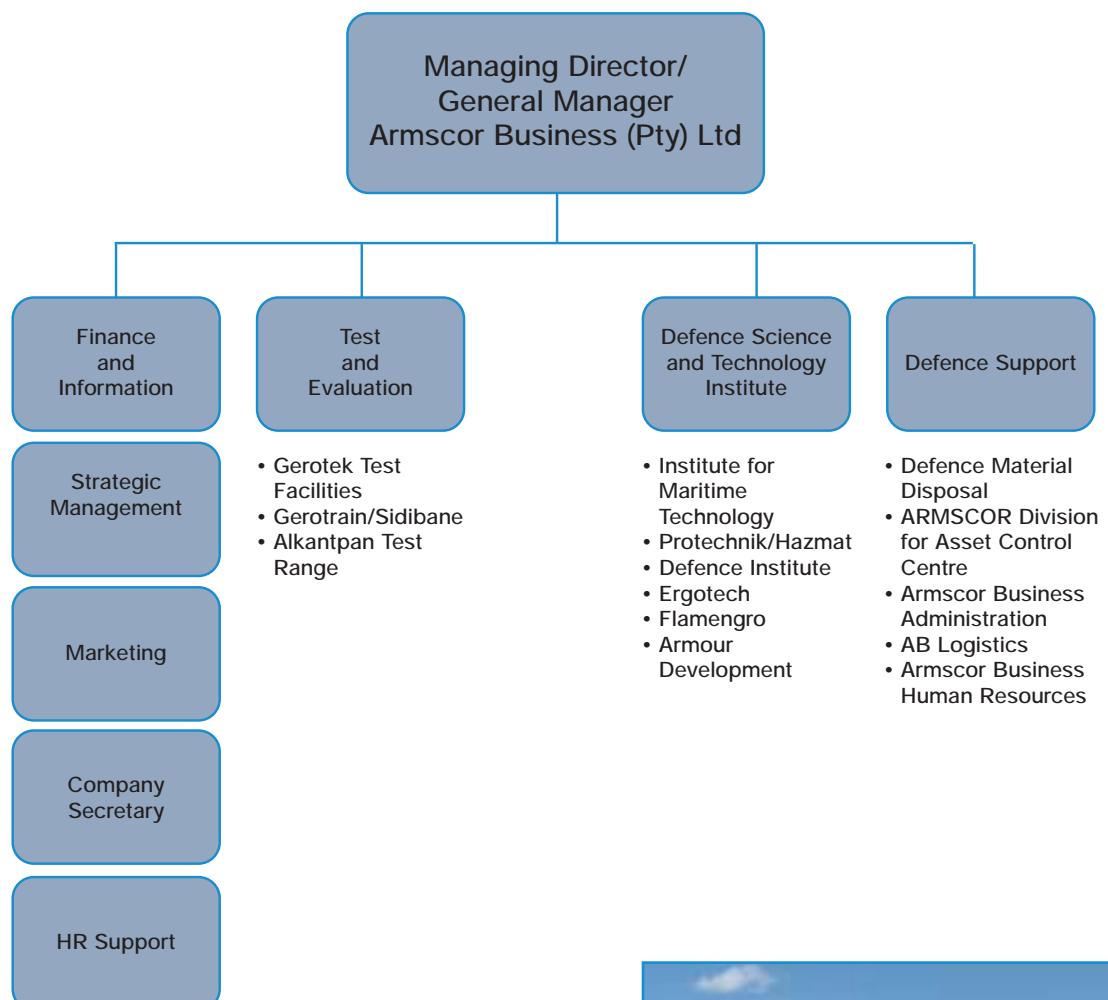
The key milestone under way is the ministerial authority for the functional transfer of the Naval Dockyard Simon's Town from the Department of Defence to ARMSCOR.

Review of operations continued

The prime focus of Armscor Business is to offer defence support services of exceptional standard to the DOD

Armscor Business (Pty) Limited

Organisational structure





Armscor Business is a wholly owned subsidiary of ARMSCOR and manages the strategic facilities of ARMSCOR which has as its primary client the DOD.

In order to retain such facilities, which include highly specialised infrastructure and equipment as well as world leading expertise for the DOD and the country, Armscor Business also provides services for commercial clients as well as other defence forces abroad.

The prime focus of Armscor Business is to offer defence support services of exceptional standard to the DOD. The core of these services includes defence research and development, test and evaluation, defence *materiel* disposal and logistic support services.

The year under review reflects an overall estimated loss of R17,5 million. This position is mainly attributable to unrealisable sales in the current period and insufficient financial support of some of the facilities.

The products and services are structured in three groups, namely:

- Defence Science and Technology Institute (DSTI)
- Test and Evaluation (T&E)
- Defence Support

Defence Science and Technology Institute (DSTI) Group

The Defence Science and Technology Institute (DSTI) focuses on defence research. It houses various divisions that provide specialised professional techno-military support in six distinct knowledge areas.

DSTI has managed to complete its contracted work for the year successfully and we are also pleased to report that the common and cohesive attributes of DSTI have been confirmed in practice.

DSTI has been active in exploiting, with approval and encouragement of its primary DOD customers, the commercial opportunities of its defence technologies.

Three commercial projects are still capable of yielding positive results and are being developed further for future returns.

The activities of the year are best illustrated by presenting a range of highlights from various divisions. These are presented below, for each of the six divisions within DSTI.



Review of operations continued

Armour Development

Armour Development's usual activities continued over the entire range of armours from light protection requirements to heavy armour for tanks.

In addition to this, Armour Development was heavily involved in support of local vehicle manufacturers in their export drives. This involved the ballistic qualification of vehicles for three foreign tenders of which two culminated in export orders. This also caused a demand for new armour against more stringent specifications which necessitated increased ballistic research and development in the RSA.

The turmoil in the Middle East and the war in Iraq placed heavy demands on our traditional armour steel suppliers. The products of alternative armour steel suppliers had to be qualified and novel alternative composites had to be developed to enable vehicle manufacturers to supply their customers.

Development of heavy tank armour resulted in a first prototype set of add-on armour to retrofit a main battle tank for protection against modern battlefield threats.

Protechnik Laboratories

Protechnik is a chemical laboratory which performs chemical defence research and development project work, and test and evaluation work for the Department of Defence at its purpose-built facility in Centurion. The laboratory also performs synthetic and analytical work and evaluation of filters and activated carbon for non-Department of Defence customers, including overseas clients.

Protechnik has obtained ISO 17025 accreditation, and tests for the evaluation of carbon, materials and filters are accredited to this standard. As Protechnik has been registered as South Africa's single small-scale facility, test work can be performed with actual chemical warfare agents.

The Chemical Weapons Convention (CWC) accepts sampling and analysis as a tool for verification. When off-

site analysis is to be performed the convention stipulates that "*samples shall be analysed by at least two designated laboratories*". The Organisation for the Prohibition of Chemical Weapons (OPCW) conducts biannual official OPCW proficiency tests with strict scoring criteria in order to maintain an international network of "designated laboratories". Such proficiency tests involve the receipt of samples spiked with chemicals relevant to the convention, which the participating laboratories have to analyse and report on within a 15-day period, according to very stringent requirements. These reports are evaluated and scored by the OPCW with assistance from international laboratories working in the field of chemical defence.

In 2004 Protechnik was requested by the OPCW to evaluate the results of the fifteenth proficiency test. Protechnik was awarded an A pass mark for its evaluation report. This resulted in Protechnik passing three proficiency tests in three years and fulfilling the requirements of an OPCW designated laboratory, and a letter was received in September 2004 from the director-general of the OPCW confirming this status. Only 17 laboratories in the world have achieved this status and Protechnik is the first laboratory in Africa and the southern hemisphere to achieve this status.

The capabilities of Protechnik Laboratories is being recognised by chemical defence manufacturers abroad and Protechnik has been contracted to perform studies on the effect on performance of persons wearing protective clothing and a start has been made to test the persistency of chemical agents under hot and dry environmental conditions for European clients. Dr PC Coleman, the head of Protechnik, was appointed to the scientific advisory board of the OPCW.

Hazmat Protective Systems

Hazmat manufactures and markets respiratory protective equipment which includes full-face and half-mask respirators, canisters and cartridges for military as well as industrial use. Impregnated carbon, a major component of canisters and cartridges, is manufactured locally by Hazmat, the only manufacturer of impregnated carbon in

South Africa. This capability is of strategic importance to the SANDF. It also has the capacity to manufacture larger filters for collective protection systems fitted to new generation vehicles and ships.

Ergotech

Ergotech is an ergonomics consultancy that provides a comprehensive and efficient service in ergonomics to the SANDF. The service primarily provides military ergonomics research in the areas of anthropometry, biomechanics and human functional performance, specification and design of human-machine systems and evaluation of environmental stressors, human-machine systems and specialised health and safety issues.

Ergotech has been responsible for the generation and maintenance of human characteristic databases that are critical in the integration of ergonomics for soldier systems. These databases include body dimensions, functional body strength, aerobic capacity, functional vision and soldier performance. These data, when applied into soldier systems, ensure improved safety and optimal system performance. The future vision is that these databases will be used for the populating and formulation of soldier performance predictive software models.

The evaluation and collation of the physical demands of certain jobs for inclusion to the post profiles have continued in this past year. Ergotech is working with military stakeholders in addressing this huge task of post profiles in a scientific and objective manner.

Valuable research was conducted on the hydration of dismounted soldiers to determine hydration status and water intake effect on performance. This study also made use of the latest international techniques on determining hydration status. This work will need to be continued to verify the results under varying operational conditions.

Ergotech was able to provide evaluation and specification inputs on, among others, back packs, ballistic protection, helmets, clothing sizes, infantry fighting vehicles and

personal combat equipment in order to address the ergonomics of these systems according to the SANDF's specific requirements.

Flamengro

The Fluid and Mechanical Engineering Group (Flamengro) renders specialist engineering services such as signal processing, fluid flow and structural analysis. The contribution of Flamengro is unique to South Africa and can be readily compared with leading-edge analysis capabilities in the rest of the world.

Computational fluid dynamics (CFD)

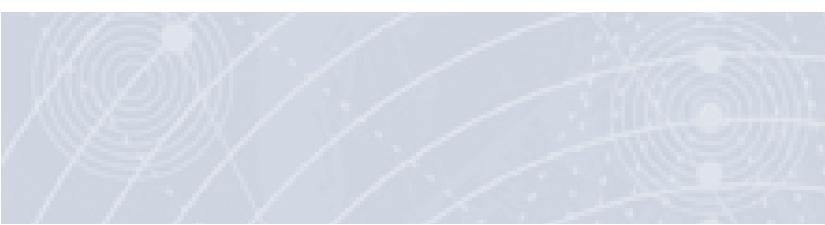
During the past year Flamengro explored several new initiatives towards the application of computational continuum mechanics. This comprises initiatives with regard to the local university training programme, with regard to postgraduate studies in the CFD field, and contact with the unexplored marine environment.

Internal ballistics

Two aspects of the two-dimensional two-phase flow internal ballistics model were updated during the past year. The numerical method used for the simulation of the gaseous phase was improved by switching from a staggered grid to a co-located grid. Numerical anomalies in the heat conduction algorithm, which could result in the incorrect prediction of propellant ignition times, were eliminated by replacing the algebraic solution method with a finite difference method.

Ignition research

A new test facility for the conducting of ignition and combustion chain research has been launched and partially established in collaboration with Denel. This facility will be expanded during the next few years. Numerical simulations are also done to characterise the ignition chain and to generate ignition and combustion models. These are used to improve the understanding of the fundamentals of the interaction of the components, and the simulation of the total combustion process.



Review of operations continued

Launch dynamics

The revised trigger mechanism configuration was analysed to establish the minimum spring force required from the trigger piston spring source. Estimated mechanical properties for an alternative spring unit were also investigated. In addition, the sensitivity of the M82 primer during extraction to its material properties was highlighted as part of the analysis.

Institute for Maritime Technology (IMT)

IMT is the scientific support service of the South African Navy. It serves the Navy from seven domains of technomilitary expertise. These are decision support, mine warfare, battlefield characterisation, submarine warfare, surface warfare, target characterisation above water and target characterisation subsurface. An IMT/SA Navy advisory board has now been established by means of a constitution that was signed by both parties in December 2004. This has opened the possibility of negotiating a service level agreement between IMT and the SA Navy.

All four of the MEKO corvettes have now been delivered. Full-spectrum signature measurement by IMT has continued in local waters with involvement of Defencetek (CSIR) on radar cross-section measurements. IMT is also actively involved in supporting the fleet on sea acceptance trials. The support entails radar, infrared and acoustic measurement and evaluation, as well as eventual development of tactics and doctrine. In addition, acoustic measurements have been taken on the first submarine in conjunction with the German authorities.

Although a further wide spectrum of operations research, test and evaluation, and technology exploration tasks for the navy once again formed the bulk of IMT's professional activities, other DOD users were also served. The intelligence community benefited from the IMT coastal surveillance system and work done for the inspector general on effectiveness measurements could be implemented more widely in the SANDF.

The first three-year cycle of the IMT cadet programme (internship in maritime defence research) has concluded

with all six candidates meeting the requirements. Three of them have been offered permanent employment with IMT while two of the candidates have simultaneously completed their academic postgraduate studies.

IMT's initiative for engagement in Africa started with presentations in Pretoria on IMT's capabilities to the defence attachés of Rwanda, Democratic Republic of the Congo, Angola, Kenya, Malawi, Gabon, Republic of Congo, Uganda, Equatorial Guinea and Nigeria.

Defence Institute

The Defence Institute is a professional organisation focused on supporting the DOD in the process of achieving defence excellence. It maintains a number of centres of excellence required to analyse problem areas and to act as advisors on short-, medium- and long-term decisions. This service is rendered over the full life cycle of defence capabilities, and is organised as three support centres, viz Decision Support Centre (DSC), Acquisition Support Centre (ASC) and Operations Support Centre (OSC).

The Decision Support Centre facilitates the translation of military strategy to the required capabilities (system level 7 and 8 work). The Acquisition Support Centre is involved to facilitate the requirements definition phase (system level 6 work). The engineering processes of specification and evaluation are supported by ASC. During the operating phase of a products system, Operation Support Centre supports the engineering work on management level.

Highlights for the 2004/2005 financial year include:

Capability management

The objective of the capability management project is to develop and evaluate the proposed capability management and analysis processes, by which capabilities can be determined and which should then be used to guide and manage capabilities in the SANDF.

Capability management has become more prominent in recent years, especially with increased pressure on



defence budgets, transparency and a varying scope of current and future employments. Capability management entails the research and analysis to determine the required capabilities, as well as basis for measurement and prioritisation, which will guide and direct capabilities over the short, medium and long term.

Capability management was accepted this year as the foundation of future planning by the DOD. This approval included the acceptance of scenario-based capability analysis, capability portfolios to integrate the management of capabilities across services and divisions, as well as the planned activity schedule. Capability management was accepted as an attempt to enhance existing processes by providing more structure, substance and detail to existing parts thereof. It further seeks to ensure an integrated approach to capability management across services and divisions.

A capability centre was established at the Defence Institute to facilitate the capability analysis and identification process that was developed during this year. An integrated team between Joint Operations and the Defence Institute was established to develop and test this approach with the involvement of defence services and divisions. This capability identification process has also been tested for "peace enforcement" and "collective defence" scenarios.

Africa operational environment

The project was commissioned by the Joint Operations Division and is aimed at creating a high-level overview of the characteristics of the current and possible future African operational environment and of some of the military implications thereof. The purpose of the project is to provide an initial orientation and common point of departure for staff and project officers, particularly those involved in operational planning and in setting requirements for future operational capabilities. As such it is complementary to the strategic environmental analysis and the detailed technical analyses conducted elsewhere in the DOD. The work has been presented to good effect at various forums within the DOD and has proven to be of great value in sensitising people to the wide range of

operational conditions that may be encountered across the continent.

Joint Air Defence

A technology project was launched with the aim to derive and verify system interoperability requirements and associated technologies between current and planned Joint Air Defence (JAD) sensors, information systems and weapon systems for optimal JAD command and control. These weapon systems include airborne air defence systems, ground-based air defence systems and naval-based air defence systems. The context of achieving this is to move from procedural control of weapon systems to semi-positive control (weapons free in an allocated sector) and later full positive control (weapons free on an allocated target). During the year the project developed a number of interfaces to demonstrate the integration of various information sets and displays and demonstrated the manual integration of the naval surface picture with the SAAF air picture display system.

Test and Evaluation Group Overview

The Test and Evaluation Group was established to provide an integrated test and evaluation service. During the past year the marketing effort of the group started paying off with tests and requests for information from new overseas clients. The group demonstrated its ability to provide a one-stop test facility on some of the projects.

Alkantpan

Alkantpan is an all-purpose ballistic test range used by South African and international clients. The range is situated near Prieska in the North Western Cape region of South Africa. Alkantpan is equipped for the testing of all kinds of weaponry ranging in calibre from 5,56 mm to 155 mm and larger, and in variety from artillery pieces to aircraft and naval systems.

The year under review has been a very difficult year for Alkantpan with very poor financial results due to a reduction in international business, mainly the result of a sharp reduction in defence spending in Singapore.



Review of operations continued

Gerotek Test Facilities rendering an independent objective consultation, training and test and evaluation service to the industry

However, the strategy of diversifying to a broader spectrum of explosives and ammunition testing has cushioned the full effect of reduction in development testing. Provisional ISO 9001 certification was obtained and Alkantpan was successful in attracting work from Germany, with indications that more work is in the pipeline. Singapore still remains the largest and most loyal overseas client.

Despite the growth in customer base, the year ahead will be very difficult due to the still low spending on development projects of Alkantpan's trading partners. Therefore the focus will be on marketing, especially international marketing, and controlling expenditure.

Gerotek

Gerotek is an international ISO 17025-accredited test laboratory that supports component and vehicle testing, vehicle promotions and advanced driver training through its business units Gerotek Testing, Gerotek Training, Gerotek Events and Conference facilities.

Gerotek Test Facilities is a multidisciplinary organisation in the field of problem solving through rendering an independent objective consultation, training and test and evaluation service to the industry. By utilising unique technology, skills, facilities and equipment, the risk that the environment and equipment used has on human life is ascertained and rectified.

Gerotek Test Facilities was established to satisfy an urgent need for an all-encompassing test facility at which vehicle

design and development could be monitored in a typical South African environment. It also offers a one-stop test and evaluation service of electrical, electronic and mechanical products and systems in accordance with a wide range of commercial, industrial and military specifications.

The year under review was marked with a growth in Gerotek's core business of vehicle and product testing. This was due to an increase in test work from the Department of Defence and sustainable growth in the commercial and international test markets. International business has been sustained with tests for, amongst others, Nokian Tyres from Finland, various German vehicle manufacturers (Smart, Audi, AMG), Ford from the USA and TATA from India.

Gerotek rendered extensive service for two major military vehicle replacement projects during this financial year and will continue these projects during 2005/2006. The integrated testing between Gerotek and Alkantpan proves to be very successful and value adding.

Gerotek Training offers driver assessment and profiling, short courses in defensive and advanced training (on and off road) as well as skills programmes and learnerships. The training unit is currently experiencing a drop in sales partially due to the postponement of a large project. Gerotek Training is finalising a joint venture with a black driver training company in order to comply with BEE requirements for future business opportunities. The





business unit obtained provisional accreditation from the Transport Education and Training Authority. This accreditation provides Gerotek Training with the opportunity to present skills programmes and full learnerships to learners in professional driving qualifications (NQF4).

Gerotek entered into an agreement with Subaru South Africa to establish a Subaru Driver Training Academy at Gerotek, with a Gerotek employee to run the academy nationally.

The positive relationship between Gerotek and Eurotipe Test Centre (a division of SABS) is contributing to better service delivery to the South African automotive industry and will be improved through the establishment of the first test forum to address future test requirements and solutions. This forum will represent local vehicle and tyre manufacturers.

In the year ahead Gerotek will continue to strive for service excellence in order to provide a one-stop service to its valued clients.

Defence Support Group

Defence Support supports the SANDF and ARMSCOR in the management of intellectual property, freight handling, the management of assets and the disposal of redundant SANDF stock. Defence Support differentiates itself by its ability to align its support capabilities with clients'

requirements, and by being able to understand and accommodate varied and diverse organisational needs.

Defence Support concentrates on providing specialised services.

ARMSCOR Defence Asset Management Centre (ADAC)

ADAC renders an asset management service, on behalf of ARMSCOR, to the DOD. To render this service ADAC has developed and maintained the following capabilities:

- Maintaining a database for DOD intellectual property.
- Document digitisation service for all DOD programme-related documents and data items in ARMSCOR's possession.
- Asset registration and management service for all DOD assets related to ARMSCOR acquisition programmes.
- Stock control service on programmes/weapon systems.
- Ammunition marking and packaging design as well as codification consulting services.
- Disposal service to clear the asset register and the programme management environment of identified redundant, obsolete and unserviceable stock.

The computer-aided logistical management information system (CALMIS) was successfully implemented at ADAC to account for all DOD stock in ARMSCOR's possession. The average value of such stock was R965 million. A total of 42 653 documents was digitised for the period under review. The average value of the DOD assets managed by this division exceeds R400 million. A 98,36% confirmation



Review of operations continued

rate was obtained by way of audit and stock verification. The DOD intellectual property documentation managed by ADAC totals 168 799. These documents are kept in electronic format on the Altris eB configuration database.

Defence Matériel Disposal (DMD)

DMD, a division of Armscor Business, has been appointed and mandated to sell excess and obsolete defence *matériel* on behalf of the Department of Defence, to the best advantage of the State. The stock varies and includes for instance ammunition, aircraft, spares, vessels, vehicles, land and/or air-based equipment.

DMD operates in the international arena and opens up the opportunity to sell the abovementioned equipment. The majority of international sales are done on a government-to-government basis. The sale of the defence *matériel* is carried out in accordance with the requirements of Government-approved regulatory authorities such as the National Conventional Arms Control Committee and the National Proliferation Committee.

DMD establishes partnerships with national or international companies to execute work in instances where the client requires that equipment be repaired or altered to their required configuration status.

Network/markets have been established over the past two years with the following countries:

- Jordan
- Chile
- Ghana
- Brazil
- Gabon

DMD was successful in the sale of the SAS Outeniqua (Replenishment Navy Vessel) as a running concern during the 2004/2005 financial year. During the 2004/2005 financial year, DMD effected sales of stock to the value of R99,6 million.

AB Logistics

AB Logistics Freight is a registered and accredited customs clearing agent with the South African Revenue Service and a member of the Internal Federation of Freight Forwarders Associations (FIATA) as well as the South African Association of Freight Forwarders (SAAFF). It also enjoys authority to act as a customs clearing agent in South Africa in terms of the United States compliance programme.

Technology Exploitation Centre (TEC)

TEC previously formed part of an Armscor Business division which was referred to as DESS (Defence Export Support Services) and which also included the responsibilities of ARMSCOR towards SADESO (South African Defence Export Support Organisation).

The prime focus of TEC was to explore opportunities whereby technologies of which the intellectual property is held by the DOD, can be commercially exploited to the benefit of the DOD and the defence-related industry. A strategic decision was taken by the Armscor Business Board of Directors to close down TEC, as there were insufficiently exploitable opportunities.

Property companies

ARMSCOR is the sole shareholder of three property companies, namely Erasmusrand Properties (Pty) Limited, Oospark (Pty) Limited and Sportrand (Pty) Limited.

Erasmusrand Properties (Pty) Limited owns the ARMSCOR Building, while Sportrand (Pty) Limited owns the stand developed for ARMSCOR's sports field situated adjacent to the ARMSCOR Building. Oospark (Pty) Limited owns a vacant stand adjacent to both the ARMSCOR Building and the ARMSCOR sports field.

No trading was undertaken by any of the three property companies during the year under review.

ARMSCOR did, however, obtain approval, in principle, from the Minister of Defence to investigate the development of the vacant land, as well as the ARMSCOR sport field, into office blocks to generate additional income for ARMSCOR.



The approach is to supply the land, under a lease or similar agreement, to a developer for the development of the vacant land without any risk or financial layout to ARMSCOR. The developer is then to develop the land, let the office block for a period of time and then to return the buildings to ARMSCOR.

ARMSCOR has already identified a preferred developer and is busy with contract negotiations. The final contract conclusion will be subject to approval by the Minister of Defence as well as support from National Treasury.

OTHER FUNCTIONS AND ACTIVITIES

Human resources

The main people management issues of concern relate to skills development, organisational renewal, transformation, the management of the HIV/Aids pandemic and the general health and wellness of the organisation's employees. In order to be able to address these issues adequately, the company places a strong emphasis on consultation with employees in the search for solutions.

Over the past few years the organisation has also had to deal with trade unionism.

Learning and development

The organisation's continuing belief in the quality and motivation of its human resources as the foundation for its future makes it imperative to continue investing in the development and motivation of its human resources and taking advantage of the opportunities presented by the skills development legislation.

Coordination of training

Over and above the role played by management in this regard, the ARMSCOR Consultative Group (ACG), the employees' consultative forum, has a learning and development workgroup which has representation in the ARMSCOR Learning and Development Committee (ALDC) whose role is to ensure that employees play a meaningful role in their development and that they make inputs in the structuring of training initiatives within the organisation or concerning the organisation's employees.

The ACG Workgroup particularly played a critical role in the approval of the Workplace Skills Plan (WSP).

Skills development

To ensure that employees' training and development-related activities may ultimately contribute to the employees acquiring formal qualifications, the organisation always endeavours to have its employees attend accredited courses. In order to support employees acquiring credits towards formal qualifications, the ARMSCOR Learning Centre, based at the head office, has acquired provisional accreditation status.

The organisation participates fully in the activities of its SETA (Sector Education and Training Authority), the DIDTETA (Diplomacy, Intelligence, Defence and Trade Education and Training Authority).

From a compliance point of view the activities that were completed include the development of the organisation's WSP; implementation, monitoring and evaluation of the WSP, and also the drawing up and submissions of the WSP quarterly and annual training reports.

Learnerships and skills development

The organisation has done extensive work to update its competency models in the core job categories within the acquisition function which are presented in the same format as that in the SAQA Act of 1995. This has been supported by the formalisation of a mentorship framework to speed up the transfer of knowledge in the people development process.

This has been linked with the development of qualifications that will constitute the basis for learnership programmes in the acquisition function. The focus of these activities has been in the development of qualifications in the following areas:

- National certificate: Management – NQF Level 3
- National certificate: Management – NQF Level 4
- National diploma: Complex Acquisition Management (Defence and Security) – NQF Level 5

Review of operations continued

ARMSCOR Bursary Scheme

As part of the transformation exercise, and to ensure that the organisation has a supply of newly qualified employees from designated groups to meet its technical human resources development needs, the organisation continues to run its engineering bursary scheme. During the year under review six students benefited from this scheme. In the current financial year six students are being supported.

The Talent Development Programme (TDP)

The provision of bursaries to students in the core functions of the organisation serves as an invaluable feeder for the TDP whereby the newly qualified students are given on-the-job training with mentorship to ensure that they become competent in their chosen professional fields. Fourteen trainees were on the programme from the beginning of the financial year. An additional four will be appointed during the new financial year.

The programme is run in conjunction with the Institute of Maritime Technology (IMT) Scientific Cadet Programme (IMTCP), whose aim, like the TDP, is to develop talented youth, who display the required scientific and technological skills and competencies to play a significant part in support of the SA Navy. Young candidates are exposed to a practical work environment where they can start applying their theoretical knowledge in the technological, scientific, maritime and military environment to support the SA Navy. Of the six trainees who completed their training, three were appointed into permanent positions at the IMT and the other three unfortunately could not be accommodated and had to find employment elsewhere.

Investors in People Standard (IIP)

The IIP is an international standard which benchmarks good practices in human resources management in order to achieve business goals through developing employees. It focuses on four key areas:

- Commitment
- Planning
- Action
- Evaluation

ARMSCOR had its first external assessment for the IIP standard and the organisation met nine of the twelve IIP

indicators. An action plan has been drafted to close the gaps identified in the assessment.

Managing the impact of HIV/Aids

The company's HIV/Aids Programme continues, with the emphasis on:

- The planning and coordinating is being undertaken by an HIV/Aids Committee;
- an on-site Voluntary Counselling and Testing (VCT) facility within the ARMSCOR Clinic;
- wellness activities highlighting the pandemic as well as providing health-related information which is accessible to all employees;
- ongoing communication with staff on the pandemic;
- liaising and exchanging information with other employers in order to identify best practices for consideration; and
- having condoms freely available to employees through condom dispensers that are placed at various points throughout the organisation's premises.

During the course of the financial year the organisation embarked on a "Know your Status" campaign. Discussions have been initiated with the ACG to get an indication on how more employees could be encouraged to know their status. It is vital for the organisation to ensure that employees know their status in order to empower them to manage their own health. This will ensure that employees whose status is positive will start to receive treatment early and thereby be able to continue to live productive lives without falling sick.

The HIV/Aids Programme, which emphasises education and awareness, will hopefully result in more employees "knowing their status" and thereby positively influencing the results obtained from the knowledge and behavioural study which had previously shown a high level of ignorance.

Employee health and wellness

ARMSCOR's Sport and Wellness Programme is aligned with and supports the National Health Observances Calendar, which is recognised by the National Department of Health as well as the World Health Organisation (WHO).



The programme has, as its point of departure, the notion that in order to pursue the goal of optimal well-being in all areas of life, one needs to accept responsibility for one's own well-being. In view of this, the programme entails providing employees with the necessary information and knowledge to make quality lifestyle choices.

Some of the wellness campaigns that were run during the year focused on:

- Stroke awareness
- World environment
- Mental health awareness
- National cancer awareness
- HIV/Aids awareness
- Drug and substance dependence awareness
- World no-tobacco day
- Deaf and disability
- Literacy

As sport plays a critical part in personal wellness, it is supported within ARMSCOR and towards that end some internal sporting teams are supported in various ways, such as volley ball, golf, running, cycling and tug-of-war. The organisation also provides the facilities to house a well equipped gym, the membership of which is at a nominal fee.

The organisation also provides its employees with an ongoing high level of health care through its clinic, which is staffed by qualified health workers.

Consultative structure

As reported previously, ARMSCOR subscribes to the firm belief that employees should always play a meaningful role in making decisions that concern them and their well-being, as one of the critical stakeholders of the organisation.

It is for this reason that the role played by the ARMSCOR Consultative Group (ACG) is considered by the organisation's leadership as being critical to how efficiently the company continues to operate and function.

The primary role of the ACG is to assist with guiding the organisation to achieve its transformation goals. The

organisation also functions as the link for employees to top management.

A number of human resources practices and other practices, which affected employees, had to be reviewed over the reporting period and the ACG played a central role in these endeavours.

Trade unionisation

As a result of the union's level of representation within the ARMSCOR workforce having been reduced, the recognition agreement that the organisation had with the trade union Solidarity was cancelled. Since July 2002 the union had enjoyed limited organisational rights on the basis of its representation having been above 30%.

Transformation

Transformation remains high on the list of ARMSCOR's priority focus areas. Budget constraints are still the biggest constraining factor for the transformation process within ARMSCOR. Learning and development plays a central role among the affirmative action measures that the company has in place to facilitate the progress towards employment equity.

Other affirmative action measures in place entail:

- Setting targets for the appointment of black and women employees. 89,8% of all appointees were black and 67,3% were women.
- Setting targets for the representation of women in supervisory and higher levels. The target of 28% that was set was achieved as the current representation is 28%.
- Setting targets for the representation of people with disabilities in the ARMSCOR workforce. This figure currently stands at 0,51%, against a target of 0,41%.
- Having a language practice in place which provides that, for practical reasons, English be used as the language for conducting business but also allows for business to be conducted in other languages where appropriate.



Review of operations continued

- Generally implementing equitable people-related policies and practices.
- Continually monitoring the workplace to ensure that it physically and socially accommodates the diverse composition and needs of employees.

Employee total by race: March 1996 – March 2005

	Black	White	Total
03/1996	218	886	1 104
03/1997	253	887	1 140
03/1998	256	843	1 099
03/1999	253	727	980
03/2000	249	710	959
03/2001	273	690	963
03/2002	280	682	962
03/2003	300	654	954
03/2004	336	641	977
03/2005	356	626	982

The staff profile of permanent employees per job level, race and gender as on 31 March 2005, as well as the changes in the racial and gender profiles over the last 10 years are reflected in the tables below:

Employee total by gender: March 1996 – March 2005

	Female	Male	Total
03/1996	383	721	1 104
03/1997	392	748	1 140
03/1998	380	719	1 099
03/1999	338	642	980
03/2000	330	629	959
03/2001	334	629	963
03/2002	333	629	962
03/2003	339	615	954
03/2004	354	623	977
03/2005	358	624	982

Staff profile as at 31 March 2005

Permanent employees

	African		Coloured		Indian		White		Total	
LEVEL	M	F	M	F	M	F	M	F	M	F
EX	3	2	0	0	0	0	4	0	7	2
SU	8	1	1	0	0	0	48	3	57	4
MP	12	6	9	0	10	1	297	42	328	49
STS	26	17	9	7	6	11	55	100	96	135
AS	43	51	17	19	2	6	14	62	76	138
OS	51	27	9	2	0	0	0	1	60	30
Total	143	104	45	28	18	18	418	208	624	358

Note:

- M – Male
- F – Female
- EX – Executive
- SU – Strategic execution/unique authority
- MP – Managing/professional contribution
- STS – Supervision/technical and specialist contribution
- AS – Advanced operation/support
- OS – Operation

Black economic empowerment (BEE)

ARMSCOR's BEE strategy and policy were finalised and approved during the previous financial year ended 2003/2004 and implementation is currently under way and continuously being monitored by the BEE Management Division.

The BEE strategy and policy encapsulate the principles of the Broad-Based Black Economic Empowerment Act, 2003, and fulfil ARMSCOR's corporate BEE responsibilities in an integrated manner covering areas such as affirmative procurement, employment equity, supportive culture, skills development and equity participation.

We have made good progress in affirmative procurement, supportive culture and introduction of BEE suppliers into

the defence industry which is developing at satisfactory pace. The mechanism was developed to appraise and evaluate the BEE status of the BEE suppliers in our database.

To further strengthen ARMSCOR's capacity to deliver on its transformation mandate, a senior manager and coordinator responsible for BEE were appointed. The senior manager is responsible for implementation and execution of the policy and other initiatives while the coordinator will in turn be responsible for monitoring, evaluating, guiding and advising on BEE matters.

ARMSCOR's CEO set up specific BEE spending targets for the financial year under review, which were exceeded by ARMSCOR as well as Armscor Business.

BEE spending analysis (2004/2005)

Infrastructure	Total contracted	Target	Actual
Purchase from Armscor	100%	30%	45%
Operational budget	R34 million	R10 million	R15 million
Acquisition and procurement (General and Special Defence accounts)	100% ** R2 500 million	7,5% R188 million	8,0% R200 million
Armscor Business	Total expenditure	Target	Actual
Figures	100% R937 million	40% R375 million	45% R421 million

*** Note that the total expenditure on general and special defence accounts is approximately R8 000 million which was contracted with suppliers for long-term projects. Acquisition department committed R2 500 million on local suppliers.*

Problem areas

- Defence industries are not well exposed to black communities.
- Lack of employment opportunities (not enough business to bring black engineers on board).
- Ensuring sustainability of industry by complementing local sales with exports.
- Developing and retaining essential defence industry capabilities, capacity and technologies to meet the

requirements of the DOD, through efficient utilisation of available resources.

Solution

Development of the BEE charter, BEE practice and review of the supplier registration practice, which will serve as a guideline on how to achieve the broad-based black economic empowerment imperatives.



Review of operations continued

ARMSCOR Security

External

Internationally ARMSCOR maintained relations with the security organisations of countries involved in the Strategic Defence Packages (Sweden and the United Kingdom specifically, where there are aeronautics programmes). Several security-related visits to South Africa were hosted. In this regard security is well entrenched and there are no issues of particular concern.

Nationally an endeavour to maintain contact with the local defence industry and a high degree of security awareness within this environment needs to be highlighted. Both these goals were seriously pursued during the period under review.

Safety, health and environment

Safety and health

In terms of the Occupational Health and Safety Act and Regulation 85 of 1993, employers must ensure a healthy and safe working environment. ARMSCOR implements preventive measures and tests in order to ensure that the ventilation and water in its building are clean and safe. External laboratories are contracted six-monthly to set the necessary standards and to conduct the necessary tests. These tests involve determining dust concentrations, bacterial contamination, gaseous pollution, oxygen and carbon monoxide, carbon dioxide (CO_2), formaldehyde, relative humidity, temperature and ventilation rates (air changes/hour). The factors considered in this investigation all have a bearing on the effectiveness of the air-conditioning systems in the building, and do not consider ergonomic and psycho-sociological influences which might well play a role in the health and/or well-being of the occupants. The Legionella test results indicated that all in-house water was clean and fit for human consumption.

Environment

One of the cornerstones of a well-managed institution is the physical environment in which it operates. A corporate culture of holistic responsibility towards environmental awareness is but one element of ARMSCOR's approach to

its physical environment which calls for continual improvement in environmental management activities.

A holistic approach addresses the entire environmental spectrum – people, plants, animals, soil, water and air.

ARMSCOR acknowledges other diverse but related issues such as pollution prevention, the efficient use of energy resources, waste minimisation and conservation of historical sites. Continuous improvement in all its management activities is strived at.

Positive environmental values are the cornerstones of sound environmental practices and ARMSCOR, which is a corporate member of the World Wildlife Fund, is a reliable partner to those who are environmentally conscious. ARMSCOR cares about holistic and sustainable development and conservation.

ARMSCOR Head Office complex

An environmental audit for the ARMSCOR Head Office complex was conducted in March 2005 with the following recommendations:

- A long-term objective is to attain ISO1400.
- An objective to compile a comprehensive Environmental Management Plan (EMP) for the ARMSCOR Head Office complex.
- To investigate whether storm water run-off could be economically diverted for irrigation purposes.

The audit concluded by stating that environmental control measures that safeguard against environmental degradation are in place at the ARMSCOR Head Office complex.

Alkantpan and IMT

An environmental audit is planned for Alkantpan and IMT in the 2005/2006 review year.

Protechnik/Hazmat

An audit was completed in June 2004 and concluded the following:



The principles of the National Environmental Management Act are being met by Protechnik and a sustainable development and environment which is not harmful to people's health or well-being are being maintained.

Conclusion

ARMSCOR's long-term goal is to develop and sustain environments where it conducts its business. It also wishes to be recognised by its stakeholders as a corporation that cares about its physical environment.

Social responsibility

Through its Corporate Social Investment (CSI) strategy, ARMSCOR aims to contribute to improving the material and spiritual conditions for the country's citizens by using its resources to promote development amongst the needy in the communities in which it operates.

ARMSCOR is therefore committed to the improvement and empowerment of these communities and focuses specifically on previously disadvantaged schools.

To this end ARMSCOR adopted the Vlakfontein Secondary School, situated in Mamelodi in the greater Tshwane metro area since 2002. The objective was to improve the

learners' performance in mathematics and science and also to create a safe and secure environment for improved learning. To achieve this objective, the following initiatives were undertaken during the year under review:

- ARMSCOR sponsored the development programme of the I-Can Foundation on Youth Day, 16 June 2004, in which 1 300 learners of Vlakfontein Secondary School participated.
- Ten computers donated by ARMSCOR were upgraded to Pentium Four standard to ensure effective utilisation by learners and educators.
- Twenty learners participated for the first time in the Gauteng North region of the Expo for Young Scientists competition of which ARMSCOR is a board member. All the learners received certificates of merit.
- Fifty learners took part in the Africa Militaire model building competition at the Africa Aerospace and Defence Exhibition. Participation in model building gave the learners the opportunity to build something from the ground up, thus helping them with hand and eye coordination and also taught them about the necessity to read and practically interpret assembling instructions.
- An environmental management plan was drafted for the school.



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Report of the independent auditors to the Minister of Defence

We have audited the annual financial statements and group annual financial statements, as well as the cash flow statement of the Special Defence Account as set out on pages 44 to 86 and the performance information in the directors' report set out on pages 45 to 58 for the year ended 31 March 2005. The annual financial statements are the responsibility of the Corporation's accounting authority. Our responsibility is to express an opinion on these financial statements, based on our audit. The performance information is the responsibility of the accounting authority. Our responsibility is to express an opinion on whether the performance information furnished in terms of subsection 55(2)(a) of the Public Finance Management Act (Act 1 of 1999), as amended, is fair in all material respects and, if applicable, is consistent with that of the preceding year.

Scope

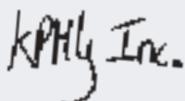
We conducted our audit in accordance with statements of South African Auditing Standards. These standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. The audit was also planned and performed to obtain reasonable assurance that our duties in terms of sections 27 and 28(1)(a) and (c) of the Public Audit Act (Act 25 of 2004), have been complied with. An audit includes:

- examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- assessing the accounting principles used and the significant estimates made by management; and
- evaluating the overall financial statement presentation.

We believe that our audit provides a reasonable basis for our opinion.

Audit opinion

- In our opinion these financial statements fairly reflect, in all material respects, the financial position of the Corporation as at 31 March 2005. The results of their operations and cash flows for the year ended, in accordance with Generally Accepted Accounting Practice (being the accounting principles generally accepted in South Africa), are applied on a basis consistent with those of the previous year and in the manner required by the Armaments Development and Production Act (Act 57 of 1968), and in the manner required by the Public Finance Management Act (Act 1 of 1999), as amended.
- The performance information furnished in terms of section 55(2)(a) of the Public Finance Management Act (Act 1 of 1999), as amended, fairly reflects, in all material respects, the Corporation's performance for the year ended 31 March 2005 against predetermined objectives and, where applicable, on a basis consistent with that of the preceding year;
- The transactions of the Corporation that had come to the auditors' attention during auditing were, in all material respects, in accordance with the mandatory functions of the Corporation, as determined by law or otherwise.



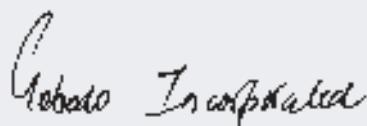
KPMG Inc.

Chartered Accountants (SA)

Registered Accountants and Auditors

Pretoria

6 July 2005



GOBODO Inc.

Chartered Accountants (SA)

Registered Accountants and Auditors

Pretoria

6 July 2005

Directors' approval of the annual financial statements

The Board recognises and acknowledges its responsibility for the group's internal control systems. Management is responsible for preparing of the annual financial statements and the group annual financial statements in accordance with generally accepted accounting practices.

The directors, supported by the Audit Committee, are satisfied that management has introduced and maintained adequate internal controls to ensure that dependable records exist for the preparation of the financial statements, to safeguard the assets of the group and to ensure that all transactions are duly authorised.

Against this background the directors of the Corporation accept responsibility for the financial statements. The information on pages 44 to 86 was approved by the Board of Directors on 6 July 2005. Signed on behalf of the Board by:



Dr PS Molefe
Chairman



Ms SN Mabaso
Chairman of Audit and Risk Management Committee

Name	Status	Period
Dr PS Molefe	Non-executive chairman	Appointed 1 October 2004
Mr CV Gamede	Non-executive director	Appointed 1 September 2001
Gen (Ret) CL Viljoen	Non-executive director	Appointed 1 September 2001
		Resigned 31 August 2004
Col (Ret) GN Ramaremisa	Non-executive director	Appointed 1 September 2001
Mr PL Zim	Non-executive director	Appointed 1 November 2002
		Resigned 31 October 2004
Ms AS Human	Non-executive director	Appointed 1 March 2002
Ms CWN Molope	Non-executive director	Appointed 1 April 2004
Mr RP Meyer	Non-executive director	Appointed 1 October 2004
Ms P Riba	Non-executive director	Appointed 1 May 2004
Mr HS Thomo	Executive director (CEO)	Appointed 1 April 2001
Mr CJ Hoffmann	Executive director (CFO)	Appointed 1 August 2004
Gen S Nyanda	Ex-Officio director	Appointed 1 April 2001
Mr JB Masilela	Ex-Officio director	Appointed 1 April 2001
Adv CVV Ramphele	Company secretary	Appointed 1 September 2003

AUDITORS	BANKERS	REGISTRATION NUMBER	REGISTERED OFFICE
KPMG Inc.	ABSA Bank	1968/008611/06	370 Nossob Street
Gobodo Inc.			Erasmuskloof Extension 4 Private Bag X337 0001 Pretoria

Directors' report

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- Corporate governance
- Schedule of attendance of Board and Board Committee meetings
- Requirements in terms of the protocol on corporate governance in the public sector
 - Organisational structure
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 - Protocol for communication with shareholder
 - Environmental analysis
 - Judicial proceedings filed
 - Investigations performed by Auditor-General
 - Going concern
- Performance against goals
 - Optimise customer service
 - Improve ARMSCOR's efficiency and effectiveness
 - Ensuring adequate funding for ARMSCOR through financial growth
 - Transform ARMSCOR to be representative
- Post-balance sheet events
- Five-year review
- Value added statement
- Financial results

Introduction

The Armaments Corporation of South Africa Limited ("ARMSCOR") is a statutory body, established in terms of the Armaments Development and Production Act (Act No 57 of 1968), and continue, its existence through the Armaments Corporation of South Africa, Limited Act (Act No 51 of 2003).

ARMSCOR is governed by the Public Finance Management Act (Act 1 of 1999), as amended (PFMA).

This report is therefore presented in terms of the provisions of the PFMA. It will provide an overview on the performance of ARMSCOR, measured against performance targets that the Corporation had set itself for the financial year.

Corporate governance

Board accountability

The Board of Directors of ARMSCOR is committed to the highest integrity, excellence and good corporate governance in conducting the affairs of the Corporation and constantly seeks balance between conforming to governance requirements and performing in an entrepreneurial way. Board activities are aligned with the principles of the PFMA, King II Report and Protocol on Corporate Governance in the Public Sector.

The Board operates in accordance with the Shareholder's Compact reviewed on an annual basis and the Board Charter which reserve, amongst others, the following responsibilities for the Board:

- the approval of the annual business plan, the financial objectives, the identification and management of key risk areas;
- the appointment and evaluation of the Chief Executive Officer;
- the determination of policies and processes to ensure the integrity of the Corporation; and
- provision of strategic direction to the Corporation.

Directors' report continued

For the period under review, the Board placed high on its agenda the following areas:

- transformation, by putting emphasis on the principles of employment equity in regard to staff appointments and incorporation of black economic empowerment in acquisition and procurement contracts; and
- risk identification and management. To improve in this area, all Board members, Board Committee members and executive management members received training specifically on risk management.

The Board, in discharging its obligations and to effectively fulfil its fiduciary role, is supported by the following subcommittees:

- Audit and Risk Management Committee;
- Human Resources Committee; and
- Executive Committee.

The Board as the Accounting Authority has delegated the Corporation's daily management to the Management Board under the leadership of the Chief Executive Officer.

Board meetings

The Board meets at least eleven times per year. The Company Secretary is responsible to ensure both the effective functioning of the Board and the proper administration of the Board proceedings.

Details of attendance of Board and committee meetings 2004/2005

Names	Board of Directors including special Board meetings	Audit and Risk Management Committee	Human Resources Committee	Executive Committee
Dr PS Molefe Appointed 01/10/2004	7 out of 8	Non-member	Non-member	-
Mr HS Thomo (CEO)	10 out of 10	2 out of 4	6 out of 7	-
Mr CV Gamede	10 out of 14	Non-member	5 out of 7	-
Ms AS Human	14 out of 14	Non-member	7 out of 7	-
Gen (Ret) CL Viljoen Resigned 31/08/2004	5 out of 5	Non-member	2 out of 2	-
Mr PL Zim Resigned 31/10/2004	4 out of 7	Non-member	Non-member	-
Col (Ret) GN Ramaremisa	14 out of 14	Non-member	7 out of 7	-
Mr RP Meyer Appointed 01/10/2004	6 out of 8	Non-member	Non-member	-
Ms CWN Molope	14 out of 14	4 out of 4	Non-member	-
Ms P Riba Appointed 01/05/2004	13 out of 13	Non-member	6 out of 7	-
Mr JB Masilela	7 out of 13	Non-member	Non-member	-
Gen S Nyanda	6 out of 13	Non-member	Non-member	-
Mr CJ Hoffmann Appointed 01/08/2004	7 out of 7	4 out of 4	Non-member	-
External members				
Ms SN Mabaso	Non-member	4 out of 4	Non-member	Non-member
Mr MD Mkhabu	Non-member	4 out of 4	Non-member	Non-member
Ms L Mthimunye	Non-member	2 out of 4	Non-member	Non-member
Company Secretary				
Adv CVV Ramphele	14 out of 14	3 out of 4	7 out of 7	-
K Mabe (Acting 16/03/2005)		1 out of 4		
Total meetings	14	4	7	-

Directors' report continued

Board subcommittees

During the period of reporting Board subcommittees named below were maintained in order to assist the Board in discharging its responsibilities. Specific responsibilities have been delegated to these committees, with defined terms of reference.

The Audit and Risk Management Committee

This committee is chaired by an independent member and further consists of two other independent members and one non-executive director. The Chief Executive Officer, Chief Financial Officer, and internal and external auditors attend meetings of the committee by invitation.

The committee focuses on accounting policies and procedures, internal controls, financial reporting practices, the relationship with the external auditors and internal audit function and the identification and monitoring of the risk management process.

The adequacy and efficiency of ARMSCOR's internal control, corporate governance and risk management processes are constantly assessed by Internal Audit which enjoys the full support of the committee. The work done by Internal Audit is complemented by the external auditors who also review all internal audit reports. The committee is satisfied that the internal control system is effective as no significant non-compliance with prescribed policies and procedures was reported.

The committee has reviewed the acceptability of the annual financial statements and for the period under review performed its duties and responsibilities in line with its formal terms of reference.

The Human Resources Committee

The Human Resources Committee comprises of four non-executive members, one of whom is the chairperson. This committee deals with remuneration issues. During the period under review the terms of reference were reviewed to include facilitation of Board appointments and performance appraisals.

The Executive Committee

The Executive Committee of the Board only sits for urgent matters, which cannot wait for the scheduled Board meeting. During the year under review this committee did not sit.

Disqualification of ARMSCOR directors

None of ARMSCOR's Board members are disqualified from being appointed as directors on any of the grounds contained in either the Companies Act,1973 (as amended), or in the PFMA and its regulations.

Requirements in terms of the Protocol on Corporate Governance in the Public Sector

Organisational structure

The organisational structure of the Corporation appears on page 16 of this report.

Significant events reported to the Executive Authority

No significant events were reported to the Executive Authority during the year under review.

Protocol for communication with shareholder

The Executive Authority for ARMSCOR is the Minister of Defence, who represents the shareholder. The Board as the accounting authority of the Corporation reports to the Minister of Defence. Communication with the shareholder is channelled

primarily through the office of the Chairman. The Board has scheduled meetings with the shareholder and reporting is regulated in terms of the Shareholder's Compact.

Environmental analysis

External and internal environmental factors influencing performance:

An environmental scan, covering the political, economic, social, technological, military and regulatory environments, was conducted by the Department of Defence in November 2004.

- The following New Threat Patterns will need to be prepared for in terms of intelligence, research and development, training and equipment:
 - Terrorism
 - Piracy
 - Chemical, biological and radiological threats
 - Information warfare
- The Government initiatives, as well as the African Union imperatives as indicated in the establishment of the African Standby Force, imply that the SANDF will remain involved in peace support operations as well as disaster relief assistance in the medium to long term.
- Social and economic issues will continue to dominate Government's agenda. In addition, personnel issues, capital renewal, the SANDF's involvement in collective security measures and commitments with respect to peace support operations in Africa will continue to put pressure on the defence budget.
- Internationally the role of research in industry is changing from one of creating a technology base, to one of accessing and exploiting it. The switch has been from predominantly in-house defence research programmes to one where the focus is on exploiting commercially funded research, or academic bodies, with the aim of creating capability in key suppliers of military systems.
- The shortage in scientific, engineering and technical personnel in South Africa will increase sharply over the next decade unless dramatic progress is made in attracting young people to these fields. Competition with the private sector will challenge ARMSCOR's ability to recruit and retain such staff and to achieve its transformation targets. Training and skills development will become major issues.
- The growing technology gap between Africa and the developed world, technology diffusion, the migration of skilled personnel and industrial espionage could compromise any leading edge South Africa may have. Intellectual property and the protection thereof will become vital issues.
- The penetration and/or disruption of IT systems for espionage, criminal or other malicious purposes will become a major threat to government and business. The protection of IT systems and other measures to protect the organisation against corruption and white-collar crime should be given high priority.
- While ARMSCOR's situation is significantly better than the national average, HIV/Aids will have a serious impact on the labour market and health industry. Recruitment, productivity and health support are issues that will require attention.

Directors' report continued

- The regulatory environment will become increasingly demanding and litigious. Legal challenges on labour, environmental, arms limitation, intellectual property and other issues will increase.

Judicial proceedings filed

During the year under review the following litigation matters were filed or were pending against ARMSCOR:

Parties	Matter description	Status
CCII Systems (Pty) Limited vs ARMSCOR (2nd defendant)	Administrative dispute on tender process	The judgement on the exception plea was received on 28 January 2005. The plaintiff was ordered to amend his particulars of claim. ARMSCOR has filed its plea of defence.
A van der Wielen	Labour dispute – unfair dismissal	CCMA arbitration was finalised during October 2004. The award indicated that the dismissal of the applicant by ARMSCOR was substantively fair but procedurally unfair. ARMSCOR was ordered to compensate the applicant by paying six month wages being the total amount of R55 878,00.
Symbiotic Systems ARMSCOR and Armscor Business	Civil claim for alleged breach of contract	An action has been instituted against ARMSCOR Limited and Armscor Business (Pty) Limited for breach of contract. Litigation process pending.
Masemola/ARMSCOR	Labour dispute – constructive dismissal	The matter went for arbitration and the arbitrator found against ARMSCOR. The matter has been referred to the Labour Court for review.
ARMSCOR/Nico Palm	Civil claim	ARMSCOR has instituted an action against the defendant for recovery of certain monies following an exhibition at the Africa Aerospace and Defence show. Summons has been issued and the matter is pending.
Mashinini/ARMSCOR	Labour dispute	The applicant is alleging unfair dismissal because of non-renewal of employment contract and has referred the matter to the Labour Court. ARMSCOR has filed a response to the applicant's statement of case and awaiting an answer from the applicant.
NGA (Pty) Limited/ARMSCOR	Eviction from ARMSCOR property and claim for unpaid rental	Matter pending, postponed by the court to September 2005.
Unisafe Intsimbi Ayigobi (Pty) Limited/ARMSCOR	Breach of contract Claim of damages	Judgement granted in favour of ARMSCOR.

Investigations performed by Auditor-General

During the year the Auditor-General independently investigated certain allegations from a member of the public regarding alleged irregularities at ARMSCOR.

The alleged irregularities related to a technology project that had as its main objectives the retention and application of technology related to ground-based defence. The series of investigations into project Cocro started when a former employee of the contractor made allegations of fraud and other irregularities. This led to investigations performed by ARMSCOR during which shortcomings were identified.

The findings of the Auditor-General's were similar to those of ARMSCOR in that both entities had found irregularities with the acquisition system as it was applied at the time when the irregularities occurred. Allegations of fraud were however considered to be unfounded.

ARMSCOR had since taken corrective measures which included disciplinary action against its employee and instituting new technology management practices. The ARMSCOR Board therefore was satisfied that suitable measures had been taken to prevent a recurrence and regards this matter as concluded.

Going concern

A "going-concern" approach has been adopted in the preparation of the financial statements. Based on forecasts and cash resources, the directors have no reason to believe that the Corporation will not remain a going concern in the foreseeable future.

Performance against goals

Operational objectives 2004/2005 financial year

ARMSCOR translates its strategic objectives into strategic initiatives. These objectives are used to measure the performance of the Corporation.

ARMSCOR has identified four strategic initiatives, which are regarded as the key result areas that will achieve our mission and, ultimately, the vision to which we aspire. Progress on ARMSCOR's goals is reported under the four key result areas, namely:

- optimising customer service;
- improving ARMSCOR's efficiency and effectiveness;
- ensuring adequate funding for ARMSCOR through financial growth; and
- transforming ARMSCOR to be representative.

Performance against goals

An overall efficiency measure used by ARMSCOR is the cost of acquisition. This measure reflects the ratio of acquisition cost versus turnover. A goal of 3,5% was set for the 2004/2005 financial year. A result of 4,1% was achieved, compared with 3,3% for the 2003/2004 period. The turnover was reduced due to delays in the deliveries of milestones on acquisition projects (R819 million) and a positive variance in the rand-USD rate of exchange (R820 million).

ARMSCOR's subsidiaries generated a net loss of R16,6 million (after R6,9 million in respect of the service level agreement with ARMSCOR had been charged) against a set target of R10 million profit.

The deviation from the goal was due to late deliveries in certain contracts resulting in a roll-over of R7,1 million net profit to the following financial year as well as the withdrawal of stock available for disposal resulting in a reduction of R19,1 million in planned net income.

Directors' report continued

Performance against the objectives specified in the corporate plan is as follows:

Optimise customer service

Objective	Key performance indicator	Performance results
1.1 Periodically update service level agreement between ARMSCOR and its clients	Updated service level agreements for the 2005/2006 financial year to be signed by 28 February 2005	A service level agreement between ARMSCOR and the DOD was completed in September 2004. This three-year agreement addresses the detailed terms and conditions in terms of which ARMSCOR delivers services to the DOD. It also contains a detailed business plan listing specific services of value of these services. The service level agreement has not been formally signed. Nevertheless ARMSCOR and the DOD have been working in accordance with the agreement and progress reporting in terms of it has been submitted to the DOD on a regular basis.
1.2 Review of the Shareholder's Compact	Updated/reviewed the Shareholder's Compact for the 2005/2006 financial year which was signed on 28 February 2005	The Shareholder's Compact was reviewed and approved by both the Board of Directors and the minister in February 2005. It has been signed.
1.3 Continuously measure customer perception of ARMSCOR's performance	<ul style="list-style-type: none"> • External customer perception survey 80% positive results • Internal customer perception 80% positive results 	An external customer perception survey was conducted during the year. A satisfaction figure of 81,83% was obtained, compared with 64,75% for 2002/2003. It was decided not to conduct any internal customer perception survey in the year under review, but to do so biannually in future.

Improve ARMSCOR's efficiency and effectiveness

Objective	Key performance indicator	Performance results
2.1 Retain ISO certification	External ISO audit reports Zero major findings on external ISO audit reports.	Two external audits were performed by the SABS. No major findings were noted and ARMSCOR ISO 9001:2000 certification was confirmed.
2.2 Develop and implement e-Business enablement plan. (This will be included in the rewriting of ARMSCOR's mainframe system and will therefore be measured as such.)	<ul style="list-style-type: none"> • Finalised User Requirement Specification (URS) – 30/09/04 • Development – 31/03/06 	<p>The User Requirement Specification was finalised.</p> <p>The Mainframe Migration Project: The Steering Committee approved the postponement of the URS until 31 January 2005. The URS was distributed to all the project members on 6 December 2004 as planned. Final review workshops were held in January 2005. The review sessions for the acquisition functions revealed gaps in the URS, which required additional work. The URS was finally approved in March 2005.</p> <p>The solution selection phase has just been initiated.</p>

Ensuring adequate funding for ARMSCOR through financial growth

Objective	Key performance indicator	Performance results
3.1 Commercial property development	<ul style="list-style-type: none"> • Main agreement signed between ARMSCOR and the consortium – 19/04/04 • First land lease(s) signed – 14/06/04 • Commence infrastructure upgrade, site works and construction of first building – 12/07/04 • Completion of first building – 31/03/05 	During the Management Board strategic session in May 2004 the milestone dates have been revised as shown under the key performance indicator column.

Directors' report continued

Ensuring adequate funding for ARMSCOR through financial growth (continued)

Objective	Key performance indicator	Performance results
	<p>Revised milestone dates:</p> <ul style="list-style-type: none"> • Request for proposals 10/08/04 Evaluation of proposals 12/11/04 • Selection of bidder – Management Board 22/11/04 • Selection of bidder – Board of Directors 01/12/04 	<p>Proposals obtained 10/08/04.</p> <p>Received final evaluation from the independent consultant on 15/11/04. The Management Board approved the preferred bidder on 22/11/04.</p> <p>The Board of Directors approved the preferred bidder on 01/12/04. The Board of Directors, however, recommended that a knowledgeable consultant be appointed to assist ARMSCOR with the contract layout and content to ensure best value for money to ARMSCOR.</p> <p>A submission to appoint the consultant who assisted with the evaluation of the tenders was referred back and a process to invite tenders in this respect must now be initiated.</p>
	<ul style="list-style-type: none"> • Obtain minister's approval 28/01/05 	<p>The final rezoning approval by the relevant authorities has not yet been received. The hearing in this regard will take place on 31/05/05.</p> <p>The minister's approval and National Treasury's support is dependent on the final contract proposal as well as the rezoning approval.</p>
	<ul style="list-style-type: none"> • Obtain National Treasury's support 01/03/05 • Award/conclude contract 31/03/05 	<p>A draft contract has been drawn up and is being evaluated for legislative soundness by ARMSCOR's legal division.</p>

Ensuring adequate funding for ARMSCOR through financial growth (continued)

Objective	Key performance indicator	Performance results
3.2 Management of Simon's Town Naval Dockyard	<p>The undermentioned items are a summary of the plans, processes and strategies that must be established as specified in the business plan and were scheduled for finalisation by 31/03/05:</p> <ul style="list-style-type: none"> • Organisational redesign • Transition and transformation plan • Staff development plan • Risk management plan • Budgeting process • Pricing approach • Master production schedule • Non-SAN Marketing and Business Development Plan • Project Tasking Mechanism 	<p>Some of the planned objectives could not be met due to the following reasons:</p> <ul style="list-style-type: none"> • They can only be effected once the dockyard has been fully transferred to ARMSCOR. • Most of the plans are to be effected within one year after the effective date of the transfer to ARMSCOR. <p>This activity will be finalised during 2005/2006.</p> <p>This activity will be finalised during 2005/2006.</p> <p>This activity will be finalised during 2005/2006.</p> <p>ARMSCOR's Board of Directors has noted the initial risk and fraud prevention plan. The plan was submitted to the Audit and Risk Management Committee which identified further issues to be addressed. The plan will be resubmitted for approval.</p> <p>This activity will be finalised during 2005/2006.</p> <p>This activity will be finalised during 2005/2006.</p> <p>The schedule has fully been developed and awaits implementation and rollout once the dockyard has been fully transferred to ARMSCOR.</p> <p>A number of potential commercial business opportunities have been identified and will be pursued for utilisation of spare capacity in the NDS after transfer of the NDS to ARMSCOR.</p> <p>A workgroup is currently in the process of developing a tasking and interface mechanism between the NDS and the SAN.</p>

Directors' report continued

Ensuring adequate funding for ARMSCOR through financial growth (continued)

Objective	Key performance indicator	Performance results
	<ul style="list-style-type: none"> • Inventory management plan • Shared service strategy • Asset and infrastructure transfer management plan • Outsourcing accreditation procedure • MIS plan 	<p>The NDS will take over this function, previously rendered by the SAN, and in this regard a suitable plan has been produced and a structure and processes put in place for when ARMSCOR takes over joint management of the NDS. Interim service level agreements between the NDS and the SAN were concluded in December 2004 to ensure continued service delivery during the transition phase of the NDS transfer process.</p> <p>Asset registers have been compiled and are in the process of approval by the relevant stakeholders.</p> <p>A draft facilities transfer plan has been completed and the aim is to finalise this plan during 2005/2006.</p> <p>This activity will be finalised during 2005/2006.</p> <p>The MIS plan has fully been developed and awaits implementation and rollout once the dockyard has been fully transferred to ARMSCOR.</p>
3.3 Optimisation of redundant stock disposal system	<ul style="list-style-type: none"> • Approval of the redundant stock disposal process by the Armscor Business Management Board and by the DOD – 30/04/04 • A user requirement statement to address the automation/computerisation of the Armscor Business stock management and stock sales processes – 30/06/04 • A feasibility study conducted to identify the possibilities for the improvement and automation of stores management – 30/06/04 	<p>The DOD's internal processes and procedures in respect of stock disposal have not yet been finalised. ARMSCOR, subsequently, could not finalise the ARMSCOR stock disposal process.</p> <p>The URS was finalised and signed on 17/05/2004. The system was subsequently implemented.</p> <p>The feasibility study was done together with the URS that was finalised and signed on 17/05/2004.</p> <p>Automation is considered to be not appropriate and it was decided to implement a computerised, standalone, accounting and warehousing system.</p>

Transform ARMSCOR to be representative

Objective	Key performance indicator	Performance results
4.1 Improve the demographic composition of ARMSCOR employees to reflect the national and regional demographic profile	<ul style="list-style-type: none"> • 80% of all appointments to be black employees • 28% female employees in the broad bands STS and above as a percentage of the total ARMSCOR work force • Four persons with disabilities in ARMSCOR 	<p>89,8% of appointees were black.</p> <p>28% of the employees in the broad bands STS and above are women.</p> <p>Currently ARMSCOR employs five people with disabilities.</p>
4.2 Train employees who have recently completed technical qualifications from university or technikon to a competency level that will ensure that they contribute to the organisation's competency and capability pool in order for it to continue to fulfil its role	<ul style="list-style-type: none"> • Completion of the content for the engineer-in-training programme – 31/03/2004 • Five additional appointments into the talent development pool – 31/05/04 • Trainees to progress according to the predetermined programme 	<p>A qualification in Complex Acquisition Management (Defence and Security) at NQF. Level 5, was developed for programme managers and has been published in the Government Gazette for public comment.</p> <p>All appointees into the talent development programme had tailor-made development programmes for them.</p> <p>As a result of the unavailability of candidates for some of the development areas, as well as the identified candidates taking up more financially lucrative offers elsewhere, the exercise was not completed by the deadline. However, 14 people were appointed into the programme, including the IMT Scientific Cadet Programme, during the financial year.</p> <p>Trainees are generally progressing well against their development programmes. Where there have been problems corrective measures have been instituted.</p>

Directors' report continued

Post-balance sheet events

As reflected in these financial statements, no material facts or significant circumstances which effect the financial position of this Corporation have arisen between the date of the balance sheet and production date of this report.

Five-year review at 31 March 2005

	2005 Rm	2004 Rm	2003 Rm	2002 Rm	2001 Rm
Consolidated balance sheets					
Assets					
Property, plant and equipment	188,3	195,8	192,2	183,6	179,3
Net current assets	197,6	195,3	189,1	166,7	157,6
	385,9	391,1	381,3	350,3	336,9
Equity and liabilities					
Ordinary shareholders' interest	385,9	391,1	381,3	350,3	336,9
Consolidated income statements					
Revenue					
Sale of goods	760,5	807,1	666,6	416,7	305,4
Allocation from the State budget for operating and technology expenditure	284,1	249,6	209,4	194,9	184,5
	1 044,6	1 056,7	876,0	611,6	489,9
Net (deficit)/surplus for the year	(5,2)	9,8	31,0	13,4	(1,4)
Total value of acquisition activities					
Special Defence Account	6 549,0	7 443,8	6 563,3	5 843,7	4 267,5
General Defence Account	728,5	783,0	1 054,3	1 006,8	843,3
Other	109,3	111,6	251,1	156,0	115,1
	7 386,8	8 338,4	7 868,7	7 006,5	5 225,9

Value added statement for the year ended 31 March 2005

The statement shows the wealth the group has created through its acquisition, maintenance and disposal activities aimed at meeting the defence *materiel*/requirements of South Africa as well as trading and investment operations. The statement shows how wealth was created and how it was disbursed amongst stakeholders, leaving a retained amount which was reinvested in the group for the replacement of assets, the development of operations and the maintenance of required capabilities.

	2005 Rm	%	2004 Rm	%
Revenue	1 044,6		1 056,7	
Other income not included in revenue	41,3		25,6	
Income from investments	21,7		26,9	
<i>Less:</i> Paid to suppliers for materials and services	<i>(757,4)</i>		<i>(778,3)</i>	
Total value added	350,2	100	330,9	100
Distributed as follows:				
To employees as salaries, wages and other benefits	328,3	94	298,5	90
To Government as taxation	6,7	2	5,0	2
Total value added distributed	335,0	96	303,5	92
Portion of value added reinvested to sustain and expand the business	15,2	4	27,4	8
Total value added distributed and reinvested	350,2	100	330,9	100
Taxation				
Paid in taxes to Government	6,7		5,0	
– Regional Services Council levies	1,1		1,3	
– Rates and taxes to local authorities	5,6		3,7	
Collected on behalf of, and paid over to Government	71,4		58,8	
– Employees, taxation deducted from remuneration paid	81,6		67,1	
– Unemployment Insurance Fund	1,0		1,0	
– Net value added taxation (VAT)	<i>(11,2)</i>		<i>(9,3)</i>	

Financial results

The following main aspects concerning the ARMSCOR group's financial results are apparent from the annual financial statements:

Balance sheet

The net value of group assets of R385,9 million shows a decrease compared with the previous year's figure of R391,1 million. Investments and cash form a substantial part of the assets and are reserved to finance specific future obligations, the most important of these being the replacement of capital equipment and marketing promotion activities.

Income statement

For the 2004/2005 financial year ARMSCOR received R284,1 million (2004: R249,6 million) from the State in the form of a transfer payment. Of this amount R282,8 million (2004: R248,5 million) was used to defray operating expenditure and R1,3 million (2004: R1,1 million) for the acquisition of assets.

The net income of the group decreased by R15,0 million, compared with a decrease of R21,2 million, the previous year.

The most significant reasons for the decrease in net income are as follows:

	2005 Rm	2004 Rm
- Increase in net operational expenditure of ARMSCOR	(18,5)	(37,7)
- Increase in Government allocation	34,5	40,2
- Decrease in profit of subsidiaries	(26,9)	(21,5)
- Decrease in net interest received	(4,1)	(2,2)
Net decrease	(15,0)	(21,2)

The increase in the operational expenditure of ARMSCOR and the increase in the Government allocation are due to the increase in personnel cost to ensure that ARMSCOR's contracted service delivery to the Department of Defence (DOD), in terms of the Service Level Agreement (SLA), is effectively and efficiently met.

The loss of subsidiaries for the year under review was R16,6 million compared to profit of R10,3 million for the previous year and is detailed as follows:

	2005 Rm	2004 Rm
- (Deficit)/Profit from operations	(24,6)	1,3
- Net finance income	8,0	9,0
	(16,6)	10,3

The decrease in the subsidiaries' profit is mainly as a result of late deliveries against certain contracts, commercial sales not materialised and the withdrawal of stock available for disposal.

Acquisition activities

The total value of ARMSCOR's acquisition activities for the year was R7,4 billion (2004: R8,3 billion). Acquisition of equipment for the South African National Defence Force constituted the major portion of this amount.

Income statements for the year ended 31 March 2005

Corporation			Note	Group	
2004 Rm	2005 Rm			2005 Rm	2004 Rm
249,6	284,1	Revenue	4	1 044,6	1 056,7
249,6	284,1	Transfer payment		284,1	249,6
–	–	Sales generated by subsidiaries		660,9	532,6
–	–	Stock sales		99,6	274,5
–	–	Cost of goods sold		(641,2)	(669,1)
–	–	ARMSCOR operating budget		–	–
–	–	Subsidiaries		(554,2)	(425,1)
–	–	Stock sales		(87,0)	(244,0)
249,6	284,1	Gross margin		403,4	387,6
249,6	284,1	ARMSCOR operating budget		284,1	249,6
–	–	Subsidiaries		106,7	107,5
–	–	Stock sales		12,6	30,5
(268,0)	(286,5)	Net operating expenditure		(430,3)	(404,7)
(268,0)	(286,5)	ARMSCOR operating budget		(286,5)	(268,0)
–	–	Subsidiaries		(125,0)	(120,6)
–	–	Stock sales		(18,8)	(16,1)
(18,4)	(2,4)	Deficit from operations	5	(26,9)	(17,1)
(18,4)	(2,4)	ARMSCOR operating budget		(2,4)	(18,4)
–	–	Subsidiaries		(18,3)	(13,1)
–	–	Stock sales		(6,2)	14,4
25,9	21,0	Net finance income	6	21,7	26,9
(8,0)	(7,2)	Net interest paid	7	–	–
(0,5)	11,4	Net surplus/(deficit) for the year		(5,2)	9,8

Balance sheets as at 31 March 2005

Corporation				Group	
2004 Rm	2005 Rm			2005 Rm	2004 Rm
		Assets			
3,4	3,1	Non-current assets			
236,1	236,5	Property, plant and equipment	9	188,3	195,8
279,0	283,0	Investments in subsidiaries	10	–	–
		Current assets		399,9	471,2
1,1	0,9	Inventories		3,2	2,2
8,8	10,1	Accounts receivable		128,5	205,7
22,4	24,7	Cash allocated to insurance reserve		24,7	22,4
246,7	247,3	Cash and cash equivalents		243,5	240,9
518,5	522,6	Total assets		588,2	667,0
		Equity and liabilities			
		Capital and reserves			
75,0	75,0	Ordinary share capital	11	75,0	75,0
257,4	268,8	Non-distributable reserves		310,9	316,1
332,4	343,8	Ordinary shareholders' interest		385,9	391,1
186,1	178,8	Current liabilities		202,3	275,9
117,2	97,0	Short-term loan	12	–	–
52,6	68,5	Accounts payable		182,3	250,4
16,3	13,3	Provisions	13	20,0	25,5
518,5	522,6	Total equity and liabilities		588,2	667,0

Statements of changes in equity for the year ended 31 March 2005

	Ordinary share capital	General reserve	Marketing promotion reserve	Capital and building main- tenance reserve	Computer upgrading reserve	Internal insurance reserve	Total
	Rm	Rm	Rm	Rm	Rm	Rm	Rm
Corporation							
Balance at 1 April 2004	75,0	187,4	10,0	22,6	15,0	22,4	332,4
Net surplus	–	11,4	–	–	–	–	11,4
Transfer to/(from)							
non-distributable reserves	–	(1,8)	(0,5)	–	–	2,3	–
Balance at 31 March 2005	75,0	197,0	9,5	22,6	15,0	24,7	343,8
Balance at 1 April 2003	75,0	186,9	9,7	22,6	15,0	23,7	332,9
Net surplus	–	(0,5)	–	–	–	–	(0,5)
Transfer to/(from)							
non-distributable reserves	–	1,0	0,3	–	–	(1,3)	–
Balance at 31 March 2004	75,0	187,4	10,0	22,6	15,0	22,4	332,4
Group							
Balance at 1 April 2004	75,0	239,0	10,0	29,7	15,0	22,4	391,1
Net deficit	–	(5,2)	–	–	–	–	(5,2)
Transfer to/(from)							
non-distributable reserves	–	0,2	(0,5)	(2,0)	–	2,3	–
Balance at 31 March 2005	75,0	234,0	9,5	27,7	15,0	24,7	385,9
Balance at 1 April 2003	75,0	225,9	9,7	32,0	15,0	23,7	381,3
Net surplus	–	9,8	–	–	–	–	9,8
Transfer to/(from)							
non-distributable reserves	–	3,3	0,3	(2,3)	–	(1,3)	–
Balance at 31 March 2004	75,0	239,0	10,0	29,7	15,0	22,4	391,1

Cash flow statements for the year ended 31 March 2005

Corporation			Note	Group	
2004 Rm	2005 Rm			2005 Rm	2004 Rm
70,3	7,0	Cash flow from operating activities		18,1	24,4
250,8 (206,4)	284,1 (298,1)	Cash receipts from customers Cash paid to suppliers and employees	A	1 121,4 (1 125,0)	931,0 (933,5)
44,4 25,9	(14,0) 21,0	Cash (utilised)/generated by operations Net finance income		(3,6) 21,7	(2,5) 26,9
(2,7)	(3,7)	Cash flow from investing activities		(13,2)	(21,2)
(2,8) 0,1	(3,8) 0,1	Investment to maintain operations Assets purchased Proceeds from sale of assets		(13,4) 0,2	(22,5) 1,3
–	(0,4)	Cash flow from financing activities		–	–
67,6 201,5	2,9 269,1	Increase in investments in subsidiaries Net increase in cash and cash equivalents for the year		4,9 263,3	3,2 260,1
269,1	272,0	Cash and cash equivalents at beginning of year	B	268,2	263,3
		Cash and cash equivalents at end of year			

Notes to the cash flow statements for the year ended 31 March 2005

Corporation		Group	
2004 Rm	2005 Rm	2005 Rm	2004 Rm
(0,5)	11,4	A. Cash (utilised)/generated by operations	
3,5	4,0	Net surplus/(deficit)	(5,2) 9,8
1,8	1,6	Adjustments for:	20,7 17,6
1,8	2,5	Depreciation	17,5 15,3
(0,1)	(0,1)	Assets written off	2,9 2,3
		Loss/(Profit) on disposal of fixed assets	0,3 –
(25,9)	(21,0)	Net finance income	(21,7) (26,9)
		Operating surplus/(deficit) before	
(22,9)	(5,6)	working capital changes	(6,2) 0,5
67,3	(8,4)	Working capital changes	2,6 (3,0)
3,3	(1,3)	(Increase)/Decrease in accounts receivable	77,2 (125,7)
0,1	0,2	Decrease/(Increase) in inventories	(1,0) 1,4
58,6	(20,2)	Increase/(Decrease) in short-term loans	– –
5,3	12,9	Increase/(Decrease) in accounts payable and provisions	(73,6) 121,3
44,4	(14,0)		(3,6) (2,5)
		B. Cash and cash equivalents	
269,1	272,0	Cash on hand and balances with banks	268,2 263,3
22,4	24,7	Cash allocated to insurance reserve	24,7 22,4
246,7	247,3	Cash and cash equivalents	243,5 240,9

Notes to the annual financial statements for the year ended 31 March 2005

1. Mandate

ARMSCOR receives its mandate for the period under review from the Armaments Development and Production Act (Act No 57 of 1968, as amended), in terms of which the Corporation is empowered to:

- develop, manufacture, service, repair and maintain armaments
- exercise control over the development, manufacture, procurement, marketing, import and export of armaments
- negotiate contracts, also on behalf of bodies established by law for the development, manufacture, modification, maintenance, testing or inspection of armaments.

The Act furthermore provides that ARMSCOR has the mandate or authority with regard to the total armament requirements of the Republic of South Africa, as determined by the Minister of Defence, and that this authority must be exercised as effectively and economically as possible.

This Act and subsequently the mandate has been reviewed and repealed by the Armaments Corporation of South Africa, Limited Act (Act 51 of 2003), which the President signed on 20 April 2004 but which still has to be promulgated by Parliament.

2. Financial policy

Activities are financed as follows:

2.1 ARMSCOR's operating funds

ARMSCOR's operating funds are obtained via the defence budget and together with interest earned thereon are utilised to finance operating expenditure, the acquisition of fixed assets and expenditure for the creation of facilities and services.

2.2 Operating capital and fixed capital of subsidiaries

Operating capital and fixed capital requirements of subsidiaries are financed from own income generated and cash allocated by the holding company, if required.

2.3 Procurement of armaments

Armament purchases are financed by means of withdrawals from the Special Defence Account in terms of the Defence Special Account Act (Act No 6 of 1974, as amended). Strategic Defence Packages are financed by means of draw-downs against credit facilities supplied by National Treasury.

3. Accounting policy

The principal accounting policies adopted by the group are set out below:

3.1 Basis of presentation

The principal accounting policies of the group and the disclosures made in the annual financial statements conform with South African Statements of Generally Accepted Accounting Practice and are consistent with those applied in the previous years.

The financial statements are presented in rands, rounded to the nearest million and prepared on the historical basis modified by the restatement of some financial instruments to fair value.

Notes to the annual financial statements continued

for the year ended 31 March 2005

3.2 Basis of consolidation

The group annual financial statements present the consolidated financial position and changes therein, operating results and cash flow information of the Corporation and its subsidiaries. Subsidiaries are those entities in which the group has an interest of more than one half of the voting rights or the power to exercise control so as to obtain benefits from their activities.

The results of subsidiaries are included for the duration in which the group exercises control over the subsidiary. All intercompany transactions and resulting profits and losses between the group companies are eliminated on consolidation. The Corporation carries its investments in subsidiaries at cost less accumulated impairment losses.

3.3 Property, plant and equipment

3.3.1 Land and buildings

3.3.1.1 Buildings on freehold land

Land is stated at cost and is not depreciated. Buildings are stated at cost and are depreciated at two percent per year.

3.3.1.2 Buildings on land leased from the State

Buildings are stated at cost and are depreciated at two percent per year.

3.3.2 Other fixed assets

3.3.2.1 Fixed assets with a purchase price of less than R15 000 per item or with a useful life of less than one year are written off on acquisition and are controlled by register. The group accounting policy with regard to the cut-off point for the capitalisation of assets by ARMSCOR subsidiaries is R1 500.

3.3.2.2 Depreciation is calculated to write off the cost of capitalised fixed assets on a straight-line basis over their expected useful lives over periods that vary between two and ten years.

3.3.2.3 The proceeds on disposal of obsolete assets are credited to income.

3.4 Inventories

Inventories representing mainly finished goods are valued at the lower of cost, determined on a weighted average basis and net realisable value.

3.5 Non-distributable reserves

All reserves are considered to be non-distributable. The full share capital and reserves are required for the total net capital requirement of the group. Cash is therefore retained to meet future commitments, and is consequently not available for the distribution of dividends.

3.6 Foreign currency

Transactions and balances

Transactions denominated in foreign currencies are translated at the rate of exchange ruling at the transaction date. Monetary items denominated in foreign currencies are translated at the rate of exchange ruling at the balance sheet date. Gains or losses arising on translation are credited to or charged against income.

3.7 Revenue recognition

Revenue comprises net invoiced sales to customers excluding VAT. Sales are recognised at the date of delivery of goods or services, when significant risks and rewards of ownership are transferred to the buyer.

Long-term contract revenue is recognised as revenue by reference to the stage of completion of the contract activity at the balance sheet date. The stage of completion is determined based on the work performed on the contract at balance sheet date.

3.8 Insurance and risk management

The insurance and risk management policies adopted by the ARMSCOR group are aimed at obtaining sufficient cover at the minimum cost to protect its asset base, earning capacity and legal obligations against unacceptable losses.

All fixed assets are insured at current replacement value. Risks of a possible catastrophic nature are identified and insured while acceptable risks of a non-catastrophic nature are self-insured. Self-insurance has been instituted where the cost-to-benefit relationship exceeds the risk and the incidence of losses is of a minor and infrequent nature. Self-insured risks are reviewed annually to ensure cover is adequate. An amount of R24,7 million (2004: R22,4 million) is held in an internal-insurance fund to cover these risks. This amount is disclosed as part of non-distributable reserves in the balance sheet. No major losses were experienced during the year under review. Claims of a general nature were adequately covered.

3.9 Financial instruments

Measurement

Financial instruments are initially measured at cost, which include transaction costs. Subsequent to initial recognition these instruments are measured as set out below.

Investments

Marketable securities are carried at market value, which is calculated with reference to stock exchange quoted selling prices at the close of business on the balance sheet date. Unlisted investments are shown at cost less accumulated impairment losses.

Trade and other receivables

Trade and other receivables originated by the group are stated at cost less provision for doubtful debts.

Cash and cash equivalents

Cash and cash equivalents are measured at fair value, based on the relevant exchange rates at balance sheet date.

Financial liabilities

Financial liabilities are recognised at amortised cost, namely original debt less principal payments and amortisation, except for derivatives which are subsequently measured at fair value.

3.10 Provisions

Provisions are recognised when the group has a present legal or constructive obligation as a result of past events, for which it is probable that an outflow of economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

Notes to the annual financial statements continued

for the year ended 31 March 2005

3.11 Retirement benefits

The Corporation contributes towards and operates the ARMSCOR Defined Contribution Pension Fund and the ARMSCOR Provident Fund, which offer benefits based on the contributions of and on behalf of every member, as well as on investment yields.

The Corporation also provides post-retirement health care benefits to their retirees. The entitlement to post-retirement health care benefits is based on the employee remaining in service up to retirement age and the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment. Valuations of these obligations are carried out by independent qualified actuaries.

Actuarial gains or losses in respect of defined benefit plans are recognised as income or expense if the net cumulative unrecognised actuarial gains and losses at the end of the previous reporting period exceeded the greater of:

- 10% of the present value of the defined benefit obligation at that date before deducting plan assets; and
- 10% of the fair value of any plan assets at that date.

The amount recognised is the excess determined above, divided by the expected average remaining working lives of the employees participating in that plan.

3.12 Discontinuing operations

A discontinuing operation results from the sale or abandonment of an operation that represents a separate major line of business of the enterprise and of which the assets, net profit or loss and activities can be distinguished physically, operationally and for financial reporting purposes.

The profit or loss on discontinuance is determined from the discontinuance date, being the date from which management has reasonable assurance as to the eventual conclusion of the formal plan of discontinuance. The profit or loss is determined by including the best estimates at the reporting date of the difference between the proceeds on disposal, if any, and the net carrying value of the assets and liabilities to be disposed of as well as all costs and expenses directly associated with the disposal.

If a loss is anticipated, full provision is made from the discontinuance date. If a profit is expected it is recognised only when realised.

3.13 Leased assets

Leases of assets to the group under which all the risks and benefits of ownership are effectively retained by the lessor, are classified as operating leases. Payments made under operating leases are charged against income on a straight-line basis over the period of the lease.

3.14 Research and development costs

Research costs, incurred with the prospect of gaining new scientific or technical knowledge and understanding, are charged as an expense in the income statement in the period in which they are incurred.

3.15 Impairment of assets

The carrying amounts of assets mentioned in the accounting policy notes are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the recoverable amount is estimated as the higher of net selling price and value in use.

An impairment loss is recognised whenever the carrying amount exceeds the recoverable amount.

A previously recognised impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount, however not to an amount higher than the carrying amount that would have been determined (net of depreciation) had no impairment loss been recognised in prior years.

3.16 Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents comprise of cash on hand, deposits held on call, investment instruments and net investment in subsidiaries, all of which are available for use by the group unless otherwise stated.

3.17 Interest and dividend income

Interest is recognised on a time proportion basis, taking account of the principal outstanding and the effective rate over the period to maturity, when it is determined that such income will accrue to the group.

Dividends are recognised when the right to receive payment is established.

Notes to the annual financial statements continued

for the year ended 31 March 2005

Corporation			Group	
2004 Rm	2005 Rm		2005 Rm	2004 Rm
–	–	4. Revenue		
		Sale of goods and services	760,5	807,1
249,6	284,1	Allocation from the State budget for operating and technology expenditure	284,1	249,6
249,6	284,1		1 044,6	1 056,7
		5. Deficit from operations		
12,9	9,7	Is arrived at after taking into account	9,7	12,9
0,9	0,8	Rent for machinery and equipment	1,1	1,1
0,8	0,8	Auditors' remuneration	1,1	1,0
0,1	–	Audit	–	0,1
		Other services		
3,6	4,1	Depreciation and fixed assets written off on acquisition	20,4	17,6
–	–	Net foreign exchange loss/(gain)	(2,4)	26,8
(0,1)	–	(Income)/Loss from the realisation of fixed assets	0,3	–
		6. Net finance income		
25,9	21,0	Interest received	21,7	26,9
		7. Net interest paid		
(8,0)	(7,2)	Interest paid to subsidiaries	–	–
(8,0)	(7,2)		–	–
		8. Total value of acquisition activities		
		Government grants for operating expenditure are obtained to undertake acquisition actions.		
		In accordance with ARMSCOR's mandate, acquisition was undertaken on behalf of the following organisations:		
7 443,8	6 549,0	Special Defence Account	6 549,0	7 443,8
783,0	728,5	General Defence Account	728,5	783,0
89,3	73,7	SA Police Service	73,7	89,3
22,3	35,6	Other	35,6	22,3
8 338,4	7 386,8		7 386,8	8 338,4

Corporation			Group		
2004	2005		2005	2004	
Rm	Rm		Rm	Rm	
–	–				
–	–				
3,4	3,1				
35,0 (31,6)	32,6 (29,5)				
3,4	3,1				
			Certain buildings are erected on leasehold premises. Detail pertaining to land and buildings is available at the registered office of the Corporation.		
Installations, machinery, equipment			Installations, machinery, equipment		
Land and buildings	and vehicles	Total	Land and buildings	and vehicles	Total
2005	2005	2005	2005	2005	2005
Rm	Rm	Rm	Rm	Rm	Rm
–	3,1	3,1			
–	3,4	3,4			
–	3,8	3,8			
–	(2,5)	(2,5)			
–	–	–			
–	(1,6)	(1,6)			
9.3 Reconciliation of carrying amount					
Net book value			157,3	31,0	188,3
Opening balance			159,0	36,8	195,8
Additions			2,2	11,2	13,4
Assets written off on acquisition			–	(2,9)	(2,9)
Assets written off/realised			–	(0,5)	(0,5)
Depreciation			(3,9)	(13,6)	(17,5)

Notes to the annual financial statements continued

for the year ended 31 March 2005

Installations, machinery, equipment			Installations, machinery, equipment		
Land and buildings	and vehicles	Total	Land and buildings	and vehicles	Total
2004	2004	2004	2004	2004	2004
Rm	Rm	Rm	Rm	Rm	Rm
9. Property, plant and equipment (continued)					
9.3 Reconciliation of carrying amount (continued)					
–	3,4	3,4	Net book value	159,0	36,8
–	4,2	4,2	Opening balance	162,2	30,0
–	2,8	2,8	Additions	1,8	20,7
–	(1,8)	(1,8)	Assets written off on acquisition	–	(2,3)
–	–	–	Assets written off/realised	(1,2)	(0,1)
–	(1,8)	(1,8)	Depreciation	(3,8)	(11,5)
Corporation					
2004	2005		Group		
Rm	Rm		2005	2004	
			Rm	Rm	
9.4 Depreciation					
1,8	1,6		Buildings, installations, machinery, equipment and vehicles	17,5	15,3
1,8	2,5		Assets written off on acquisition	2,9	2,3
3,6	4,1			20,4	17,6
10. Investment in subsidiaries					
–	–		Shares at cost	–	–
236,1	236,5		Loans to subsidiaries	–	–
236,1	236,5		Mutually agreed interest-bearing, unsecured loans without fixed conditions of repayment	–	–

10. Investment in subsidiaries (continued)

South African subsidiaries (at 100% holdings)	Issued share capital	Shares at cost		Loans due by/ (due to) subsidiaries	
		2005 R	2004 R	2005 Rm	2004 Rm
Armscor Business (Pty) Limited	4 000	4 000	4 000	0,6	(19,7)
Erasmusrand Properties (Pty) Limited	1	1	1	135,8	135,5
Overberg Toetsbaan (Pty) Limited*	5	5	5	–	–
Oospark (Pty) Limited	1	1	1	1,1	1,1
Sportrand (Pty) Limited	1	1	1	2,0	2,0
	4 008	4 008	4 008	139,5	118,9

* Dormant subsidiary

The attributable interest of the Corporation in the net (loss)/profit of its subsidiaries amounted to (R16,6) million (2004: R10,3 million)

Corporation		Group	
2004 Rm	2005 Rm	2005 Rm	2004 Rm
1,000	1,000	1,000	1,000
75,0	75,0	75,0	75,0
117,2	97,0	–	–
117,2	97,0	–	–

11. Share capital
 Authorised
 – 1 000 000 000 ordinary shares of R1 each

12. Short-term loan
 Loan from subsidiary: Armscor Business (Pty) Limited
 The short-term loan represents the current account which is utilised to manage the overall cash flow of the group. This loan is unsecured, interest-bearing and repayable on demand. The rate of interest levied is based on the rate of return earned by ARMSCOR on surplus funds.

Notes to the annual financial statements continued

for the year ended 31 March 2005

	Provision for post- retirement medical liability Rm	Provision for maintenance of military weapons Rm	Provision for performance bonus Rm	Total Rm
13. Provisions				
<i>Corporation</i>				
Balance at 1 April 2004	2,4	–	13,9	16,3
Provisions made during the year	–	–	13,1	13,1
Provisions utilised during the year	(2,2)	–	(13,9)	(16,1)
Balance at 31 March 2005	0,2	–	13,1	13,3
Balance at 1 April 2003	1,4	–	12,1	13,5
Provisions made during the year	1,0	–	13,9	14,9
Provisions utilised during the year	–	–	(12,1)	(12,1)
Balance at 31 March 2004	2,4	–	13,9	16,3
<i>Group</i>				
Balance at 1 April 2004	4,3	–	21,2	25,5
Provisions made during the year	–	–	19,8	19,8
Provisions utilised during the year	(4,1)	–	(21,2)	(25,3)
Balance at 31 March 2005	0,2	–	19,8	20,0
Balance at 1 April 2003	3,3	0,9	18,2	22,4
Provisions made during the year	1,0	–	20,8	21,8
Provisions utilised during the year	–	(0,9)	(17,8)	(18,7)
Balance at 31 March 2004	4,3	–	21,2	25,5

The liability for accumulated leave to the value of R30,8 million (2004: R31,1 million) for the Corporation and R43,8 million (2004: R44,1 million) for the group is included in accounts payable.

Accounts receivable for the group includes a provision for doubtful debts of R2,4 million (2004: R3,9 million).

Corporation		Group	
2004 Rm	2005 Rm	2005 Rm	2004 Rm
26,5	126,0	14. Contractual liabilities Projected outstanding commitments in respect of orders placed for expected deliveries	126,0
–	–	15. Capital commitments Capital expenditure approved but not yet contracted for plant and equipment	4,9

16. Contingent liabilities

16.1 Guarantees

16.1.1 A guarantee has been issued in favour of a commercial bank amounting to R1,1 million (2004: R1,1 million) in respect of marketing transactions.

16.1.2 A guarantee to the ARMSCOR Retirement Fund to a maximum amount of R4,0 million in respect of any losses which the fund may incur as a result of dishonesty or fraud of the officials of the fund (inclusive of the trustees of the fund), who receive or handle money of the fund. The risk has been reinsured in the commercial market.

16.1.3 Bank guarantees have been issued in favour of the South African Revenue Services: Customs and Excise and other creditors amounting to R15,1 million (2004: R13,5 million) with regard to local guarantees and USD 0,1 million with regard to foreign guarantees.

16.2 Other

At 31 March 2005 the group had a contingent liability in respect of rehabilitation of the test range at Alkantpan (Pty) Limited. Future environment studies will be performed to assess the financial impact of the rehabilitation.

17. Retirement benefits

17.1 Pension and provident schemes

The Corporation contributes towards and operates the ARMSCOR Defined Contribution Pension Fund and the ARMSCOR Provident Fund, which offer benefits based on the contributions of and on behalf of every member, as well as on investment yields. The fund, which has approximately 979 (2004: 967) members, is registered and controlled in terms of the Pension Funds Act No 24 of 1956, as amended. Due to the nature of these funds the accrued liabilities by definition equate to the total assets of the funds.

Notes to the annual financial statements continued

for the year ended 31 March 2005

Corporation		Group	
2004 Rm	2005 Rm	2005 Rm	2004 Rm
		17. Retirement benefits (continued)	
14,6	17,0	17.1 Pension and provident schemes (continued) The amount of contributions to the above scheme	25,7 26,1
14,6	17,0	The total amount expended during the year	25,7 26,1
		17.2 Post-retirement medical benefits The AC116 valuation of the group's post-employment benefits was carried out at 31 March 2003. Based on the latest projection performed at 31 March 2005 the present value of the obligation is R148,3 million (2004: R135,9 million) and the fair value of plan assets is R184,3 million (2004: R135,6 million). Provision is being made for the projected obligation, spread over five years.	
		Amounts recognised in the balance sheet	
108,5 (112,0)	117,5 (148,8)	Present value of funded obligations Fair value of the plan assets	148,3 (184,3) 135,9 (135,6)
(3,5) (10,1) 9,5 6,5 2,4	(31,3) (5,1) 30,8 5,8 0,2	Present value of obligations in excess of plan assets Unrecognised transitional liability Unrecognised actuarial gains/(losses) Unrecognised past service gains Net liability in balance sheet	(36,0) (6,0) 34,2 8,0 0,2 0,3 (11,9) 7,3 8,6 4,3

Corporation		Group	
2004 Rm	2005 Rm	2005 Rm	2004 Rm
		17. Retirement benefits (continued)	
		Reconciliation of net liability in the balance sheet and amounts recognised in the income statement	
1,4	2,4	Opening balance	4,3
9,1	7,1	Expense recognised in employee remuneration costs	10,5
3,3	3,5	Current service cost	6,4
10,5	9,6	Interest cost	11,8
(9,0)	(10,3)	Expected return on plan assets	(12,6)
5,0	5,0	Transitional liability recognised	5,9
(0,7)	(0,7)	Past service loss recognised	(1,0)
(4,0)	(4,3)	Employer benefit payments	(4,4)
(7,9)	(9,0)	Employer prefunding contributions	(14,2)
3,8	4,0	Payments from plan assets	4,0
2,4	0,2	Closing balance	0,2
		Reconciliation of change in plan assets	
80,2	112,0	Fair value of assets at beginning of year	135,6
17,3	17,3	Actual return on assets	21,0
7,9	9,0	Contributions	14,2
(3,8)	(4,0)	Benefits paid	(4,0)
(4,3)	(4,2)	Other expenses	(5,1)
14,7	18,7	Revaluation	22,6
112,0	148,8	Fair value of assets at end of year	184,3
		The main actuarial assumptions are:	
		2005	2004
		Discount rate (%)	9
		Health care cost inflation (%)	7
		Rate of interest (%)	9
		Average retirement age	60
		Expected return on plan assets (%)	9
		Future salary increases (%)	6

Notes to the annual financial statements continued

for the year ended 31 March 2005

18. Financial instruments

18.1 Interest rate risk

Fluctuating interest rates impact on the value of short-term cash investments and financing activities, giving rise to interest rate risk. In the ordinary course of business, the group receives cash from the transfer payment and its operations and is required to fund working capital and capital expenditure requirements. This cash is managed to ensure surplus funds are invested in a manner to achieve maximum returns while minimising risks.

18.2 Credit risk management

Trade debtors comprise a large, widespread base. The granting of credit is controlled by well established criteria, which are reviewed and updated on an ongoing basis. At 31 March 2005 the group did not consider there to be any significant concentration of credit risk which had not been adequately provided for.

18.3 Liquidity risk

The group has no overdraft facilities.

18.4 Fair values

The fair values of all financial instruments are substantially identical to the carrying values reflected in the balance sheet.

19. Income tax

The Corporation and its subsidiaries are exempted from income tax in terms of legislation.

20. Information required in terms of section 8(4) of the ARMSCOR Act

20.1 Changes in the nature of business

No material changes have taken place in the nature of the Corporation's business.

20.2 Share capital, assets and reserves

No shares have been issued during the year. All movements in the reserves and assets are disclosed in the financial statements.

20.3 Loans

No additional loans were negotiated during the current financial year.

20.4 Material subsequent events

No matters of significance having an effect on the financial position and results of the group occurred between 31 March 2005 and the date of this report.

21. Information required in terms of section 55(2) of the Public Finance Management Act

21.1 During the year one incident was investigated where a lack of financial management within the area of responsibility of that official led to losses for the Corporation that did not exceed R40 000.

21.2 An amount of R1 610 955 (2004: R90 950) relating to unrecoverable debts was written off during the year.

21.3 Fruitless and wasteful expenditure of an immaterial amount of less than R1 000 was incurred.

						Retirement and other contri- butions	Total
		Fees	Basic salary	Other benefits (14)	Allowances (15)	R	R
	Notes		R	R	R	R	R
22. Directors'/executive members' emoluments							
31 March 2005							
Directors' emoluments							
Executive directors							
HS Thomo			856 271	208 087	273 696	174 854	1 512 908
CJ Hoffmann	1		367 996	56 927	122 366	85 560	632 849
<i>Subtotal</i>			1 224 267	265 014	396 062	260 414	2 145 757
Non-executive directors							
N Molope	2		93 850				93 850
P Riba	3		81 875				81 875
GN Ramaremisa			97 650				97 650
CL Viljoen	4		29 475				29 475
CV Gamede	5		154 600				154 600
AS Human			101 450				101 450
RP Meyer	6		32 400				32 400
PL Zim	7		30 625				30 625
PS Molefe	8		100 000				100 000
<i>Subtotal</i>			721 925				721 925
Total directors' emoluments			721 925	1 224 267	265 014	396 062	2 867 682
Management Board emoluments							
Executive members							
GJ Smith			575 504	123 263	123 480	120 601	942 848
JC Oosthuizen			530 325	115 420	126 156	117 880	889 781
CJ Hoffmann	1		163 369	71 450	59 308	39 324	333 451
CVV Ramphele	11		129 042	–	27 483	18 623	175 148
TT Goduka	17		423 275	90 968	109 932	106 534	730 709
X Magojo			460 806	108 813	163 008	101 294	833 921
NRM Borotho	20		357 672	16 448	146 223	59 591	579 934
Total			2 639 993	526 362	755 590	563 847	4 485 792
Directors' emoluments							
Armscor Business (Pty) Limited							
JAJ de Necker			534 955	121 100	123 600	131 303	910 958
E Hurter			474 180	107 926	96 247	118 703	797 056
Total			1 009 135	229 026	219 847	250 006	1 708 014

Notes to the annual financial statements continued

for the year ended 31 March 2005

	Notes	Fees R	Basic salary R	Other benefits (14) R	Allowances (15) R	Retirement and other contri- butions (16) R	Total R
22. Directors'/executive members' emoluments (continued)							
31 March 2004							
Directors' emoluments							
Executive director							
HS Thomo		745 803	172 948	262 670	156 515	1 337 936	
<i>Subtotal</i>		745 803	172 948	262 670	156 515	1 337 936	
Non-executive directors							
SN Mabaso	9	39 375				39 375	
F Titi	19	200 000				200 000	
GN Ramaremisa		71 500				71 500	
CL Viljoen		71 500				71 500	
CV Gamede		88 700				88 700	
AS Human		63 900				63 900	
EM Kubushi	10	12 550				12 550	
PL Zim		52 500				52 500	
<i>Subtotal</i>		600 025				600 025	
Total directors' emoluments		600 025	745 803	172 948	262 670	156 515	1 937 961
Management Board emoluments							
Executive members							
GJ Smith		507 608	102 826	104 373	107 057	821 864	
JC Oosthuizen		448 443	100 988	130 020	105 031	784 482	
CJ Hoffmann		447 074	111 910	177 288	110 702	846 974	
ME Phiyega	12	91 578	22 277	32 382	20 820	167 057	
TT Goduka	13	368 840	24 728	109 296	98 838	601 702	
X Magojo		376 648	94 652	162 372	87 382	721 054	
Total		2 240 191	457 381	715 731	529 830	3 943 133	
Directors' emoluments							
Armscor Business (Pty) Limited							
JAJ de Necker		450 293	101 463	122 964	107 690	782 410	
E Hurter		404 587	86 677	74 464	95 257	660 985	
Total		854 880	188 140	197 428	202 947	1 443 395	

22. Directors'/executive members' emoluments (continued)

Notes

- 1 Appointed on 1 August 2004 as executive director.
- 2 Appointed on 1 April 2004 as non-executive director.
- 3 Appointed on 1 May 2004 as non-executive director.
- 4 Resigned on 31 August 2004 as non-executive director.
- 5 Acting chairman of the Board of Directors from 1 April 2004 to 30 September 2004.
- 6 Appointed on 1 October 2004 as non-executive director.
- 7 Resigned on 31 October 2004 as non-executive director.
- 8 Appointed as chairman of the Board of Directors for a period of three years from 1 October 2004.
- 9 Resigned on 5 December 2003 as non-executive director.
- 10 Resigned on 20 May 2003 as non-executive director.
- 11 Appointed on 1 October 2004 to Management Board.
- 12 Resigned on 30 June 2003 from Management Board.
- 13 Appointed on 1 April 2003 to Management Board.
- 14 Includes bonus and performance-related payments.
- 15 Includes sums paid by way of expense allowances, ie computer, club, motor, cellphone allowances and long service grant.
- 16 Includes contributions made to any pension fund, medical benefit fund, medical aid, unemployment and funeral funds.
- 17 Appointed on 9 March 2005 as executive director on the Armscor Business Board of Directors.
- 18 No emoluments are payable to ARMSCOR board Ex-Officio directors: Gen. S Nyanda and Mr J Masilela and Armscor Business Ex-Officio directors: Mr HS Thomo, Mr CJ Hoffmann and Mr X Magojo.
- 19 Resigned on 31 March 2004 as non-executive director.
- 20 Appointed on 1 September 2004 to Management Board.

Share options

No share options exist and therefore no gains are included in the amount of emoluments received as directors of the Company.

Directors' service contracts

Notice periods in respect of service contracts of executive directors do not exceed one year. Non-executive directors are not bound by service contracts.

Pensions

Pensions paid or receivable by executive directors are paid or received under contributory pension schemes.

Special Defence Account

for the year ended 31 March 2005

Administration and financing

In terms of the provisions of the Defence Special Account Act (Act No 6 of 1974, as amended), the Chief Executive Officer of ARMSCOR has been charged with the administrative and accounting responsibility for money paid by ARMSCOR out of the account in connection with its special defence activities and purchases.

Accounting policy

Contractual commitments

ARMSCOR contracts under its own name and is legally empowered to act accordingly. Contractual commitments which may arise out of these contracts are covered in full by the South African National Defence Force by means of financial authorisations. In other cases cover is obtained by means of back-to-back orders.

The outstanding commitments at 31 March 2005 arising from these contractual commitments are accounted for in the financial statements and comprise the amount still outstanding on delivery plus estimated additional costs based on historical information.

The commitments for the Strategic Defence Packages represent the capital amount outstanding as at 31 March 2005. The foreign portion is converted at prevailing exchange rates at year-end. The local and foreign portions exclude escalation and other additional costs.

Trust funds

The funds withdrawn in anticipation of final execution of procurement actions, together with funds appropriated but not yet set off against procurement projects, are dealt with in a trust capacity in the financial statements.

Advances, capital assets and stocks

Advances and progress payments to contractors, capital assets acquired for use during production by contractors and material supplied to contractors are accounted for in procurement projects.

Advances, inventory and capital assets at contractors are controlled by means of control systems which make provision for identification, listing, physical protection, recording and clearance upon completion of contracts.

Foreign currency

Transactions denominated in foreign currencies are translated at the rate of exchange ruling at the transaction date. All transactions of foreign offices are converted and accounted for during the year at an average rate. Monetary items in overseas banks at 31 March 2005 are not converted at prevailing exchange rates as accounting entries are recorded on a cash flow basis.

Special Defence Account – Cash flow statement

for the year ended 31 March 2005

	Note	2005 Rm	2004 Rm
Funds employed			
Withdrawals against Special Defence Account		3 281,8	3 856,2
Draw-down against credit facilities for Strategic Defence Packages		3 259,2	3 596,1
		6 541,0	7 452,3
Employment of funds			
Acquisition of armaments		6 549,0	7 443,8
Adjusted for: (Decrease)/increase in trust funds	1	(8,0)	8,5
		6 541,0	7 452,3

Special Defence Account – Notes to the Cash flow statement for the year ended 31 March 2005

	2005 Rm	2004 Rm
1. Trust funds		
1.1 Expenditure incurred but not yet recorded against the Special Defence Account	(3,5)	(1,4)
1.2 Cash in banks	8,7	14,6
	5,2	13,2
2. Estimated outstanding commitments <i>(Excluding Strategic Defence Packages)</i>		
2.1 Subject to contracts entered into	3 914,6	2 923,3
2.2 Approved but not yet contracted	1 331,7	474,4
	5 246,3	3 397,7
3. Outstanding commitments: Strategic Defence Packages		
3.1 Estimated outstanding capital commitments – foreign	11 190,0	13 798,4
3.2 Estimated outstanding capital commitments – local	483,3	966,4
	11 673,3	14 764,8
4. Fixed assets at contractors		
At original cost	399,0	421,4
These assets are accounted for within the Department of Defence and fully written off upon acquisition as part of the related project.		
5. Net (recoveries)/payments on behalf of the South African National Defence Force		
– Chief of Finance	(7,0)	72,7
Payments and recoveries take place on request of the different subdivisions of the South African National Defence Force. The flow of funds and recording of transactions are controlled.		
6. Acquisition out of General Defence Account		
Acquisition of armaments-related products is done from the General Defence Account, at the request of the South African National Defence Force, against financial authorisations issued by the South African National Defence Force.	728,5	783,0
6.1 Estimated outstanding commitments		
Subject to contracts entered into	244,9	661,7
Approved but not yet contracted	1 580,8	1 209,0
	1 825,7	1 870,7



Notes

Notes

Administration

Corner of Delmas Drive and Nossob Street
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Hawk pictures supplied by BAE Systems/Frans Dely



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