ARMSCOR
Armaments Corporation of South Africa Ltd

www.armscor.co.za

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Annual Report '07

Gateway to defence solutions

ARMSCOR
Armaments Corporation of South Africa Ltd




Contents


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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

We believe in the highest standards and are committed to equal opportunities transparency and accountability

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.

Corporate profile

Armscor is a statutory body. The Minister of Defence is the Executive Authority responsible for Armscor. The management and control of Armscor reside with a Board of Directors, whilst its day-to-day management vests in the hands of the Management Board.

Armscor has established and maintains capabilities and technologies that are required to fulfil its mandate

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, the Defence Industrial Participation (DIP) programme, the management of technology projects and strategic facilities.

Armscor as an acquisition agency

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 Service (SAPS).

The acquisition role 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

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 be broadly divided into the following four categories: systems acquisition management, procurement management, product systems management and technology acquisition management.

Corporate profile *continued*

Armscor, in addition, also performs the following functions:

- Quality assurance;
- Defence Industrial Participation (DIP); and
- Management of strategic facilities.

The management of strategic facilities is vested in a subsidiary company, Armscor Business (Pty) Limited.

The management of strategic facilities is vested in a subsidiary company

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

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

Chairman's Report

Dr PS Molefe
Chairman-Amscor

Armscor is a Corporation of Government for the acquisition of defence matériel and operates within the context of the country that is undergoing continuous transformation led by Government. The Defence environment in which Armscor operates is equally undergoing transformation which is characterised by, amongst other things, the consolidation of the industry, the definition of new niches of existence where organisations should be focusing their respective competitive edge, and the alignment and forging of partnerships in order to capitalise on each other's synergies for success.

The evolution of a corporation such as Armscor closely resembles that of the country in which it is situated. As South Africa has evolved, especially culminating in the democratic elections of 1994, so also has Armscor evolved. The evolution of Armscor is intertwined with the requirement to protect the integrity and sovereignty of our country, in the air, at sea and on land, but most importantly to protect the democratic dispensation enjoyed by all South Africans. This is reflected in the strategic defence packages already completed.

The work of Armscor is neither immune nor oblivious to the challenges of transformation

Of necessity, the work of Armscor is neither immune nor oblivious to the challenges of transformation as characterised by the historical developments in the country coupled with the globalisation impact of world political economies, global security demands, and the requirements for peacekeeping on the African continent and worldwide in support of South Africa's Foreign Policy and its important role as a member of the United Nations.

All these developments continue to pose exciting challenges for Armscor if it is to support the industry to achieve a pinnacle of excellence. Armscor will continue to serve the industry in a consistently dispassionate manner.

Currently the support that Armscor provides to the industry manifests itself in project management, research, testing, training and development.

Naturally, in the transforming environment these areas of support are currently being reviewed with a view to repositioning the Corporation so that it continues its critical role while using partnerships to deliver the support service in which it has become successful and for which it is well known.

Several exciting developments took place during the period under review, all of which were intrinsic to the discharge of Armscor's mandate which focuses

on the continuing strategic challenge of restructuring the Corporation to refocus on its key role as an acquisition arm of the state.

Armscor's mandate

Armscor currently derives its mandate from the Armscor Act (Act 51 of 2003), which states that Armscor's objectives are to meet the defence matériel requirements of the Department of Defence (DOD) 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.

Armscor currently derives its mandate from the Armscor Act (Act 51 of 2003)

As was reported previously, Armscor was initially constituted in such a way that it should pursue two major roles, namely acquisition and certain business activities. Cabinet subsequently decided that there must be a separation between acquisition activities for the SANDF and defence business activities. As a result of the restructuring of Armscor, the Armscor Act 2003 (as amended) will be either reviewed or repealed at the appropriate time through the parliamentary process.

As result of restructuring the Armscor Act 2003 will either be reviewed or repealed

The year's overview

Restructuring of Armscor

The period under review was characterised by the beginning of the transformation of Armscor as instructed by the Minister of Defence. As previously reported, this transformation focuses on consolidating the research, test and evaluation capabilities of Armscor, the CSIR and Denel in a new DERI (Defence Evaluation and Research Institute). The transformation also seeks to refocus Armscor on its primary role of defence matériel acquisition organisation.

The transformation seeks to refocus Armscor on its primary role of defence matériel acquisition organisation

The Armscor Board of Directors acknowledges that current and future requirements of the Department of Defence and the viability of the local defence-related industry dictate a refocusing of Armscor's resources and the restructuring of the organisation so that it can deliver efficiently and effectively on its mandate. Armscor therefore fully supports the initiatives of the Ministry of Defence and the Department of Defence, and recognises that a restructured Armscor with better streamlined activities and a refocused mandate can only improve its service delivery.

With better streamlined activities and a refocused mandate Armscor can only improve its service delivery

During the period under review a draft Ministerial directive was prepared on Armscor's reclassification as a schedule 3A Public Entity in support of the Department of Defence's Category 1 defence matériel requirements and matters related thereto, and was communicated to Armscor.

In terms of this Ministerial directive, Armscor would in the new fiscal year undergo major transformation, with the new DERI and the organisation created assuming a new name.

The primary focus and core mandate of the new organisation, would be defence matériel procurement and acquisition

The primary focus and core mandate of the new organisation, would be defence matériel procurement and acquisition, all for the benefit of the Department of Defence and the Republic of South Africa.

In the light of this assessment and in order to ensure a smooth implementation of these changes, two steering committees – each with a number of working groups – have been established to focus on specifically identified areas that will be affected by the intended transformation. The new fiscal year will thus experience a further drive towards the implementation initiatives to transform Armscor.

Strategic Defence Packages (SDPs)

During the year under review Armscor continued to demonstrate its commitment to support the DOD and the defence-related industry at large. Major milestones have been achieved in the professional acquisition management of Armscor, despite the declining defence budget and limited human resources.

The last three of the four frigates were commissioned and handed over to the SA Navy as fully operational warships

The first of the three submarines ordered, the SAS 'Manthatisi, was commissioned in Kiel, Germany, in November 2005. After an extensive crew training exercise the submarine left German waters in February 2006 for its maiden voyage to South Africa, arriving in Simon's Town on 7 April 2006. The last three of the four frigates, the SAS Isandlwana, SAS Spioenkop and SAS Mendi, were commissioned and handed over to the SA Navy as fully operational warships in July 2006, February 2007 and March 2007 respectively. These very welcome additions and pride and joy of the SA Navy have undoubtedly strengthened the capability of the SANDF to discharge its mandate.

The CEO's report and the acquisition report outline the broader details of the strategic defence packages.

Corporate governance

Armscor places strong emphasis on corporate governance and has continued to take steps to comply with requirements in this regard. One of the key fiduciary duties that the directors of Armscor have to comply with is the requirement to declare any conflict arising between a director's own interests and those of Armscor. Armscor has not only made it a requirement for directors to disclose their interest, but has also extended this requirement to its employees.

Strong emphasis are placed on corporate governance

These declarations are all the more necessary in an organisation such as Armscor, where the Board of Directors fulfils a dual role, namely that of controlling the affairs of Armscor and that of acting as the tender board for defence matériel for the Department of Defence.

In addition to the disclosure requirements, the Board of Directors delegates specific responsibilities and functions to three committees – the Audit and Risk Management Committee, the Human Resources Committee and the Executive Committee – which brings further depth to the activities of the Board. Each committee is chaired by a non-executive director who possesses special expertise and knowledge to lead the relevant committee.

In order to ensure continuous improvement on issues of corporate governance, Armscor, assisted by the Institute of Directors, conducted regular training for management and the Board. Through its Audit and Risk Management Committee the Board keeps a vigilant eye by monitoring and managing and preventing risk facing the organisation. Armscor subscribes to best practice in corporate governance and as far as possible adheres to the codes of good corporate practice.

Armscor conducted regular training for Management and the Board

The oversight role of the Board during the transformation of the organisation has been heightened. This has become necessary in order for the Board to ensure the integrity of the acquisition process during the period under review. Most importantly the Board seeks to ensure that the new envisaged organisation would be sustainable and that it possesses the integrity, professionalism and credibility necessary for the complex acquisition task. Accordingly, a governance model that provides comfort to the shareholders and stakeholders alike is imperative.

The oversight role of the Board during the transformation has been heightened to ensure the integrity of the acquisition process

The Board was confident that it had put in place credible support systems to effectively discharge its audit and risk management function despite the loss of some of its members

During the year under review there were some challenges with capacity of the Board and its Audit and Risk Management Committee deriving from the resignation of a Board Member occasioned by her appointment to a new position in an audit firm whose rules do not allow for partners to serve on Boards of Companies that they might be required to audit. The other challenge was caused by the expiry of the term of office of some of the members and the fact that they were precluded by law from serving for more than two terms.

This limitation was overcome through an intervention which involved the appointment of more members of the Board to the Audit and Risk Management Committee. This intervention was undertaken as it became evident to the Board that it would be extremely difficult to attract new members to the Board and to this committee when the organization was going through transformation. This challenge will persist into the new fiscal year. The Board, however, was confident that it had put in place credible support systems to effectively discharge its audit and risk management function despite the loss of some of its members.

Because of the changing nature of the mandate of the organisation, prioritisation was given to understanding transformation and working diligently towards this goal. To this end, it was felt that the Shareholder's Compact for the year under review and even for the new financial year might not be necessary and that the organisation should focus on the service level agreement between Armscor and the Department of Defence to measure performance.

Employment Equity Status

Employment equity remained high on Armscor's agenda

Employment equity remained high on Armscor's agenda. While some progress had been made, there were still a lot of challenges. Black employees accounted for 41% compared to 28% of the total work force in 2001. Great as it was, that achievement still fell short of the target of 88% necessary to reflect the national demographic profile for the economically active population.

However, I am pleased to report that the present eight-person Board of Directors comprises no fewer than five prominent members of the country's black leaders from all walks of life. Similarly, we ended the year under review with a black CEO, four black General Managers and one black Acting General Manager on our eight-person Management Board.

Armscor has introduced intervention measures to accelerate the transformation process in respect of achieving the desired gender and racial representivity at middle management level.

Armscor set itself a goal to ensure that 80% of all externally recruited employees would be black, and 95% has been achieved. Overall, the affirmative appointments grew from 89,9% in 2005 to 94,87% in 2006 and 95% so far in 2007. This continual improvement has made an impact on redressing the demographic composition of staff.

This annual report is an account of Armscor's performance in discharging its mandate. The articulation in detail in the Directors' Report on Armscor's performance against goals in all its complex activities is an achievement of milestones. It indicates that the organisation is striving to fully deliver on its mandate and I take pride in presenting this Armscor Annual Report for the 2006/2007 financial year.

Performance against goals indicates that the organisation is striving to fully deliver on its mandate

Acknowledgements

The year under review has been full of challenges, both of an operational and transformational nature. With the guidance, wisdom and leadership of the Honourable Minister of Defence, Mr MGP Lekota, and his deputy, Mr ME George, the challenges were easily surmounted. I thank both the Minister and the Deputy Minister and their respective offices for the support and guidance that they gave to Armscor and to me personally.

With guidance, wisdom and leadership, the challenges were easily surmounted

A special word of thanks to the Secretary for Defence, Mr JB Masilela, the Chief of the SANDF, Gen N Ngwenya, and the Chief of Defence Matériel Division, Mr B Ramfolo, for their invaluable support to Armscor.

Our primary clients – the DOD and the SANDF as a whole, the SA Police Service and SA Correctional Services – have to be thanked for their support as well.

Thanks also to the defence-related industry, spearheaded by AMD, for having been part of the defence team.

Parliament's Portfolio Committee on Defence has contributed to the successful execution of our work. Its oversight role is appreciated. On behalf of the

Directors, Management and staff I extend to the Chairperson and Members of the Portfolio Committee our profound gratefulness.

The members of the Board have all been pivotal in steering this national asset, Armscor, in a direction in which it has fulfilled its mandate with professionalism, dedication and integrity. Their stewardship of the organisation has enabled us to hold our heads high in the knowledge that the organisation's commitment to good governance, efficiency and professionalism was being monitored by a Board that maintained the highest ethical standards and degree of vigilance.

Armscor remained at the cutting edge of delivery and efficiency

The Armscor Management Board and all the personnel are the indispensable human capital which ensured, through their dedication, contributions and sacrifices, that Armscor remained at the cutting edge of delivery and efficiency, and a reservoir of scientific and engineering excellence. I thank them immensely. Without them the success recorded during the year under review would not have been realised.

Armscor can, with confidence, look forward to meeting the challenges of the future and playing its important role in the Defence Team and in the Defence Ministry.

Dr PS Molefe

Chairman

Board of Directors

Dr PS Molefe
Chairman - Armscor

HS Thomo
Chief Executive Officer

RP Meyer

CWN Molope

CJ Hoffmann
Chief Financial Officer

Col (Ret) GN Ramaremisa

CV Gamede

P Riba

AS Human

Chief Executive Officer's report

Mr HS Thomo
CEO - Armscor

The financial year under review posed exciting challenges for Armscor. The organisation did some introspection, which resulted in the need for restructuring. This restructuring initiative and the achievement of the goals we set ourselves in the preceding year are the subject of discussion in this report under the following headings:

- Restructuring of Armscor
- Progress with the strategic defence packages
- The South African defence-related industry
- Review of the previous financial year
- Implementation of the Acquisition benchmarking study recommendations
- Transfer of the Simon's Town Naval Dockyard to Armscor
- Implementation of black economic empowerment (BEE)
- ISO 9001:2000 certification

Armscor's mandate is to acquire, procure, test and evaluate defence materiel for the South African National Defence Force

Restructuring of Armscor

Armscor was founded in 1964 as the Munitions Production Board and contained what is today known as Denel (Pty) Ltd. Armscor's mandate, since Denel was separated from it, is to acquire, procure, test and evaluate defence matériel for the South African National Defence Force (SANDF) and in some cases for the South African Police Service (SAPS).

The Minister for Defence directed that Armscor shed its test and evaluation capabilities and focus only on acquisition and procurement activities

Whilst many aspects of the South African defence-related industry (SADRI) started to change in the last ten years, Armscor – although being part of this industry – has largely remained the same. The Government, through the Minister for Defence, has now directed that Armscor shed its test and evaluation capabilities and focus only on acquisition and procurement activities. The test and evaluation capabilities of Armscor, the Council for Scientific and Industrial Research (CSIR) and Denel are to be consolidated into a new entity that is to be known as the Defence Evaluation and Research Institute (DERI). This DERI will be located in the Department of Defence as a new organisation.

The period under review has seen the beginning of this restructuring of Armscor. The process is currently in the planning stage and it is estimated that it will take about two years to fully implement it.

Progress with the Strategic Defence Packages

The strategic defence packages (SDPs) were concluded in December 1999. The financial year under review saw significant progress on each of the SDP programmes and all projects are on schedule.

The Defence Industrial Participation (DIP) obligations, connected with the SDPs, initially represented a considerable challenge for most obligators and still remains so today. It is the largest ever defence offset obligation with strict conditions for its performance, including fixed and pre-set six monthly performance milestones which are continuously monitored by Armscor through to 2012. Strong penalties are levied by Armscor for non-performance.

Submarine Programme

The submarine programme provides for the acquisition of three (3) Class 209 submarines from the German Submarine Consortium (GSC), for the South African Navy. The submarines were assembled at two dockyards in Germany, in Kiel and Emden.

The submarine programme provides for the acquisition of three Class 209 submarines from the German Submarine Consortium

The first of these vessels, SAS 'Manthatisi, was commissioned in Kiel in November 2005. After an extensive crew training exercise, the submarine left German waters in February 2006 for its maiden voyage to South Africa, arriving in Simon's Town on 7 April 2006. The second submarine, SAS Charlotte Maxeke, was named and commissioned in Emden in March 2007. She set sail for South Africa as a fully operational submarine on 16 March 2007 and arrived in Simon's Town on 26 April 2007. The commissioning of the third submarine, SAS Queen Modjadji, is scheduled to take place in South Africa on her arrival in Simon's Town in April 2008.

The total Defence Industrial Participation (DIP) obligation of the GSC on this programme is R1,12 billion. To date R741,1 million or 66% of this obligation has been discharged in the form of work packages, technology transfers and export orders to the benefit of local defence-related companies.

The total Defence Industrial Participation obligation on this programme is R1,12 billion

The submarine DIP obligation draws to a close in July 2007. Although 34% of this obligation is still outstanding, the risk of non-performance by the GSC is low. Approximately 23% of this outstanding obligation relates to a technology transfer activity, which is only scheduled to be completed in July 2007. The balance of the outstanding obligation is covered by ongoing exports.

Chief Executive Officer's report
continued

Patrol Corvette Programme

The patrol corvette programme entails the acquisition of four MEKO® A-200 frigates from the German Frigate Consortium

The patrol corvette programme entails the acquisition of four (4) MEKO® A-200 frigates from the German Frigate Consortium (GFC), for the South African Navy. The vessels were constructed in two German shipyards, in Hamburg and Kiel, and then sailed to Simon's Town for the integration of their combat suites by South African defence-related companies.

The last three frigates were commissioned as fully operational warships in July 2006, February 2007 and March 2007

The last three of the four frigates, namely SAS Isandlwana, SAS Spioenkop and SAS Mendi, were commissioned and handed over to the SA Navy as fully operational warships in July 2006, February 2007 and March 2007 respectively. All four vessels are now undergoing operational test and evaluation trials in South African waters.

The total DIP obligation of this programme is R2,9 billion

The total DIP obligation of this programme is R2,9 billion and to date R1,95 billion or 66,3% of that commitment has been discharged in the form of work packages on the corvettes, technology transfers and export orders to the benefit of the local defence-related industry.

The platform portion of the obligation drew to a close in April 2007 and was approximately 95% complete. A large portion of the remaining obligation relates to activities under the combat suite obligation. To maximise benefit to the industry, these activities have been extended to 2010. The involvement of the local defence company ADS in the combat suite of the corvette programme has secured them a contract in the French frigate programme (FREMM).

Light Utility Helicopter Programme

A contract was concluded with Agusta SpA of Italy to supply 30 Agusta A109 helicopters

A contract was concluded with Agusta SpA of Italy to supply thirty Agusta A109 helicopters for the South African Air Force.

A total of 16 helicopters already delivered to the South African Air Force

The initial seven helicopters, three of which were manufactured in Italy, were delivered during the previous financial year. A further nine helicopters, eight of which were assembled by Denel Aviation, were delivered during the financial year under review. This brings the total number of helicopters already delivered to the South African Air Force to sixteen.

More than 2 000 hours have been flown by the SAAF by the end of the reporting period, and the A109 LUH fleet has been on its first international mission to Mozambique in a disaster relief role.

The total DIP obligation on this programme is R1,2 billion. Agusta has successfully discharged its full DIP offset obligation within the contractually agreed discharge period, which ended on 19 April 2007. In fact, the DIP claims submitted by Agusta exceeded the obligation by approximately R25 million, which Agusta intends to claim under the maritime helicopter obligation in due course.

The total DIP obligation on this programme is R1,2 billion

Agusta has also succeeded in fully entrenching several SA defence-related companies in its supply chain, with the resultant continuous benefit to these SA defence-related companies as Agusta secures further export orders in other countries.

Advanced Light Fighter Programme

A contract was concluded with the BAE Systems/SAAB consortium to supply twenty-eight JAS39 Gripen advanced light fighter aircraft to the South African Air Force. The number of aircraft was subsequently reduced by two in order to fund additional functionality in the remaining twenty-six aircraft. The aircraft are being manufactured by SAAB at its Linköping factory in Sweden.

A contract was concluded to supply twenty-six JAS39 Gripen advanced light fighter aircraft

The first Gripen aircraft destined for delivery to the SA Air Force was rolled out of the Linköping factory in Sweden in October 2005. This Gripen aircraft conducted its first successful flight in November 2005, well ahead of schedule. The programme is on schedule with the delivery of the first dual seat aircraft to the SA Air Force expected in March 2008. The entire programme is expected to be concluded in March 2012.

The programme is on schedule with the delivery of the first dual seat aircraft expected in March 2008

To date, local defence-related companies have benefited to the tune of R3,4 billion or 67% of the R5 billion contracted DIP programme. The main beneficiaries are Denel Aviation, which received technology transfer to establish a Gripen Design and Development Centre, and the Grintek Group, which was contracted for the local development and manufacture of various electronic subsystems.

Local defence-related companies have benefited to the tune of R3,4 billion of the R5 billion contracted DIP programme

Lead-In Fighter Trainer Aircraft Programme

The twenty-four Hawk lead-in fighter trainer aircraft were contracted to be acquired from BAE Systems UK for the SA Air Force. The aim of this programme is to bridge the training gap between the existing ASTRA basic trainer aircraft

The twenty-four Hawk lead-In fighter trainer aircraft were contracted to be acquired from BAE Systems UK

and the Gripen advanced light fighter aircraft. As part of the DIP programme, all 24 aircraft are to be assembled locally by Denel Aviation.

Sixteen Hawk aircraft were delivered to 85 Combat Flying School at Air Force Base Makhado

By the end of the reporting period, sixteen Hawk aircraft were delivered to 85 Combat Flying School at Air Force Base Makhado. The remaining seven aircraft are at Denel waiting for delivery in October 2007. Two of these aircraft are already painted in the national livery.

The total DIP obligation of BAE Systems is R4,3 billion

In this case, the total DIP obligation of BAE Systems is R4,3 billion and to date R4 billion or 94% of this obligation has been discharged.

Through the DIP obligations of BAE Systems and SAAB, Denel Aviation (now Denel Saab Aerostructures) contributes components not only on the Hawk and Gripen aircraft but also on the international A400M aircraft programme. This contribution extends to export customers for these aircraft in addition to the South African customer.

Through offset contracts placed with Aerosud by BAE Systems and other customers like Airbus, Aerosud is now contracted to supply components to Airbus for its passenger aircraft and for the A400M programme. Aerosud (the only foreign company outside of the European Union consortium) also supplies components for the Typhoon aircraft, the world's most advanced aircraft in its class.

On the defence electronics side, Denel Optronics supplies the key systems that are the heart of the HMD (helmet mounted display) systems fitted to the Gripen and Typhoon aircraft.

Denel PMP has received considerable orders from BAE Systems (the latest being the largest export order in its history) for the supply of high-precision small-calibre ammunition components.

Black economic empowerment (BEE) companies have supplied ground support equipment for the Hawk and Gripen aircraft. In addition, BEE companies have undertaken software development for overseas clients through the offset programme.

Maritime Patrol Helicopter Programme

The maritime patrol helicopters are the last of the SDPs and entail the acquisition of four Super Lynx Mk 64 helicopters for the South African Air Force from Westland Helicopters in the United Kingdom. These helicopters will be operated from the four patrol corvettes. The contract was signed in August 2003.

The maritime patrol helicopters entail the acquisition of four Super Lynx Mk 64 helicopters

Construction has been completed and the helicopters are expected to be delivered to the South African Air Force by July 2007. Conversion training of the South African Air Force air and ground crew in the UK was completed in April 2007.

Construction has been completed and the helicopters are expected to be by July 2007

The DIP obligation of the maritime patrol helicopters is R553 million and to date R149 million or 27% has been discharged. With delivery of the aircraft in July 2007, it is appropriate to note that certain onboard systems – the interrogation friend or foe (IFF), high-frequency antennae, as well as electro optical sight system – were provided by South African companies. Other DIP activities focus on the through-life support of the helicopters.

The DIP obligation of the maritime patrol helicopters is R553 million

The South African defence-related industry

The South African defence-related industry is a relatively new player in the international defence arena. Previously the industry was largely dependent on the South African Defence Force for its orders.

Notwithstanding the actual level of DIP credits being recorded by the obligors, a key objective of the DIP obligations is the sustainability of the South African defence-related industry. In many respects this objective has been met. Despite an overall global decline in aerospace and defence markets since the year 2000, many companies in the South African defence-related industry have generally been sustained through the work that has resulted from the various offset programmes. Some of these companies have even experienced growth that is directly attributable to the contracts placed with them by the obligors.

Notwithstanding the actual level of DIP credits being recorded by the obligors, a key objective of the DIP obligations is the sustainability of the South African defence-related industry

Some of these SA defence-related companies now supply complete defence products to first-world customers, in addition to contributing to the world's most advanced defence product systems. The DIP programmes have also

played a key role in forging links with major international companies, which will further promote the sustainability of the South African defence-related industry beyond the expiry of the offset obligations.

The shape of the South African defence-related industry is significantly different from what it was in 2000. The industry is now outward looking and able to meet the demanding export requirements of first-world defence programmes, and the DIP programmes have hugely contributed to this refocusing of South Africa's defence-related industry.

Review of the previous financial year

In my previous report I stated that the company objectives are covered in more detail under the Directors' Report. However, the objectives that Armscor set for itself in 2004/2005 were of such a nature that they could not be completed in one financial year. In 2005/2006 and in the period under review, Armscor concentrated on finalising these objectives, which included:

- Implementation of the Armscor Acquisition benchmarking study recommendations
- Further implementation of black economic empowerment
- Finalisation of the transfer of the Simon's Town Naval Dockyard to Armscor.

Implementation of the Acquisition benchmarking study recommendations

The objective was to streamline the tendering and contracting process and to ensure that it remains as cost effective and timeous as possible, while maintaining the integrity and accountability of the process

One of the Armscor Management Board's initiatives was to benchmark Armscor's tendering and contracting processes. The objective of this initiative was to streamline the tendering and contracting process and to ensure that it remains as cost effective and timeous as possible, while maintaining the integrity and accountability of the process.

A very successful internal project was launched in July 2004 to benchmark Armscor's tendering and contracting process. This benchmarking project was concluded in March 2005, with a number of recommendations that had to be implemented by Armscor, starting in April 2005.

The improvement recommendations could be broadly categorised into three categories, namely:

- Enhancement of the electronic contract and order management system
- Focusing of responsibilities of personnel
- Enhancement of contracting processes and approach

The period under review addressed all recommendations, including the specification for a new electronic contract management and administration system. Armscor also revised its Acquisition Management Practice.

The recommendations of the benchmarking study resulted in an internal restructuring exercise of the Acquisition Department. Full implementation of all recommendations is dependent on the implementation of the planned new electronic contract management and administration system.

Implementation of black economic empowerment (BEE)

The BEE Practice was first implemented in June 2006. One of the new provisions was the mandatory subcontracting when an Armscor contract is awarded to a non-BEE compliant supplier. This provision requires that the non-BEE compliant supplier subcontracts a minimum of 25% of the value of the contract to a BEE supplier, subject to the availability of BEE suppliers for that particular type of work or portions thereof.

A non-BEE compliant supplier must subcontract a minimum of 25% of the value of the contract to a BEE supplier

Armscor has had an opportunity to contribute towards the proposed alignment of the Preferential Procurement Policy Framework Act (PPPFA) and the Broad Based Black Economic Empowerment Act (BBBEE) by the DTI through an organisation called SOEPF (State Owned Enterprises Procurement Forum). This is a structure created by parastatals to share information on global best practices in supply chain management. The objective is to identify areas where synergies exist and to exploit them. This includes sharing tender specifications, vetting suppliers, encouraging traditional suppliers to transform, and supplier development opportunities. Armscor is a member of SOEPF.

SOEPF is a structure created by parastatals to share information on global best practices in supply chain management

Chief Executive Officer's report
continued

Transfer of the Simon's Town Naval Dockyard to Armscor

Ministerial authority was granted by the Minister of Defence for the formal transfer of the Simon's Town Naval Dockyard from the Department of Defence to Armscor

During the year under review, ministerial authority was granted by the Minister of Defence for the formal transfer of the Simon's Town Naval Dockyard from the Department of Defence to Armscor. This resulted also in the Minister of Public Services and Administration granting the determination for the transfer of the Dockyard to Armscor.

The scheduled transfer on 1 April 2007 did not take place as planned due to a court interdict obtained on the eve of the transfer by one of the Dockyard Simon's Town unions against the transfer of the dockyard to Armscor. The matter is currently being addressed and it is envisaged that the transfer will now take place around August or September 2007.

ISO 9001:2000 certification

Armscor has always been synonymous with quality

Armscor has always been synonymous with quality. This organisation led the South African drive for quality during the seventies and also made its expertise and experience available to South Africa by playing a leading role in the formalisation of a quality institute in the name of the South African Excellence Foundation.

I am proud to report that Armscor has yet again been assessed by the South African Bureau of Standards (SABS) and found to fully comply with the requirements of ISO 9001:2000.

Acknowledgements

I wish to express my thanks and appreciation to the Minister of Defence, Mr MGP Lekota, and his Deputy, Mr ME George, for their guidance and support, as well as to the Secretary for Defence, Mr JB Masilela, and the Chief of the SANDF, General GT Ngwenya, for their invaluable support to Armscor. 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 operational matters.

My congratulations go to the South African defence-related industry for delivering quality defence equipment to our clients in the SANDF.

I am greatly indebted to the Board of Directors of Armscor and my management team together with their staff for their contribution to Armscor's success during the year under review.

Armscor has been assessed and found to fully comply with the requirements of ISO 9001:2000

In conclusion, Armscor looks forward to the new fiscal year despite its challenges. I am confident that under the wise and competent leadership of the Board of Directors and the Management Board, these challenges will be turned into opportunities.

HS Thomo
Chief Executive Officer

Management Board

HS Thomo
Chief Executive Officer

JS Mkwanazi
General Manager
Quality and IT
Acting for Acquisition

CJ Hoffmann
General Manager Finance and Infrasrtructure

Dr JAJ de Necker
General Manager
Armscor Business (Pty) Ltd

MM Matibe
Acting General Manager
Quality and IT

TT Goduka
General Manager
Dockyard

X Magojo
General Manager
Human Resources

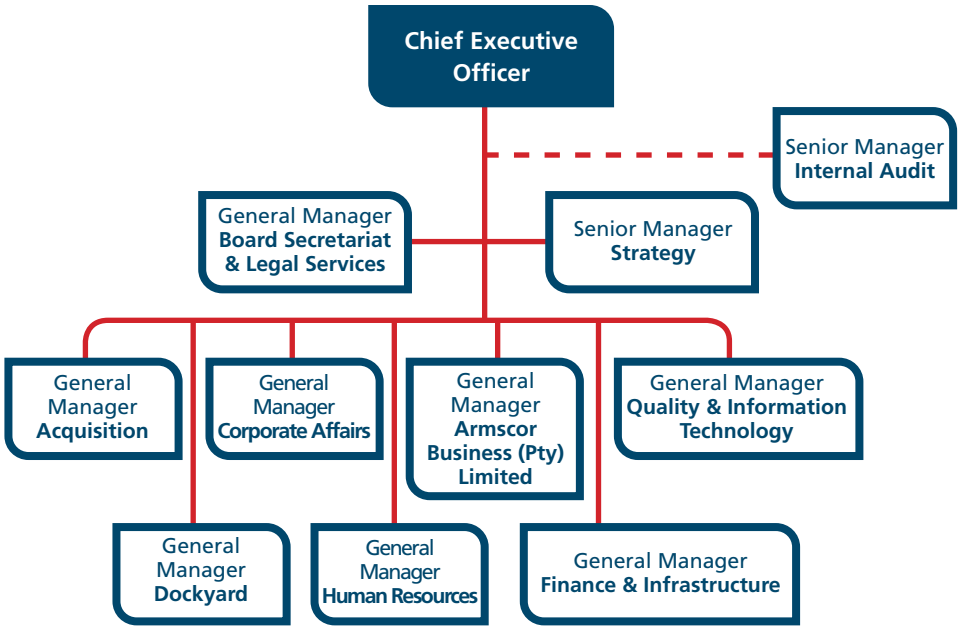
NRM Borotho
General Manager
Corporate Affairs

TN Msomi
General Manager
Board Secretariat and Legal Services
(Appointed 01/01/2007)

GJ Smith
General Manager Acquisition
(Retired 31/08/2006)

Review of operations

Organisational structure



Function

The core function of Armscor is to acquire defence matériel, primarily for the South African National Defence Force (SANDF) but also for other government departments and services with the permission of the Minister of Defence.

The core function of Armscor is to acquire defence matériel, primarily for the South African National Defence Force

The acquisition role of Armscor entails all the actions that need to be taken to satisfy the need for matériel, facilities or services intended for use in or in support of client requirements. This includes long-term operational research, requirement planning, establishment and the management of technology development, design and development of products and systems, and the industrialisation and manufacturing of mature products and systems that fully meet the stated user requirements.

The acquisition role of Armscor entails all the actions that need to be taken to satisfy the need for matériel, facilities or services intended for use in or in support of client requirements

Armscor's acquisition role (Acquisition Business Management) can be broadly divided into four categories, namely System Acquisition Management, Procurement Management, Product Systems Management, and Technology Acquisition Management. System Acquisition Management presently represents the bulk of Armscor's acquisition function and involves all the activities, from the translation of mission and related needs into appropriate technical specifications, to the provision of operationally effective, suitable,

survivable and supportable products and systems in accordance with the stated requirements of Armscor's 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 Armscor's clients during the operating phase of products and systems and includes 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.

Process

Formalised process of risk reduction

A significant portion of the programme management function within Armscor is centred on the acquisition of complex systems and entails execution of the System Acquisition Management role. Armscor's acquisition involvement traditionally starts with the receipt of an approved User Requirement from its client. From there a formalised process of risk reduction is followed, which eventually leads to the contracting of suitable suppliers to develop and manufacture the fully specified products or product systems. A formalised source selection process entailing the development and application of value systems is followed to identify preferred suppliers that would provide the best value for money solutions for providing specific user requirements. In cases where no existing products can meet the specific user requirements, selected suppliers are contracted to develop the required product systems and deliver successive development models. These development models range from experimental development models through advanced development and engineering development models up to pre-production models. After successful evaluation and qualification of the designs and related production processes, contracts are established and managed for the required number of products and product systems.

Integrated Project Teams

At the core of all acquisition programmes are integrated project teams

The proper 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 assurance and design assurance. At the core of all acquisition programmes are integrated project teams that comprise members from

Armscor and the Department of Defence (DOD) with the responsibility to properly and adequately meet all the programme management requirements of acquisition programmes. Such integrated 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. In order to properly execute their diverse responsibilities, Armscor programme managers not only need to be knowledgeable in their specific technical domains, but also need to be proficient in, for instance, the systems and logistics engineering, commercial and legal fields.

In order to properly execute its professional project management responsibility as required by the Armscor Act, it is essential that the proficiency level of Armscor's programme managers be maintained and continually updated – in all the required domains. In order to achieve this, specific training courses and modules are offered that have been developed in-house and that are focussed specifically on the competencies required by personnel in the various subdisciplines within the acquisition environment. These training modules, which are mostly computer based, serve both to fast track new programme managers and to act as refresher courses for current programme managers.

Structure

Functionally structured and provides single points of entry to the respective DefMatDiv Directorates

Armscor's Acquisition Department is functionally structured with technical divisions focussing on specific technical disciplines. The technical divisions thus provide a home base to programme managers specialising in the specific technical domains. In order to improve liaison and interaction with the DOD, Armscor's main client, divisions within the Acquisition Department have been grouped together so as to mirror the structure of the newly formed Defence Matériel Division (DefMatDiv) as far as possible. This grouping provides single points of entry to the respective DefMatDiv Directorates where possible, and has served to provide significant improvement in communication with the DOD. The Acquisition Department continually strives to improve and streamline its interaction with the DOD and is, as a result of this effort, in the process of developing a new departmental structure in collaboration with DefMatDiv that, once implemented, should fully satisfy the requirements of the DOD in terms of allocation of responsibility and should also ensure optimal employment of the very scarce human resources that are vested in the Acquisition Department.

Review of operations
continued

Technology Development

The use of new technology in the design and development of equipment is important in order to optimise the cost efficiency and effectiveness of new equipment. In order to ensure that the development of new equipment and capabilities for the SANDF is based on the utilisation of suitable modern and mature technology, Armscor and the DOD identify and manage a number of technology development programmes within local industry, which are 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 its weapon systems. Involvement in the initiation of new technology development projects remains a very important aspect of the responsibilities of Armscor's programme managers, and in order to effectively execute this responsibility it is imperative that the programme managers remain technologically up to date in their specific areas of expertise. It is essential, therefore, that the programme managers gain as much exposure as possible to new developments in the international arena.

The research into and development of identified critical technologies contributed greatly towards providing the SANDF with competitive advantages in its weapon systems

Strategic Defence Packages

The strategic defence package (SDP) programmes continue to form a significant part of the acquisition portfolio of Armscor. The period under review saw significant progress on all of the SDP programmes, with the conclusion of the foreign part of both the corvette and the light utility helicopter programmes. Highlights included the commissioning and handing over to the SA Navy of the last three of the four corvettes, delivery and commissioning of the first sixteen of the Hawk lead-in fighter aircraft to 85 Combat Flying School at Air Force Base Makhado, the arrival in South Africa of the first South African JAS39 Gripen advanced light fighter aircraft for commencement of flight trials at the Test Flight and Development Centre at Overberg, and the successful first flight of the Westland Super Lynx Mk 64 maritime patrol helicopter. During the review period, the project office for

The strategic defence package programmes continue to form a significant part of the acquisition portfolio

the acquisition of the Airbus A400M strategic heavy lift transport aircraft was established in Toulouse, France. This programme is already bearing fruit with the participation of local industry in the development and manufacturing of selected components for all aircraft of this type.

Acquisition

Armscor is still suffering from a lack of capacity to manage all the current programmes to the depth that is required by the DOD's acquisition policy. However, the initiatives of the Armscor Acquisition Department are progressing well to refocus its resources towards adding more technical value in the relevant integrated project teams.

Initiatives

Drive to re-emphasise technical assurance management as part of the acquisition function

The re-establishment and enhanced formalisation of a baseline management system on all acquisition projects is delivering very positive results. A forum has been reconstituted to formally oversee and govern the technical baselines on all acquisition projects, and it is functioning well. This initiative, which forms part of the drive to re-emphasise technical assurance management as part of the acquisition function, is producing benefits in terms of exposing project risks and integration issues and has led to the introduction of several measures to strengthen the capability of integrated project teams at ground level.

A number of the new initiatives launched by the Acquisition Department in the recent past are showing good progress. Examples of these initiatives that will serve to enhance the efficiency and effectiveness of the Acquisition Department are the further development of the capability management process and the integration thereof with the newly developed computerised acquisition business register, as well as the development, testing and initial implementation of a work authorisation system.

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, a rolling three-year service level agreement between Armscor and the DOD has been developed, approved and implemented. Quarterly reporting to the DOD takes place in terms of this.

Review of operations
continued

Service Level Agreement to further enhance the effective and efficient use of the available Armscor resources

Work is presently underway to update this SLA focussed primarily at updating the service descriptions and detailed definitions of the various tasks performed by Armscor for the DOD in terms of the SLA. The objective is to further enhance the effective and efficient use of the available Armscor resources in providing acquisition and other services to the DOD and to ensure a clearly defined business plan and an accountable business relationship between the two parties.

Maritime Systems

Type MEKO®A-200 Patrol Corvettes

All four frigates are in operational use

The acquisition programme of the frigates has moved a step closer to completion with the successful completion of the sea acceptance trials during the review period of the last three of the four frigates, namely SAS Isandlwana, SAS Spioenkop and SAS Mendi. Formal contractual handover and commissioning of these three vessels took place in Durban in July 2006, in Simon's Town in February 2007 and in Port Elizabeth in March 2007, respectively. All four frigates are now in operational use within the SA Navy and are being put through their paces during a period of operational test and evaluation, both in local and international waters. Two of the four vessels have already participated successfully in two separate extensive naval exercises with other foreign navies in international waters since being commissioned.

Class 209 Mod 1400 Submarines

The acquisition programme has progressed according to expectations during the review period. The first of the three submarines, SAS 'Manthatisi, which was commissioned in the Howaldtswerke-Deutsche Werft shipyard in Kiel, Germany, in November 2005, arrived in Simon's Town as a fully operational vessel on 7 April 2006 after her successful maiden voyage to the Republic of South Africa. The production of the remaining two submarines continued during the review period with the sea acceptance trials of the second vessel being completed in November 2006. This submarine, SAS Charlotte Maxeke, was named and commissioned in the Norseewerke shipyard in Emden, Germany, on 14 March 2007 and set sail on her maiden voyage to the Republic of South Africa on 16 March 2007, accompanied by SAS Drakensberg, and arrived in Simon's Town on 26 April 2007. Her operational test and evaluation phase has already commenced.

The name of the third submarine, namely SAS Queen Modjadji, was also unveiled at the commissioning ceremony of the second submarine. She commenced her sea acceptance trials in German waters in April 2007 and is expected, as a fully commissioned and operational submarine, in South African waters in April 2008.

Airborne Systems

Rooivalk Attack Helicopter

The current main focus of the project is to achieve the interim operational baseline to enable deployment for the Rooivalk combat helicopter in peace support operations. A number of required design improvements to the transmission deck were identified during the reporting period and these have all been developed. The resulting retrofit modification kits for the prototype fitment have been delivered for installation on the development aircraft at Denel Aviation.

The main focus of the project is to achieve the interim operational baseline

Testing of the weapon system accuracy resulting from the improvement programme has commenced and there is a noticeable improvement in meeting the functional performance requirements in this regard.

Tests have commenced on the deployment baseline status aircraft and interim type certification is scheduled for August 2007.

Maritime Patrol Helicopter

The acquisition of four Super Lynx maritime patrol helicopters from Westland Helicopters in the United Kingdom is progressing according to plan. The manufacturing of the four helicopters has been completed and they should be delivered to Air Force Base Ysterplaat in Cape Town by mid-2007. Conversion training of the first SA Air Force air and ground crew was completed in April 2007.

The helicopters should be delivered to Air Force Base Ysterplaat in Cape Town by mid-2007

These helicopters will be operated from the SA Navy's newly acquired corvettes and are specifically equipped to support their operational roles. A number of South African subcontractors are involved in supplying subsystems for the helicopters.

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1
Handover ceremony of Hawk MK120 trainer aircraft at AFB Makhado

2
Charlotte Maxeke

3
Type MEKO® A-200 Patrol Corvettes

4
Rooivalk attack helicopter

5
Super Lynx maritime patrol helicopter

6
Hawk MK120 at AFB Makado

7
SAS 'Manthatisi

8
A109 LUH helicopter

9
Commissioning of SAS Spioenkop at Simon's Town.

Review of operations
continued

Light Utility Helicopters (LUH)

The acquisition of thirty A109 LUH helicopters from Agusta in Italy progressed very well during the reporting period. Nine helicopters were delivered during the financial year under review, bringing the total number delivered to the SA Air Force to sixteen.

More than 95% of the logistic support package, including computer based and cockpit procedural training systems, has been delivered and commissioned.

The helicopters have also been deployed on their first international mission to Mozambique in a disaster relief role

The delivered A109 LUH helicopters are being flown extensively by the SAAF, with more than 2 000 hours having been flown by the end of the reporting period. The helicopters have also been deployed on their first international mission to Mozambique in a disaster relief role.

Airbus A400M Strategic Heavy-Lift Transport Aircraft

Contract provides for the participation in the development of the A400M

The Airbus Military S.L. (AMSL) contract provides for participation in the development of the A400M strategic heavy lift transport aircraft and the delivery of eight aircraft by 2012.

The assembly of the first aircraft is to start on the final assembly line by the end of June 2007.

Although there is a three-month time risk on the first test flight, AMSL has stated that delivery of the first production aircraft will remain on schedule.

Advanced Light Fighter Aircraft (ALFA)

The contract with the BAE Systems/SAAB consortium provides for the supply of twenty-six JAS39 Gripen advanced light fighter aircraft to the SA Air Force. The aircraft will be manufactured by SAAB in Sweden and the development of specific South African functionality to adapt the Gripen system to the SAAF's operating environment is progressing well with the participation of South African specialists from Armscor and the SAAF.

Delivery of the first dual seat aircraft to the SA Air Force expected in March 2008

The first Gripen aircraft destined for delivery to the SA Air Force was rolled out of the factory in Linköping in Sweden in October 2005 and conducted its first flight in November 2005. This programme is on schedule with the delivery of the first dual seat aircraft to the SA Air Force expected in March 2008, and the entire programme is expected to be completed in March 2012.

HAWK Lead-In Fighter Trainer Aircraft (LIFT)

The LIFT aircraft system is being acquired from BAE Systems UK to bridge the training gap between the ASTRA basic trainer and the Gripen advanced light fighter aircraft. The system includes twenty-four aircraft, operational support equipment, a logistics support package, a ground based training system, facilities and training of personnel.

To date, sixteen Hawk aircraft have been delivered to 85 Combat Flying School, AFB Makhado. These aircraft are being extensively flown in order to achieve full operational status at the earliest possible date. The flight test instrumented aircraft has been delivered to the Test Flight and Development Centre at Overberg and the remaining seven aircraft are at Denel awaiting delivery.

Aircraft are being extensively flown in order to achieve full operational status at the earliest possible date

The airframe, engine and avionics hardware meet the specifications. Development of the final operational capability software, representing the implementation of the full avionics requirements specification, is nearing completion and testing has commenced in May 2007, after which it will be retrofitted to all aircraft.

New Generation Short Range Air-to-Air Missile

During the review period Armscor entered into a contract with COMAER, the command structure of the Brazilian Air Force, for co-funding of the development of the A-Darter short-range air-to-air missile system of Denel and for the transfer of technology to Brazil. This is the result of a series of agreements reached between the Governments of the RSA and Brazil, including South Africa's DOD and the Brazilian Air Force, in terms of the IBSA initiatives.

Armscor entered into a contract with COMAER for the co-funding of the development of the A-Darter short-range air-to-air missile

Following the contracting between Armscor and COMAER, Armscor has successfully concluded a contract with Denel to perform the actual development work on the missile system. This development programme and transfer of technology is scheduled to take place over a period of five years. For the purpose of technology transfer, the Brazilian Air Force has placed a number of engineers with Denel to participate in the development activities. Full- scale development started recently and the programme is well on its way.

The contracting model, where funding from South Africa's DOD is combined with funding from a foreign country for the development of a weapon system, is the first of its kind in the South African defence acquisition environment and poses interesting challenges for Armscor.

The contracting model is the first of its kind in the South African Defence Acquisition

Review of operations
continued

Landward Systems

Ground Based Air Defence System (GBADS) for the SA Army

In February 2003, Armscor placed a contract with Denel for the development and delivery of the Local Warning Segment (LWS) of the new Ground Based Air Defence System (GBADS) for the SA Army. The planned contract period was forty-two months, with a contractual delivery date of July 2006. For various reasons this programme has slipped by an indicated forty-one months, and the new expected completion date is November 2009.

The majority of the subsystems subcontracted to both local and foreign suppliers have been delivered and are in the process of being integrated

A number of corrective actions have been implemented to ensure that the programme will be completed by the new planned date. During the reporting period, good progress was made on two functional elements, namely the Air Defence Control (ADC) and Tactical Command & Control (TCC) software, with factory acceptance of these elements scheduled for mid-2007. The majority of the subsystems subcontracted to both local and foreign suppliers have been delivered and are in the process of being integrated.

New-Generation Infantry Combat Vehicle

This project provides for the delivery of a new-generation infantry combat vehicle to replace the ageing Ratel infantry combat vehicle that has been in service since 1976.

An affordable contracting position has now been reached

A single offer was received from Denel. The technical performance of the prototype vehicle that was supplied as part of the offer process was thoroughly evaluated at the Gerotek Vehicle Test Track and other locations, and was found to meet the stated requirements in the user requirement document. During the latter part of the review period, Armscor has been engaging with Denel with regard to the price offered, and an affordable contracting position has now been reached. A formal contract between Armscor and Denel was signed on 21 May 2007.

Quality

Acquisition quality

Quality Assurance personnel continue to provide support on the various acquisition programmes

Quality Assurance (QA) personnel continue to provide support on the various acquisition programmes, to ensure that programme objectives are met and that quality products are delivered to the SANDF. QA personnel have been

actively involved, as members of the integrated project teams overseas and locally, on the development, qualification/certification, production and acceptance of the various aircraft and naval product systems and associated logistic support products being procured under the strategic defence programmes.

Finalising the QA surveillance plan for Gripen and establishing one for A400M production via QA working groups, also received priority over the period. Steps were also taken, as delegated by the DOD, to reactivate the Memorandum of Understanding with the Spanish MOD in order to facilitate future cooperation on QA matters during A400M production.

Good progress was also made on the recruitment and training of new QA personnel in line with Armscor's strategic objectives.

Review and optimisation of processes and ISO 9001 listing

The first three-year cycle after Armscor's ISO 9001 registration in 2003 elapsed in June 2006, during which time six audits were performed (two per year) by the South African Bureau of Standards (SABS), Armscor's independent registration body. Armscor's continuous maintenance and improvement of the quality management system resulted in no major findings being made by the SABS during these audits and consequently a new ISO 9001 certificate was issued to Armscor for the three-year period up to 14 June 2009. Two further audits were conducted by the SABS since then, in November 2006 and February 2007, again with no major findings.

A new ISO 9001 certificate was issued to Armscor for the three-year period up to 13 June 2009

A quality management system re-alignment plan for the years 2006–2009 has also been developed to ensure that internal and external audit efforts focus on supplying Armscor management with the necessary information to enhance decision-making on strategic, business and supporting process improvements.

Information Technology (IT)

The IT infrastructure renewal project entailed the replacement of servers at Head Office with a blade frame server, the replacement of notebook computers and the purchase of thin client devices as replacement for lock-down workstations. One of the most important milestones that will be

IT Renewal entails the replacement of hardware and the mapping of business processes to a level where a user requirement statement for all applications can be generated

achieved through this project is that Armscor will consolidate its large number of servers at Head Office into a single blade technology server. Cost savings will materialise once this consolidation process has been completed due to fewer licences, lower server support and maintenance costs.

The second phase of the enterprise architecture project entailed the mapping of the business processes of Armscor to a level where a user requirements specification can be generated for all the application systems. This phase of the project was completed at the end of October 2006.

The project to re-engineer the application systems of Armscor has been put on hold

The project to re-engineer the application systems of Armscor to migrate the mainframe applications, solve the 16-bit applications dilemma, solve the human resource applications issues, address BEE requirements, address acquisition process changes, etc, has been put on hold, pending approval of the information and communication technology strategy by the Board of Directors, as well as clear business direction as regards the transformation of the organisation.

Security and arms control compliance

Security continues to be well entrenched and there are no issues of particular concern

Internationally, Armscor continued to maintain relations with the security organisations of the countries involved in the strategic defence packages, and several security-related visits to South Africa were hosted in this regard. Security continues to be well entrenched and there are no issues of particular concern. Nationally, contact with the local defence industry was maintained, as well as the programme to ensure a high degree of security awareness within the environment.

Arms control compliance function

The main objective of the arms control compliance function is to establish and implement the necessary procedures to ensure compliance with arms control and non-proliferation requirements set by South African legislation, international agreements South Africa has committed itself to, and defence export controls of supplier countries. This is a prerequisite for the international recognition of Armscor as a responsible and trustworthy trade partner, enabling it to optimally satisfy the needs of the SANDF regarding defence equipment. In order to reach its objectives, the functions of the Arms Control Division are divided into two components. The core component ensures adherence to national and international arms control and non-proliferation requirements. This is complemented by a component providing

support to Armscor, its contractors and clients, in the form of technical support regarding control of defence matériel and the development and presentation of training sessions.

During the past year there were no violations of arms control legislation by Armscor.

Defence Industrial Participation (DIP)

Although South Africa's Industrial Participation programme was highlighted with the conclusion of the Strategic Defence Packages (SDPs), Armscor has successfully applied offsets since 1988. Armscor's efforts have grown into the current Defence Industrial Participation (DIP) programme, which together with the National Industrial Participation (NIP) programme forms the basis for the Government's initiative to stimulate the economy through offsets.

Sustainability of the SA defence industry enhanced by applying 50% DIP on foreign purchases above USD2 m

The Department of Trade and Industry (DTI) manages the NIP programme and applies a 30% NIP obligation on the imported content of all government purchases above USD10 million. Armscor applies an additional DIP obligation of 50% on the imported content of all defence-related purchases above USD2 million.

DIP is a government-initiated process whereby defence purchases are used as leverage to oblige a seller of foreign commodities/services to do defence–related business in South Africa on a reciprocal basis in order to advance military strategic and defence-related industrial imperatives.

Within Armscor, the DIP Division executes DIP policy on behalf of the Department of Defence and works closely with Armscor's Acquisition Department to maximise benefit to the industry, without compromising the integrity of the acquisition programme.

At the outset of an acquisition programme, the DIP Division is involved with compiling the request for proposal (RFP) documents to ensure that DIP requirements are met by potential bidders. It forms an integral part of the tender evaluation team to determine the successful bidder, after which a separate DIP Agreement is concluded with the appointed contractor.

Review of operations
continued

Six monthly milestones in firm agreements ensure timely discharge of DIP obligations

The DIP agreement establishes the value and period of the obligation, as well as a discharge schedule condensed into six–monthly milestones. This is based on viable business plans presented by the contractor and credits for discharging the obligation are only granted against these agreed plans. The success of DIP is mostly attributed to this approach of regular, close scrutiny of performance and opportune adjustment of plans resulting from changed circumstances. The approval of agreements and credits by an independent authorisation committee occurs within the strict guidelines of formal practices and procedures. To further underpin the management of DIP agreements, the DIP Division operates a reliable, auditable system of recording all transactions to ensure the highest visibility of progress and performance by a contractor.

Contractors or "obligors" can discharge their obligations by either performing work directly related to the acquisition programme (Direct DIP), or by directing other business towards to broader Defence Industry (Indirect DIP). They are further guided to allocate the work to any one of a number of different DIP categories, i.e. Local Industry Participation, Exports, Technology Transfer, Investments, Loan Interest Benefit, SMME & BBBEE and Marketing Support.

The DIP Division currently manages seven DIP agreements related to the SDPs, eight other active agreements, as well as a number of pro-active agreements in anticipation of upcoming acquisition programmes.

The DIP obligations on the SDPs represent approximately 73% of all the DIP obligations currently managed by Armscor. To date, the SDPs alone have delivered benefits to the SA defence-related industry worth in excess of R11,4 billion.

DIP Status of the Strategic Defence Packages as at 31 March 2007

Project	Obligation	Planned perfor-mance	Actual perfor-mance	Actual vs planned	Actual vs Obligation	Sales (Local and export)	Technology Transfer	Investments
	Rm	Rm	Rm	%	%	Rm	Rm	Rm
Corvettes	2 941	1 979	1 950	99	66	1 423	501	26
Submarines	1 121	746	741	99	66	639	95	7
Light utility helicopters	1 194	1 194	1 194	100	100	676	487	31
Hawk aircraft	4 252	3 616	4 001	111	94	3 195	789	17
Gripen aircraft	5 050	3 130	3 383	108	67	1 461	1 750	172
Maritime helicopters	553	188	149	79	27	118	29	2
Total	15 111	10 853	11 418	105	76	7 512	3 651	255

The outstanding obligations currently present a low risk of non-achievement as they are all covered by sufficient and viable planned activities.

R11,4m of value already returned to SA from SDP-related DIP

Approximately twenty-five BEE companies are currently involved in the DIP programme and are at different stages of becoming part of international supply chains. Included in the actual performance to date are DIP credits to the value of ±R128 million awarded for contracts placed with some of these BEE companies.

Naval Dockyard Simon's Town

The transformation of the Naval Dockyard Simon's Town, which entails its transfer from the Department of Defence (DOD) to Armscor, gained momentum during the period under review.

The Minister of Defence directed that the process of transfer be accelerated and effected by 1 April 2007.

The Minister of Defence directed that the process of transfer be accelerated and effected by 1 April 2007

This process culminated in the Minister of Defence requesting the Minister of Public Service and Administration to grant a determination to transfer the Naval Dockyard Simon's Town from the DOD to Armscor with effect from 1 April 2007. The determination was granted in December 2006.

The determination resulted in the finalisation of the Human Resources Agreement. The aim of this agreement is to apportion the employment liabilities and human resource arrangements of the DOD and Armscor with

respect to the transfer of the Dockyard to Armscor as a going concern in terms of section 197 of the Labour Relations Act on the transfer date.

The Dockyard employees were briefed by the DOD on the imminent transfer to Armscor. They were also formally informed in writing of their current conditions and given the opportunity to query the data where necessary.

The scheduled transfer could not take place on 1 April 2007 because of a court interdict obtained on 30 March 2007 by NEHAWU

The scheduled transfer could not take place on 1 April 2007 because of a court interdict obtained on 30 March 2007 by NEHAWU, one of the labour unions operating in the Dockyard. The court interdict was requested based on the failure to respond to issues raised with both the Department of Defence and the Department of Public Service and Administration in correspondence dated 27 March 2007.

The issues raised relate to the following:

- Whether the transfer is as a going concern in terms of the Labour Relations Act, section 197, as stipulated in the transfer agreements;
- The financial position of Armscor as negatively reported in the press following the quarterly report back to the Portfolio Committee on Defence;
- Whether Armscor will be in a position to run the Dockyard effectively under the alleged financial position;
- Whether the Minister of Public Service and Administration had taken into consideration the alleged Armscor financial difficulties when granting the determination to transfer the Dockyard to Armscor; and
- A request for copies of the Agreement entered into between the DOD and Armscor.

These issues are being addressed by a team comprising representatives of the Department of Defence, the Department of Public Service and Administration and Armscor. A formal response to the Union's issues has been undertaken. The court proceedings are scheduled for 12 June 2007. The transfer has been suspended pending the Union's response to the feedback and ultimately the court outcome should the Union's response not be favourable.

The first year under Armscor's control is viewed as a consolidation phase of the transfer, which will include finalisation of the asset and facilities transfer plans,

rollout of required systems and processes, development of a reorganisation plan and the development of a business plan for the Dockyard.

Armscor Business

Armscor Business is a wholly-owned subsidiary of Armscor and the functions as stated in the Act are grouped and managed as separate business units, namely:

Armscor Business is a wholly owned subsidiary

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

Armscor Business successfully obtained ISO 9001:2000 accreditation on 13 December 2006. This is a major achievement for Armscor Business and at a hand-over ceremony the award was presented to the General Manager of Armscor Business by the Acting General Manager of Services and Regional Affairs for SABS Commercial (Pty) Ltd.

Armscor Business obtained ISO 9001:2000 accreditation

Test and Evaluation (T&E)

The T&E group is considered as highly strategic with respect to the testing of military equipment. The group comprises the Gerotek Test Facilities at Elandsfontein, Pretoria West, and the Alkantpan Ballistic Test Range near Prieska.

Gerotek

Gerotek Test Facilities

Gerotek Test Facilities is an ISO/IEC17025 accredited test facility that has been delivering services to the local military industry since 1975 and from 1986 also to international military and commercial industries.

Through its four business units, Gerotek supports the complete acquisition value chain. Component testing ensures that components used in a system comply with local and international safety and quality standards. Complete system tests verify that the final product meets the end user's requirements. Launches and ride-and-drives are offered for products to be promoted to the target market in a safe, fit-for-purpose environment. Advanced driver

Gerotek supports the complete acquisition value chain

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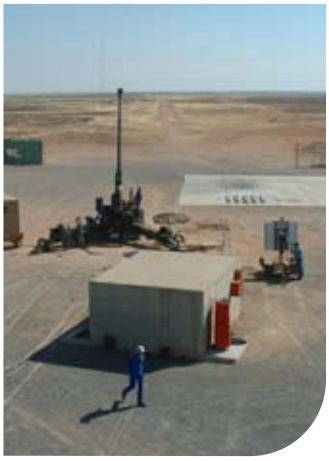

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1
AAD 2006 International Exhibition

2
Signing of handover certificate for Hawk MK120 Trainer aircraft at AFB Makhado

3
Olifant MBT at Alkantpan ballistic test range

4
Signing of contract for development of A-Darter short range air-to-air missile

5
Signing of contract for new generation infantry combat vehicle

6
Testing G5 artillery system at Alkantpan

7
Minister of Defence at AAD 2006 exhibition

8
Learner thanking Armscor on behalf of Gando Junior Secondary School for IT equipment

9
New-generation infantry combat vehicle

10
Traditional dancing by learners of Gando Junior Secondary School

training concludes the value chain by training users to utilise products in the appropriate manner.

Gerotek Testing provides repeatable vehicle, component and antenna compliance and development testing. It has partnership agreements with various entities to facilitate a one-stop service to industry.

Gerotek continues to be the exclusive distributor in South Africa for the German-based CORSYS-Datron Sensorsysteme GmbH, a technologically advanced and highly accurate measuring system. This system is used mainly by Gerotek clients in motor manufacturing's research and development divisions. In terms of the agreement Gerotek receives a percentage of between 10% and 20% from the sale of this equipment for its administrative support.

Both the SABS and Gerotek support the vehicle industry with safety and reliability tests

Gerotek has a strong relationship with the South African Bureau of Standards (SABS). Both the SABS and Gerotek support the vehicle industry with safety and reliability tests.

Significant progress has been made by Gerotek to create international awareness of the company and its capabilities. This is proven by the yearly increase in the number of international clients being serviced.

Gerotek has skills and facilities that are in some cases unique

On the local front Gerotek has supported the military and automotive industries with skills and facilities that are in some cases unique and not duplicated anywhere.

Practical training opportunities were offered to electrical and mechanical engineering students using Gerotek training programmes that were assessed and approved by the major technical universities.

Alkantpan

Alkantpan was established as a ballistic test range

Alkantpan was established in 1987 as a ballistic test range for artillery, armour, rocket, short-range missile, mortar, rapid fire and anti-aircraft tests. The strategic requirement of the DOD and the related weapons and ammunition industry provides for:

- Test of HE (high explosive) and other types of ammunition

- Safety of personnel in the case of catastrophic failures
- A dedicated ballistic range for development, qualification and investigation tests

Alkantpan is ISO 9001:2000 certified and with its functional infrastructure, high-tech electronic equipment and skilled workforce, contributed to various successful DOD projects, or related projects, over the last two years, which included the following tests:
Surveillance, armour development, tests for the Special Forces, M64 charges, naval and helicopter mount, Hoefyster, Denel Land Systems LEW weapons, Denel Munitions Naschem mortars and 76 mm, Fuchs fuses, Denel Munitions Somchem charges and insensitive munitions, Denel Munitions PMP rapid fire, Denel Aerospace Systems Rexnord 4 and 105/RPG 7 warhead initiations.

Services provided range from various logistic requirements and storage of ammunition in magazines, to preparation and execution of weapon and ammunition tests, recovery and demolition. The services are supported by a measurement and instrumentation capability.

Alkantpan is a respected international test range

Alkantpan is a respected international test range and earns 40% of its income from foreign clients. This enables Alkantpan to be in phase with new developments and technologies, which contributes significantly to the enhancement of skills of its personnel. One such example is the exposure over the last few years to insensitive munitions tests of foreign clients, which enables Alkantpan to manage and execute such tests for the DOD in future.

The strategic goals for the financial year were not only met on the financial perspective but also on the improvement of service delivery through the utilisation of new test equipment. However, the resignation of key personnel towards the end of the year places a big challenge on management to recruit qualified and experienced personnel to execute tests.

Defence Science and Technology Institute

The DSTI group focuses on defence research

The Defence Science and Technology Institute (DSTI) group focuses on defence research and consists of various divisions that provide specialised, professional techno-military support in distinct knowledge areas. DSTI is active in exploiting, with the support of its primary Department of Defence

customers, the commercial opportunities of its defence technologies. The group has once again successfully completed its contracted work for the year and the highlights presented below give a perspective of the activities of the various divisions. The group comprises Armour Development, Defence Institute, Ergonomics Technologies, Flamengro, Hazmat, Institute for Maritime Technology, and Protechnik.

Armour Development

The 2006/2007 work for the two ongoing armour development programmes was completed. This entails development of both passive and reactive armour systems.

Armour Development develops both passive and reactive armour systems

Two armour steel manufacturers abroad were visited and their processes and quality assurance systems were studied. This is to ensure the availability of excellent quality armour plate material when required. Ballistic trials on their products yielded good results.

Ballistic trials carried out on the new generation mechanized infantry fighting vehicle protection system confirmed the initial design. More work is in progress to refine this protection and to reduce costs.

Mass effective armours were developed

Mass effective armours were developed against artillery projectile fragments and against fragments from improvised explosive devices.

The effect of aramid spall liners inside vehicles, to enhance crew survivability, was determined and quantified against fragment simulating projectiles.

A number of protection solutions for light and medium armoured vehicles were tested and qualified.

Metallurgical engineering services were rendered to other sectors of the armament manufacturing industry.

Defence Institute (DI)

DI acts as advisor on short, medium and long-term decisions

DI is an organisation that focuses on supporting the Department of Defence in achieving defence excellence. DI 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 a matrix organisation with the emphasis on client, project, knowledge and resource management.

Capability Development

This three-year project led by Joint Operations resulted from instructions by the Secretary for Defence. The aim is to find an auditable method for determining the long-term capability requirements of the SANDF. Besides being required for complying with the Public Finance Management Act, many other advantages for the SANDF became evident.

The aim is to find an auditable method for determining long-term capability requirements

System Management Enhancement

The SA Army environment and specifically Dir Army Product Systems Management is engaged in the enhancement and creation of enablers and governance supported by related processes, which are required to manage products systems in the SA Army.

Staff support for system management enhancement

The purpose of the project is to provide staff support for system management enhancement (SME), which encompasses integrated logistic support (ILS), capability management and related processes, as well as products system management in the SA Army.

Project Battlespace

This project was commissioned by Joint Operations 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. In the year under review the work focused on studies of selected defence and security topics which, in addition to other environmental monitoring under the project, provided input to expand the existing database. In addition, a draft Joint Defence Publication on the African operational environment was updated and was handed over to Defence Intelligence Division for further development and/or promulgation. As of 2007/08, the project will be incorporated under the DOD Capability Development project.

Creating a high-level overview of the characteristics of the current and possible future African operational environment

Weapon System Decision Support

The purpose of the Weapon System Decision Support Project (WSDS) is primarily to maintain and expand a decision support capability, able to meet the requirements of the DOD, at the Defence Institute. This has included studies of developments in and the tools and methodologies of decision science and studies of topics of a military functional nature which provided background knowledge for the application of decision support.

Primarily to maintain and expand a decision support capability

Joint Command and Control Staff Support

The Command and Control (C^2) Staff Support Project team provides staff support to Joint Operations for the development and maintenance of C^2 concepts, doctrines, C^2 portfolio master plans, and C^2 systems architectures (current and future).

Project Simunye

Project Simunye is a technology project for defining, testing and evaluating Joint Air Defence (JAD) Command and Control (C^2) systems concepts and related systems architectures.

The main focus of project work for the previous financial year was to implement the mission control functionality and related Link ZAP messages on the Simunye test platform (Joint Picture Display System (JPDS)) to test and evaluate (T&E) the new data link based mission control concepts. The overall requirement for the data link based mission control of Gripen is to establish situational awareness through the exchange of the common air situation picture between the sector control centre (SCC) and the Gripen in real time. To achieve this local tracks generated by the SCC and Gripen need to be fused into common system tracks for distribution.

Ergonomics Technologies (ERGOTECH)

Ergotech provides a structured ergonomics programme for the effective and efficient integration of ergonomics in all defence systems

ERGOTECH provides a comprehensive service in ergonomics (human factors) to the DOD in order to satisfy its requirement for a structured ergonomics programme for the effective and efficient integration of ergonomics within all defence systems. The service includes military ergonomics research in the areas of human body dimensions (anthropometry), physical force exertion, soldier functional performance, specification and design of human-machine systems, the evaluation of environmental stressors (such as vibration, humidity, temperature and noise) and human-machine systems and specialised health and safety investigations that are unique to our soldiers and the environments in which they operate.

ERGOTECH is responsible for the generation and maintenance of the human characteristics databases for the SANDF that are critical for the integration of ergonomics into soldier equipment and systems within the context of the operating environment.

The division's objectives for the past year were to provide a high quality scientific service to the DOD, to maintain client contact through user requirement and feedback work sessions and to provide timeous ergonomics inputs to acquisition projects. During the last year ERGOTECH worked towards these objectives and further progress has been made in utilising existing data in software models to support decision-making in the military acquisition process.

The requirement was for these modelling capabilities to be expanded to provide cost effective soldier performance prediction, soldier-equipment interface evaluation tools and a biomechanical analysis capability to determine and advise on the risks of military tasks and equipment to the soldier. Considerable progress has been made in modelling soldier performance when executing visual observation and shooting tasks, the interface characteristics of SANDF population computer manikins within a new generation fighting vehicle, and the creation of a foot model to predict military boot shock attenuation capabilities.

ERGOTECH was also involved in the integration and development of ergonomics during the specification phase of two acquisition projects. The one project is concerned with the dismounted soldier and his/her equipment while the other was directed at the ergonomics of the new tactical communications system. Data from the databases and the series of experiments that were conducted during previous phases of the projects were utilised. The intention was to develop a series of specifications that will enhance human performance and contribute towards overall soldier operational effectiveness.

Specifications that will enhance human performance and contribute towards overall soldier operational effectiveness

Fluid and Mechanical Engineering Group (FLAMENGRO)

Flamengro maintains a minimum sustainable level of capacity in structural and fluid dynamics, as well as gun dynamics and internal ballistics modelling and analysis.

Flamengro maintains a minimum sustainable level of capacity in structural and fluid dynamics

Scientific, engineering and operational support is provided on the design and development of weapon systems.

Recent developments include alternative M82 primer magazine tube concepts, having been designed and manufactured for further evaluation, with the aim of improving a number of design elements using both improved geometry and alternative materials.

A study to characterise alternative primer ignition charge materials was documented, the results of which are envisaged to improve the ignition process.

Hazmat Protective Systems

Hazmat is one of only a few companies in the world capable of impregnating activated carbon

Hazmat Protective Systems manufactures and markets a complete and comprehensive range of filter cartridges, canisters and silicone half-mask respirators to protect the individual soldier against the majority of respiratory health hazards. Hazmat also manufactures impregnated activated carbon, which is used in a range of cartridges and canisters. Hazmat is one of only a few companies in the world capable of impregnating activated carbon. This technology was developed by the military in order to supply chemical and biological filters to the SANDF.

Canisters and various chemical and biological filters were manufactured for the SANDF to replace expiring filter stocks

Hazmat's manufacturing process has been certified to ISO 9001:2000 by TÜV Rheinland since 1994, and all respiratory products are approved (homologated) by the SABS, or comply with the applicable military standard. Hazmat is currently the only local manufacturer of canisters, and various chemical and biological filters were manufactured for the SANDF to replace expiring filter stocks.

In the past year Hazmat, with the assistance of Protechnik Laboratories, developed a replacement water purification filter for the presidential business jet shower. PMA certification was obtained from the South African Civil Aviation Authority to manufacture water shower filters for the Boeing 737-700 IGW. Hazmat is currently the sole manufacturer of these water shower filters and the first batch of filters was delivered to the SAAF at the end of February 2007.

Institute for Maritime Technology (IMT)

IMT strives to meet the South African Navy's (SA Navy) present and future needs in scientific and technical system support and real-time naval operational solutions requirements, including the maintenance of strategic capabilities. IMT also provides scientific and technical support services to the broader Department of Defence and the South African and regional maritime community.

All four of the SA Navy frigate sonars acquired have been accepted using the

locally IMT developed portable sonar target (PSTAR) during the sea acceptance trials. Acoustic data were analysed and used to verify the contractual acoustic sea acceptance tests of the SAS Charlotte Maxeke (S102).

SA Navy frigate sonars have been accepted using the locally IMT developed PSTAR during the sea acceptance trials

A concerted effort was made to develop a long-term vision and strategy for underwater security, in cooperation with the SA Navy. This has already translated into concrete steps of assistance with planning for SA Navy activities for the 2010 Soccer World Cup.

The autonomous underwater vehicle (AUV) demonstrator has completed succesful optical surveillance trials.

A baseline was established for the submarine warfare simulation environment, using the ORACOM tool. This simulation environment will be used to design and implement deployment strategies for countermeasures and escape manoeuvres.

Apart from usual weapon system support activities, services relating to integration assistance culminating in the first operational weapon system launches from the SAS Manthatisi (S101) were also rendered.

IMT performed the programme management functions for a technology demonstrator programme on an active offboard decoy, and a long-term programme for the development and establishment of technologies and skills related to autonomous underwater vehicles (AUVs) in the South African training environment.

The Effectiveness Model developed by IMT has delivered consistent value to clients over the past few years. Benchmarking our efforts against those of New Zealand and Australia indicated that the standard thereof at IMT was on par with theirs, and even further advanced in terms of conceptual development and implementation.

The Effectiveness Model developed by IMT has delivered consistent value to clients over the past few years

A new situation centre concept demonstrator was established for the SA Navy. This trial facility uses geospatial technology (a form of electronic mapping) on large plasma screens to display own shipping information.

IMT, the Defence Institute and the Naval Warfare School used knowledge

sharing technology to develop a new naval operations/exercise planning system. This demonstrator provides a basis for naval operations planners to manage and access a wide diversity of documents that are required to generate comprehensive planning.

In response to an invitation from the Algerian Navy, IMT was included in a SA maritime industries visit to Algeria. It became apparent that they are keen to establish an IMT similar institution in Algeria.

Possible future cooperation options are being pursued that may result from a visit to IMT by a German naval research institute.

IMT was invited to participate in an unclassified NATO experiment

IMT was invited to participate in an unclassified NATO Ship and Atmospheric Propagation Phenomenon Infrared Experiment (SAPPHIRE). Eleven NATO countries and South Africa (the only non-NATO invited guest country) participated in this trial. The IMT team was well received by the other countries and many were impressed by the capability of IMT in the field of infrared signature characterisation and modelling.

The second cycle of the IMT cadet programme was completed in December 2006. Two of the six cadets that participated in the programme were appointed by IMT and one at Ergotech. All these new appointees are from the previously disadvantaged community.

IMT together with the SA Navy, Table Mountain National Parks, University of Cape Town and Cape Metropolitan Council hosted a most successful public feedback session to residents and interested persons on environmental health of the ocean and other similar topics in Simon's Town.

Protechnik Laboratories

Protechnik Laboratories performs chemical and biological research and development work for the Department of Defence

Protechnik Laboratories performs chemical and biological research and development work for the DOD in six domains, viz. detection, decontamination, protection, synthesis, verification and biomedical.

Much of the project work in the current year focused on developing detection and decontamination techniques for use in urban areas and buildings and the mass decontamination of civilians. The new equipment and procedures

were evaluated in joint exercises with the Tshwane Emergency Services, South African National Defence Force (SANDF) and the South African Police Services (SAPS). In these exercises, many operational problems were solved and the results can be utilised as preparative work for the 2010 Soccer World Cup tournament.

A prototype fully encapsulated suit made from Tychem F was produced and evaluated with representatives of the chemical industry, SAPS, South African Navy (SAN) and 7 Medical Battalion Group. The suit, which can be made at a fraction of the cost of the imported suit, was favourably received and a number of minor improvements were suggested.

A prototype fully encapsulated suit made from Tychem F was produced and evaluated

Project work for the SA Navy continued and a chemical warfare (CW) agent detector has been permanently fitted to one of the corvettes and will undergo sea trials in the new year. A range of protective suits was evaluated with SA Navy personnel on the corvette, and a hybrid of the Protechnik decontamination suit and fully encapsulated suit was proposed as the answer to the SA Navy's requirements.

The capability has been established to analyse toxic compounds in a variety of matrices and white powders, and Protechnik could confirm within three hours that a white powder sample found in a post office was not anthrax. A cooperation agreement is being negotiated with the SAPS Forensic Laboratory which will enable Protechnik to analyse samples suspected to contain CW agents on behalf of the SAPS.

Capability established to analyse toxic compounds in a variety of matrices and white powders

The Service Level Agreement between the Department of Trade and Industry and Protechnik is functioning well. Protechnik assisted the Non-Proliferation Council to organise the OPCW Regional Assistance and Protection Course. This was attended by twenty-eight participants from Africa. In addition, a team of Protechnik scientists went to Lusaka to assist with the analysis of a suspicious package.

Defence Support

The Defence Support group comprises three divisions, namely Defence Matériel Disposal, Armscor Business Logistics and Armscor Defence Asset Management Centre.

Review of operations
continued

Defence Matériel Disposal (DMD)

DMD manages and sells excess and obsolete defence matériel on behalf of the Department of Defence

DMD is mandated to manage and sell excess and obsolete defence matériel to the best advantage of the State on behalf of the Department of Defence. The defence matériel includes, for instance, ammunition, aircraft, spares, vessels, land and/or air-based equipment.

The management and sale of the defence matériel is carried out in accordance with the requirements of the Department of Defence and government approved regulatory authorities such as the National Conventional Arms Control Committee and the National Proliferation Committee.

DMD has in terms of its mandate successfully established and managed seven defence matériel warehouses. The DMD Naval Depot in Wingfield, the DMD Air Force Depot in Thaba Thswane and the DMD Army Depot at Wallmannstal are DMD's main depots.

Disposal of vehicles, identified as a priority by the DOD, both at Polokwane and Wallmannstal, was completed with the sale of 800 vehicles.

Thirty-five Ratel vehicles were sold to an African country.

Armscor Business Logistics Freight

AB Logistics Freight renders logistic services in support of Armscor's strategic acquisition function

AB Logistics Freight renders logistic services in support of Armscor's strategic acquisition function, and for the SANDF and the South African defence-related industry.

AB Logistics Freight has, through its capabilities, also extended its specialised services to various government departments, the SAPS, and to foreign defence forces.

South Africa's international acceptance has resulted in joint exercises held between the SANDF and other foreign defence forces, with AB Logistics Freight rendering the logistical support required by the visitors for the freight forwarding of their military equipment. The high standard of service rendered by AB Logistics Freight in the past has resulted in these logistical support services being contracted for the next two years.

In terms of the Explosives Act, AB Logistics Freight is also a registered explosives transporter, offering this specialised service to the SANDF, Armscor and the defence-related industry through its trained personnel and with its own fleet of trucks.

AB Logistics Freight is registered as explosives transporters

The shipment of military commodities and explosives has become more complex due to limited shipping opportunities. AB Logistics Freight has successfully developed shipping routes, which has resulted in contracts with the Denel Group.

AB Logistics Freight is currently playing an important role in the shipping and customs clearance process of the strategic defence packages equipment. The special customs and excise manufacturing warehouse facility is in full operation and handles all the required extensive administration processes to ensure that all the customs rules and formalities are complied with. A total of 15 LUH A109 helicopters and 16 Hawk aircraft were customs cleared out of this warehouse facility, while a number of components are still being imported into this facility for the local manufacture of the remainder of the LUH A109 helicopters and Hawk aircraft. The manufacturing of certain parts for the Gripen fighter and the Airbus A400M military cargo aircraft is also supported by this warehouse facility.

AB Logistics Freight is currently playing an important role in the shipping and customs clearance process of the strategic defence packages equipment

AB Logistics Freight is supporting Denel Aviation with the A400M military cargo aircraft and has successfully shipped the first deliveries of the locally manufactured components to the different Airbus production plants in Europe.

AB Logistics Travel is a registered member of the International Air Transport Association and the Association of South African Travel Agents. Its main business is to provide a 24-hour travel service to assist Armscor and Armscor contractors with all their defence and project-related travel arrangements. In the year under review travel assistance was also rendered to the Defence Force for ten months. AB Logistics Travel offers a diversified range of travel arrangement support, including air travel, land travel, car rental, accommodation, and other related services.

AB Logistics Travel provides a 24-hour travel service for defence and project-related travel arrangements

Armscor Defence Asset Management Centre (ADAC)

ADAC provides asset management support to assist the defence environment. ADAC renders the following services corporately to Armscor and on behalf of Armscor:

ADAC provides asset management support to assist the defence environment

Review of operations
continued

Intellectual Property Management Support Service (IPMS)

ADAC acts as the custodian of DOD intellectual property documentation in Armscor's possession. Data and information integrity are ensured by applying configuration management principles in the administration thereof within a configuration database.

Document Digitising Service

The function of this service is to digitise the large volumes of paper-based DOD programme-related documents and data items in Armscor's possession. This service plays an important role in the distribution of information in electronic format to all applicable stakeholders.

Project Asset and Accounting Management Service

All DOD assets in Armscor's acquisition-related programmes are accounted for in a central asset register. A quantity of three hundred and thirty-three (333) contractors, who manage assets for the DOD at locations countrywide, was visited to verify these assets. A 98,4% confirmation was obtained in the period January 2006 to December 2006.

DOD Stores and Equipment Management Service

This service allows for the management of all DOD stores and equipment in Armscor's possession. A DOD Logistic Information Management System is utilised for accounting, enabling thereby the integration of work processes and information flow between the DOD and Armscor. Accounting is also done for surplus and redundant DOD stores and equipment transferred to Armscor for alienation.

Ammunition Marking Service

ADAC works in close cooperation with the DOD and the defence industry in the creation and management of ammunition marking drawings. A total of 12 000 drawings are involved. Codification and packaging advice service is also rendered.

Assets, Stores and Equipment Disposal Service

The Disposal Service conducts, in association with the DOD, the disposal of all identified, redundant, obsolete and unserviceable DOD assets, stores and equipment in possession of or controlled by Armscor. The process involves disposal investigations, submissions and finalisations.

Other functions and activities

Human Resources

As a service organisation, Armscor's people are its backbone and the need to maintain capabilities has increasingly become the main area of challenge from the point of view of human capital management. Consequently the HR organisational structure was changed during the period under review, to place increased emphasis on the area of skills development within Armscor. The net effect of this has been that several new training initiatives have been launched to supplement the activities that were already being pursued.

Several new training initiatives have been launched

Skills development

Existing initiatives

Adult Basic Education and Training (ABET)

Armscor provided ABET to twenty-two of its personnel as well as to twenty-seven Molly Mop (Armscor's cleaning contractor) staff and DOD personnel. The courses offered at present are limited to Numeracy and Literacy at the ABET levels 1 to 4.

Through grants being offered by the Services SETA, it is hoped that the course offers can be expanded next year to address a complete NQF level 1 qualification or, alternatively, skills courses that can be used in the workplace.

New Talent Management

The talent development programme (TDP) provides opportunities for newly qualified personnel typically from designated groups to gain meaningful experience in the Armscor environment. The incumbents are contracted for periods ranging from one to two years. A coaching programme is structured for them.

In the past year, eight incumbents occupied TDP posts in the Finance, Quality and Acquisition Departments. One incumbent completed his contract this year and was appointed full time.

In addition, Armscor sponsored three cadets on the IMT cadet scheme from the TDP funds.

As a feeder to the TDP, Armscor also has a bursary scheme. Bursaries for engineering were granted to five students: one White, one Indian and three African. The bursary scheme's attractiveness to potential students is limited as it covers only the cost of fees and therefore competes unfavourably with bursaries that also cater for accommodation or travel and text books.

New learning initiatives

E-learning

Armscor took advantage of the international move to using e-Learning

The nature of the work environment in Armscor (e.g. time constraints, access to work stations and intranet, the self-disciplined nature of the typical Armscor employee) has meant that Armscor could take advantage of the international move to using e-learning as another means of training personnel.

Courses are delivered to personnel via an intranet-based Learning Management System (LMS) that has been installed. The LMS tracks the learner's progress and facilitates the learning process. Courses have been developed to meet Armscor's special needs (e.g. military culture, armaments acquisition), and off-the-shelf courseware for generic skills (business and computer skills) has been outsourced.

E-learning is gaining increased acceptance as a viable means of skills development, as demonstrated by the growing number of learners enrolled in the various courses.

Traditional classroom-based training has not been relegated to history, however, but remains the method of choice for certain types of courses or learners who are not computer literate or do not have access to the intranet.

Learnership

The Services SETA sponsored twenty Armscor personnel on their Supervisor Learnership

The Services SETA has sponsored twenty Armscor personnel on their Supervisor Learnership, leading to the qualification National Certificate, Generic Management, NQF level 4.

This learnership was begun in September 2006 and is due to be completed at the end of August 2007 and is uniquely and very satisfactorily being conducted using a blend of self-paced e-learning, coaching, and workshops. The mix is working well and Armscor expects all but one of the learners to graduate. The training provision of this course is outsourced.

Registered Qualifications for Armscor

Armscor registered the national qualification Diploma in Complex Procurement with SAQA in October 2005. In this year, the qualification Post Graduate Diploma in Defence Research was initiated. This qualification stems from a requirement of IMT to formalise its cadet training scheme, but has been broadened to cater for the impending DERI. The qualification is expected to be registered by mid-2008.

The qualification Post Graduate Diploma in Defence Research was initiated

Employment equity

Transformation remains a major challenge which has to be achieved while maintaining the core capabilities for the organisation. Targets set for the 2006/2007 financial year were as follows:

Transformation remains a major challenge which has to be achieved while maintaining the core capabilities for the organisation

- At least 80% of all external appointees in Armscor to be black
- At least 20% of external appointees in the technical functional groups to be women
- At least 62% of external appointees in the non-technical functional groups to be women
- At least 29,2% of employees in the broad bands STS and above to be women

The performance registered against these target was as follows:

- 95% of appointees were black
- Only 12% of external appointees in the technical groups are women (This target was not achieved due to the scarcity of women with technical skills in the labour market)
- 81% of external appointees in the non-technical functional groups are women.
- 28% of employees in the STS and above broad bands are women. (The organisation underachieved as a result of some positions having been frozen)

Although the organisation still has a long way to go, some progress has been made as black people now constitute 41% of the Armscor workforce as compared to 28% in 2001. The representation of women has been slower, mainly due to supply constraints. However, women now make up 37% of the Armscor employees as compared to 35% in 2001.

Defence Industry Support

In terms of section 4 (2) (k) of the Armaments Corporation of South Africa Limited Act, Act 51 of 2003, Armscor must provide marketing support to the

defence-related industry in respect of defence matériel, in consultation with the Department of Defence.

Armscor should focus on coordinating and rendering export support to the defence-related industry

Armscor focussed its defence industry support activities on coordinating and rendering export support to the defence-related industry, as recommended by the Minister of Defence and the Portfolio Committee of Defence, rather than on actual marketing activities.

The DOD actively supports the defence industry by making its personnel, equipment and facilities available to assist in the marketing initiatives of the domestic defence-related industry. Armscor facilitates the processes for satisfying requests from the defence-related industry for marketing support in the form of personnel, equipment, materiel aid and visits to SANDF facilities on behalf of the DOD. During the review period 69 requests were received from the defence-related industry for support and matériel aid and all were satisfied.

Exhibitions

Exhibitions provide good networking opportunities

Armscor with support of the Department of Trade and Industry (DTI) facilitated the participation of the defence-related industry in the following exhibitions: DSA2006 in Malaysia, SOFEX 2006 in Jordan, Milipol Qatar 2006, Eurosatory 2006 in France, AAD 2006 in South Africa, Aero India 2006 and IDEX 2006 in the UAE.

These exhibitions provide a platform for the South African defence-related industry to showcase its capabilities and to encourage exports.

Black Economic Empowerment (BEE)

The BEE Practice has been in operation for one year since its implementation on 1 June 2006.

BEE Spending Analysis (2006/07)

Operating budget	Total expenditure	Target	Actual
Percentage Amount	100% R44,051,351	45% R19,823,108	66.62% R29,347,260
Acquisition	**Total expenditure**	**Target**	**Actual**
Percentage Amount	100% R1,225,292,594	25% R306,323,148	20.95% R256,703,194

The Acquisition total expenditure figure excluded the Airbus A400M heavy lift transport aircraft, Super Lynx maritime patrol helicopters, and the strategic defence packages. A major problem area, however, is the scarcity of BEE suppliers in the South African defence-related industry.

Some highlights of the previous year were the gazetting of BBBEE Codes of Good Practice, increasing BEE awareness, some suppliers becoming proactive to transform, and BEE training of all relevant Armscor employees to support BEE objectives.

Safety, Health and Environment (SHE)

By their very size, scope and global distribution, Armscor's activities have an impact on the human, economic and natural environments in which we operate. We are committed to the highest standards of SHE performance and to the principles of sustainable development.

We are committed to the highest standards of Safety, Health and Environmental performance and to the principles of sustainable development

Armscor's SHE programme evolves every year as Armscor learns from experience and interactions with its stakeholders. It is, and will remain, deeply rooted in Armscor's corporate strategy. Armscor's vision is that the principles of sustainable development will become an instinctive part of everyday business. Armscor must deliver fair value to its stakeholders based on competence, vision, minimising risks and maximising the opportunities.

During the year under review, Armscor established a corporate SHE strategy that aims to provide a framework for managing the impact of services and activities undertaken by Armscor as the acquisition agent of the Department of Defence (DOD), to ensure the safety and health of employees, and to protect the environment within which Armscor operates.

Review of operations
continued

Armscor's policy on Safety, Health and Environment is that Armscor promotes a corporate culture in which full compliance with SHE regulations is a minimum level of acceptable performance and where business initiatives are consistent with SHE responsibilities. Armscor has defined a SHE policy statement that was signed by the CEO.

SHE audits were conducted at all Armscor sites and no significant weaknesses were identified.

Health and wellness

Armscor has a fully equipped clinic on site

Armscor has built up a substantial healthcare service over the past year, a base from which the Corporation continually seeks to develop and improve the programmes that promote employee health and wellbeing. Armscor employs two occupational health practitioners at its head office, and a qualified occupational medical practitioner (on contract). It has a fully equipped clinic on site that had an average utilisation of 39% in 2006/2007.

HIV/AIDS

Armscor's workplace programme incorporates three main elements – education, prevention and training initiatives; voluntary counselling and testing (VCT); and treatment programmes

The primary focus of Armscor's HIV/AIDS initiatives is the workplace, Armscor's employees and on-site contractors. The Corporation's objective is to maximise the number of employees who know their status and to ensure that every HIV positive employee receives treatment and counselling. Armscor also aims to create a supportive work environment free from discrimination for employees living with HIV/AIDS and to break down the stigma surrounding HIV/AIDS.

Armscor's workplace programme incorporates three main elements – education, prevention and training initiatives; voluntary counselling and testing (VCT); and treatment programmes.

Employee wellness

Armscor runs a number of wellness programmes across its operations aimed at promoting and enhancing the wellbeing of all its employees.

Armscor runs a number of wellness programmes aimed at promoting and enhancing the wellbeing of all its employees

The programmes in 2006/2007 addressed issues of obesity, nutrition, stress management, fatigue management, mental health and other health or personal problems. Specialists engaged include the wellness officer, the occupational health nurses, medical practitioners and other external resources.

In particular studies have shown that the levels of obesity in South African working individuals is approaching serious proportions and that it is one of the main risk factors of heart diseases, diabetes and stroke. Armscor has introduced campaigns to encourage exercise and promote a healthy lifestyle.

Armscor has introduced campaigns to encourage exercise and promote a healthy lifestyle

Corporate Social Investment

In fulfilling its role as good corporate citizen, Armscor focuses its social responsibility on the "bending them while they are still young" concept, contributing to the growth and development of our young nation. In this process Armscor provided material and other support to secondary schools in rural areas and disadvantaged communities.

Armscor focuses its social responsibility on the growth and development of our young nation

In February 2007 Armscor made a donation of R10 000 to the Steve Tshwete Secondary School situated in Olievenhoutbosch, Tshwane. This young school, which was established in 2002, has an impressive record with a pass rate of 96% in 2005 and 92% in 2006. The teachers here are parents and they work "overtime" without expecting reward; the children's perseverance and performance is reward enough for them.

Two new personal computers with a desktop multiplier solution, providing up to ten work stations to educators and learners, were handed over in March 2007 to the Gando Junior Secondary School at Qamata, near Queenstown in the Eastern Cape Province. This computer system will enable educators and learners to obtain literacy and to access the Internet for communication and education purposes.

Group annual financial statements

Contents

Report of the Audit and Risk Management Committee

The Audit and Risk Management Committee reports that it has adopted appropriate formal terms of reference as its Audit and Risk Management Committee charter, and that it has discharged all of its responsibilities as contained therein.

The Audit and Risk Management Committee is satisfied that an adequate system of internal control is being maintained to:

- reduce the entity's risk to an acceptable level;
- meet the business objectives of the group;
- ensure that the group's assets are safeguarded; and
- ensure that the transactions undertaken are recorded in the entity's records.

The Audit and Risk Management Committee has evaluated the annual financial statements of the Armscor group for the year ended 31 March 2007 and considers that the statements comply, in all material respects, with the requirements of the Public Finance Management Act (Act No 1 of 1999), as amended, as well as with South African Statements of Generally Accepted Accounting Practice.

The Audit and Risk Management Committee agrees that the adoption of the going concern premise is appropriate in preparing the annual financial statements. It has therefore recommended the adoption of this annual report to the Board of Directors at its meeting on 4 July 2007.

Ms CWN Molope
Chairperson
27 June 2007

Report of the Auditor-General

REPORT OF THE AUDITOR-GENERAL TO PARLIAMENT ON THE GROUP FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF THE ARMAMENTS CORPORATION OF SOUTH AFRICA LIMITED FOR THE YEAR ENDED 31 MARCH 2007

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying group financial statements of the Armaments Corporation of South Africa Limited which comprise the consolidated and separate balance sheet as at 31 March 2007, consolidated and separate income statement, consolidated and separate statement of changes in equity and consolidated and separate cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages 70 to 125.

Responsibility of the accounting authority for the financial statements

2. The accounting authority is responsible for the preparation and fair presentation of these financial statements in accordance with South African Statements of Generally Accepted Accounting Practice and in the manner required by the Public Finance Management Act, 1999 (Act No. 1 of 1999) (PFMA), the Companies Act of South Africa and the Armaments Corporation of South Africa, Limited Act, 2003 (Act No. 51 of 2003), as amended. This responsibility includes:

- designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
- selecting and applying appropriate accounting policies
- making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004), my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with the International Standards on Auditing and General Notice 647 of 2007, issued in Government Gazette No. 29919 of 25 May 2007. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity and group's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity and group's internal control.

6. An audit also includes evaluating the:

- appropriateness of accounting policies used
- reasonableness of accounting estimates made by management
- overall presentation of the financial statements.

7. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

8. In my opinion the financial statements present fairly, in all material respects, the financial position of the Armaments Corporation of South Africa Limited (Armscor) and group as at 31 March 2007 and their financial performance and cash flows for the year then ended, in accordance with the basis of accounting as described in accounting policy note 3 and in the manner required by the PFMA and Companies Act of South Africa.

Emphasis of matter

Without qualifying my audit opinion, I draw attention to the following matter:

9. Going concern

Attention is drawn to the directors' report in which the process of transforming Armscor at a strategic level is discussed and the impact that this will have on the group in future periods.

OTHER MATTERS

I draw attention to the following matter that is ancillary to my responsibilities in the audit of the financial statements:

10. Special investigation

During the period under review an independent investigation requested by management into contracts placed by Armscor with the Defence Institute (DI) was performed. The nature and results of this investigation is included in the directors' report.

OTHER REPORTING RESPONSIBILITIES

Reporting on performance information

11. I have audited the performance information as set out on pages 78 to 89.

Responsibilities of the accounting authority

12. The accounting authority has additional responsibilities as required by section 55(2)(a) of the PFMA to ensure that the annual report and audited financial statements fairly present the performance against predetermined objectives of the public entity.

Responsibility of the Auditor-General

13. I conducted my engagement in accordance with section 13 of the Public Audit Act, 2004 (Act No. 25 of 2004) read with General Notice 646 of 2007, issued in Government Gazette No. 29919 of 25 May 2007.
14. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
15. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings.

Audit findings

16. No audit findings came to the fore.

APPRECIATION

17. The assistance rendered by the staff of Armaments Corporation of South Africa Limited and the group during the audit is sincerely appreciated.

G J Lourens for Auditor-General

Pretoria
30 July 2007

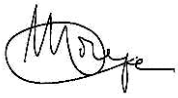
Directors' approval of the annual financial statements

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

The directors, supported by the Audit and Risk Management 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 88 to 123 was approved by the Board of Directors on 4 July 2007.

Signed on behalf of the Board by:



Dr PS Molefe
Chairman

Directors' report

The composition of the Board of Directors during the year under review was as follows:

ARMSCOR BOARD COMPOSITION		
NAME	STATUS	PERIOD
Dr PS Molefe	Non-Executive Chairman	Appointed 1 October 2004
Mr CV Gamede	Non-Executive Director	Appointed 1 September 2001
Col (Ret) GN Ramaremisa	Non-Executive Director	Appointed 1 September 2001
Ms AS Human	Non-Executive Director	Appointed 1 March 2002
Ms CWN Molope	Non-Executive Director	Appointed 1 April 2004
		Resigned 30 March 2007
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
Ms TN Msomi	Company Secretary	Appointed 7 January 2007
Mr JP de M du Plessis	Acting Company Secretary	Period 7 February 2006 – 30 December 2006

Auditors

Auditor General

Bankers

ABSA Bank

Registration number

1968/008611/06

Registered office

370 Nossob Street
Erasmuskloof Extension 4
Private Bag X337
0001 Pretoria

Company secretary

Ms T N Msomi
370 Nossob Street
Erasmuskloof Extension 4
Private Bag X337
0001 Pretoria

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Directors' report *continued*

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 continues its existence through the Armaments Corporation of South Africa, Limited Act (Act No 51 of 2003) and the Armaments Corporation of South Africa, Limited Amendment Act (Act No 16 of 2005), which came into effect on 8 May 2006.

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 provides 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 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.

The Board placed the following as priority on its agenda during the period under review:

- transformation, by putting emphasis on the principles of employment equity as regards staff appointments and incorporation of black economic empowerment in acquisition and procurement contracts;
- 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.

Schedule of attendance of Board and Board committee meetings

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

Details of attendees of Board and committee meetings 2006/2007

Names	Board of Directors Meetings	Audit and Risk Management Committee	Human Resources Management Committee	Executive Committee Meetings	Special Board of Directors Meetings	Special Committee Meetings
Dr PS Molefe	7 out of 11	Non-member	Non-member		2 out of 2	Non-member
Mr HS Thomo (CEO)	11 out of 11	1 out of 2#	5 out of 5		1 out of 2	2 out of 2
Mr CV Gamede	9 out of 11	Non-member	4 out of 5	-	1 out of 2	7 out of 7
Ms AS Human	11 out of 11	Non-member	5 out of 5	-	2 out of 2	5 out of 5
Gen (Ret) GN Ramaremisa	11 out of 11	Non-member	4 out of 5	-	1 out of 2	2 out of 2
Mr RP Meyer	10 out of 11	1 out of 2	Non-member		2 out of 2	3 out of 3
Ms CWN Molope	7 out of 11*	2 out of 2	Non-member	-	1 out of 2	3 out of 3
Ms P Riba	9 out of 11	1 out of 2	3 out of 5	-	2 out of 2	9 out of 10
Mr CJ Hoffmann (CFO)	11 out of 11	2 out of 2#	Non-member		2 out of 2	Non-member

*Officially resigned as Board member with effect from 30 March 2007.

#On invitation

External members

Names	Board of Directors Meetings	Audit and Risk Management Committee	Human Resources Management Committee	Executive Committee Meetings	Special Board of Directors Meetings	Special Committee Meetings
Mr MD Nkhabu	Non-member	2 out of 2	Non-member	Non-member	Non-member	Non-member
Ms L Mthimunye	Non-member	0 out of 2*	Non-member	Non-member		

*Officially resigned with immediate effect from 13 /11/2006.

Company Secretary

Mr JP de M du Plessis (Acting from 7/2/2006 – 30/12/2006	9 out of 9	2 out of 2	4 out of 5	-	-	-
Ms TN Msomi	2 out of 2	0 out of 1	1 out of 1	-	2 out of 2	8 out of 9

Board subcommittees

During the period of reporting the 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

The committee which operates in terms of an approved Charter consisted of three non-executive directors and two independent members. One independent member resigned during the period under review due to other responsibilities while the term of directorship of the non-executive director, chairing the meeting, expired at the end of the financial year. She will however remain as chairperson of the committee. The Chief Executive Officer, Chief Financial Officer, internal and external auditors attended meetings of the committee by invitation.

The committee focuses on accounting policies and procedures, internal control, financial reporting, the cooperation and co-ordination and effectiveness of audit effort and the identification and monitoring of the risk management process.

The Human Resources Committee

The Human Resources Committee comprises four non-executive members, one of whom is the chairperson. This committee deals with remuneration and broader HR issues.

The Executive Committee

The Executive Committee comprises non-executive members and is convened on an urgent basis to deliberate and decide on urgent matters of the Board.

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 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 23 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

One of the functions of the Strategic Management Process of Armscor is to continuously monitor the related environment so as to detect changes that have a significant impact on the achievement of Armscor's vision, mission and strategic objectives. This forms part of environmental monitoring and control of the Strategic Management Process.

The annual environmental scan confirmed that focused, committed leadership, the quality of the current workforce, teamwork, robust processes, a positive corporate image and good client relations provide an excellent foundation upon which Armscor can build its future. It also confirmed that the issues identified as giving cause for concern in the previous scan remain valid and have in some cases been exacerbated by developments over the past period. These will have to be monitored and attended to as a matter of urgency.

- **Funding:**
  South Africa's commitment to peace, stability and development will result in continued high levels of SANDF involvement in peace missions in Africa. The demands of capital renewal and extended operational deployments will put pressure on the budget of the Department of Defence and hence on the allocation to Armscor. This may be exacerbated by the requirements of funding the establishment and migration of the planned Defence Evaluation and Research Institute (DERI). In addition, the restructuring of Armscor as a schedule 3A Public Entity will limit the ability to generate funds through business activities such as the commercialisation of the Simon's Town Dockyard. Funding of the activities of Armscor will thus continue to pose a challenge.

- **Mandate:**
  The restructuring of Armscor and the creation of an autonomous DERI will have a substantial impact on Armscor's mandate and scope of activities. The transfer of certain Armscor Business functions to the DERI and the incorporation of others into Armscor will have far-reaching implications for the continued existence of Armscor Business. Armscor's new mandate as acquisition agency for the South African Department of Defence will be more restrictive and its possible transformation into a Defence Acquisition and Support Organisation (DASO) will have important legal, organizational, operational and contractual implications. Other issues that should be considered in the clarification of the mandate include the provision of services to the other security services in South Africa, the provision of such services to other countries, particularly within the African Union, and opportunities for international cooperation and joint ventures beyond Africa.

- **Workforce:**
  The ageing workforce and the relative scarcity of new specialized technical personnel have resulted in high cost structures, the erosion of core capabilities and a lack of capacity in certain areas. The competition for scarce human resources places increasing emphasis on focused recruitment and the training and mentoring of new recruits. The ability to attract and remunerate highly skilled employees at competitive levels is a key issue that has to be addressed if Armscor or the new DASO is to fulfil its mandate.

- **Defence research:**
  The establishment of an autonomous DERI will consolidate the defence research and evaluation capabilities currently existing within the state and parastatal environment, ensuring the efficient structuring and utilization of those capabilities. Since substantial defence science and technology, and test and evaluation capabilities currently reside in Armscor, the transfer of those functions to the DERI will have important implications, including financial, legal, governance and administrative and human resource issues. These will have to be resolved in the very near future.

Litigation matters

During the reporting period Armscor was involved in three civil matters. In one matter, legal action was instituted against Armscor and two others for the recovery of damages allegedly suffered as a result of administrative action taken. The first matter was settled between the parties. In the second matter, Armscor instituted legal action for the recovery of damages suffered as a result of breach of contract by a contractor. The third matter involves the arbitration of a dispute regarding penalties levied by Armscor on a contractor. Armscor was also involved in two labour disputes. One dispute emanated from alleged constructive dismissal, which was subsequently dismissed by the Labour Court, and the other from a grievance as a result of alleged unfair dismissal.

Armscor Business was involved in two civil matters during the reporting period. In the first matter Armscor Business was the plaintiff in a claim for the recovery of damages suffered as a result of unlawful occupation of premises of Armscor Business. The second matter involves the arbitration of a dispute regarding the reduction in the selling price of a vessel sold by Armscor Business.

Investigation performed

During the period under review an independent investigation requested by management into contracts placed by Armscor on the Defence Institute (DI), a business unit of Armscor Business, was completed. The investigation confirmed certain shortcomings identified but also recommended that the application with regard to some contractual conditions needs further clarification. Management initiated corrective actions to address the shortcomings identified which relate mainly to the contracting model followed and the procurement processes of DI. The contracting process will furthermore be strengthened to ensure that the intentions of both parties (Armscor and DI) are accurately reflected in the order conditions.

Going concern

Although the period under review has seen the beginning of the process of transforming Armscor at strategic level, a "going concern" approach has been adopted in the preparation of the financial statements. The Cabinet decision required that Armscor should focus on its key role as acquisition arm of the state. Therefore the directors have no reason to believe that Armscor will not remain a going concern in the foreseeable future.

Performance against goals

Operational Objectives 2006/2007 Financial Year

The Armscor Three Year Integrated Corporate and Business Plan defines thirteen Key Result Areas. The first eleven of these Key Result Areas are directly linked to Armscor's functions as defined in the Armscor Act.

The other two Key Result Areas deal with corporate governance and with Armscor's black economic empowerment (BEE) initiative, which is in support of government BEE policy.

A three-year strategy was developed for each of the aforesaid Key Result Areas, with specific Performance Indicators / goals for the 2007/2008 financial year in each area.

Performance against goals:

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

An overall efficiency measure used by Armscor is the cost of acquisition. This measure reflects the ratio of acquisition cost versus the total of acquisition activities. A goal of 2,9% was set for the 2006/2007 financial year. A result of 3,5% was achieved, compared with 3,9% for the 2005/2006 period. The goal for 2006/2007 was not fully achieved, however, because the total of acquisition activities was reduced due to the R1,640m extension of milestone deliveries on acquisition projects and requirements for R1,838m not received from the South African National Defence Force.

Armscor's subsidiary companies generated a net income of R27,8m of which Armscor Business (Pty) Ltd contributed R31,3m against a set target of R2,9m net income. The loss of the property companies amounts to R3,5m, which consists of depreciation on buildings. The much improved performance of Armscor Business (Pty) Ltd is mainly due to increased turnover as well as additional funding received from the DOD.

Armscor's Key Result Areas and performance against set objectives are contained in the following table:

OBJECTIVE	KEY PERFORMANCE INDICATOR	PERFORMANCE AGAINST GOAL
The Corporation must acquire defence matériel facilities and services		
1.1 Develop and maintain acquisition capabilities	Establish and implement a (acquisition) capability management model for Armscor by 1 September 2007 (e.g. to manage domain knowledge, technical skills, management skills and personnel capacity in each domain). • Goal (2005/2006): Establish and implement a capability management model on a trial basis by 31 March 2006 • **Goal (2006/2007): Refine capability management model by 31 March 2007** • Goal (2007/2008): Fully deploy capability management model by 1 September 2007	**Goal (2006/2007) was achieved** This initiative has achieved an operational state and initial use of the capability data for a variety of purposes has commenced. The execution of a Business Audit has been completed. The design of the Gap Analysis techniques will be carried out in the new financial year leading to an identification of future capability requirements.
1.2 Review and optimise processes and maintain ISO 9001 listing	Armscor is subjected to annual ISO 9001 audits. Zero significant audit findings allowed and ISO listing to be maintained at the end of each financial year (i.e. maintain the robust and accountable processes of the Corporation). • Goal (2005/2006): Maintain ISO 9001 listing by 31 March 2006 • **Goal (2006/2007): Maintain ISO 9001 listing by 31 March 2007** • Goal (2007/2008): Maintain ISO 9001 listing by 31 March 2008	**Goal (2006/2007) was achieved** Armscor was audited by the SABS and no major deviations were found. A new ISO 9001 certificate was issued to Armscor by the SABS which is valid until 14 June 2009.

OBJECTIVE	KEY PERFORMANCE INDICATOR	PERFORMANCE AGAINST GOAL
1.3 Enhance Armscor's acquisition services to the DOD	Implementation of the acquisition benchmark study findings (i.e. with a view to refining improving and streamlining acquisition / procurement processes, systems, tools and practices) • Goal (2005/2006): Implement recommendations from the acquisition benchmark study in accordance with the implementation plan • **Goal (2006/2007): Implement recommendations from the acquisition benchmark study in accordance with the implementation plan** • Goal (2007/2008): -	**Goal (2006/2007) was achieved** All incomplete recommendations of the benchmark study have been included in the various relevant initiatives such as implementation of COMAS and use of information technology (IT) tools to enhance the contracting process. These are included in key result 5. The rest of the recommendations are completed and this exercise is thus complete.
The Corporation must acquire defence-related technology		
2.1 Re-align process to comply with the new DOD Technology Policy	Updated Practice and Procedure documents • Goal (2005/2006): - • **Goal (2006/2007): Amend processes for Technology Management Update/establish and implement applicable management documents and processes (Practices and Procedures) by 31 March 2007** Goal (2007/2008): -	**Goal (2006/2007) was not achieved due to reasons beyond Armscor's control** No progress has been achieved as the DOD Policy has not yet been completed and promulgated.

OBJECTIVE	KEY PERFORMANCE INDICATOR	PERFORMANCE AGAINST GOAL
The Corporation must establish a programme management system		
3.1 Develop and maintain a project management system incorporating a Work Authority System with formal resource allocation and resource usage	Refined and implemented system to be fully operational by 31 March 2007 • Goal (2005/2006): Refine use of MS Projects as a Project Management System and Work Authority System by 31 March 2006 • **Goal (2006/2007): Implement MS Projects as a Project Management System and Work Authority System by 31 March 2007** • Goal (2007/2008): -	**Goal (2006/2007) was partly achieved** An initial project management system was established utilising Microsoft Projects. For various reasons such as very high cost of annual licence, complexity and lack of integration with the COMAS system, it was decided to investigate alternatives and it was found that the objectives could be met with a much simpler system based on the Microsoft Office Suite of Programs allied to a SQL database. A system was already being developed to generate a Business Plan for the SLA and extensions to and adaptation of this implementation were thus subsequently selected as a more suitable tool. As this system dealt to a large extent with the problems encountered it was decided to discontinue the use of Microsoft Project with the resultant cost savings. The alternative system, the business audit system, has been completed and its extensions which will be utilised for status reporting and Works Authorisation have been completed, and implementation and rollout are underway.

OBJECTIVE	KEY PERFORMANCE INDICATOR	PERFORMANCE AGAINST GOAL
The Corporation must provide for a Quality Assurance capability		
4.1 Maintain and expand a capability in the quality discipline	Accepted and approved Learnerships • Goal (2005/2006): Develop level 4 learnership by 31 March 2006 • **Goal (2006/2007): Develop level 5 learnership by 31 March 2007** • Goal (2007/2008): Implement Learnership by 31 March 2008	**Goal (2006/2007) was achieved** Level 5 learnership has been developed. First student intake is busy with the learnership. Completion in August 2007.
4.2 Maintain and expand a capability in the quality discipline	Establish baseline for Quality Assurance capabilities, develop and implement Capability Management Model • Goal (2005/2006): Determine capabilities (i.e. skills, capacity for medium term (i.e. 5 – 10 years))and capture in a baseline by 31 March 2006 • **Goal (2006/2007) Design/develop capability management model and implement on a trial basis by 31 March 2007** • Goal (2007/2008): Implement capability management model by 31 March 2008	**Goal (2006/2007) was achieved** Feedback on the practical execution of the model during the trial run has been received from Line Managers. A report has been compiled with lessons learnt which will be worked into the model if the model is to be deployed to the rest of the Department.

OBJECTIVE	KEY PERFORMANCE INDICATOR	PERFORMANCE AGAINST GOAL
The Corporation must establish a system for tender and contract management		
5.1 Transform current KBA System (Contract Management and Admin system) to be more cost effective and include additional functionalities as defined in the User Requirement Statement	• Goal (2005/2006) Complete planning and initiate transformation of system by 31 March 2006 • **Goal (2006/2007): Run the system on trial/pilot basis between 1 April 2006 and 31 March 2008** • Goal (2007/2008): System fully operational: 31 March 2008	**Goal (2006/2007) was not achieved** The URS was completed 31 October 2006. The second phase of the project which is solution selection is awaiting Board of Directors approval of the funds and the ICT strategy.
The Corporation must dispose of defence matériel in consultation with the instance that originally manufactured it		
6.1 Dispose of excess forfeited defence matériel in consultation with OEM and to the best advantage of the State	Sales turnover to be reached for each financial year as indicated below • Goal (2005/2006): 90% of Sales Plan by 31 March 2006 • **Goal (2006/2007): 90% of Sales Plan by 31 March 2007** • Goal (2007/2008): 90% of Sales Plan by 31 March 2008	**Goal (2006/2007) was achieved** The total sales for the year amounted to R121m, which is R8m (7%) higher than the budgeted sales target of R113m.

OBJECTIVE	KEY PERFORMANCE INDICATOR	PERFORMANCE AGAINST GOAL
The Corporation must establish a Compliance Administration System		
7.1 Establish, maintain and manage an Arms Control System in cooperation with the DOD, ensuring compliance by Armscor and the SANDF with international and national requirements aimed at arms control and non-proliferation of weapons of mass destruction	• Goal (2005/2006): Determine scope of project in cooperation with the DOD by 31 March 2006 Plan implementation by 31 March 2006 • **Goal (2006/2007): Established structures and management documentation necessary to implement project by 31 March 2007** • Goal (2007/2008): Implement by 1 September 2007	**Goal (2006/2007) was not achieved due to reasons beyond Armscor's control** 1. Discussions have been held with Armscor and DOD role players. 2. DOD is in the process of drafting an arms control policy document that will enable Armscor to identify its roles and responsibility in this regard. 3. Only then will it be possible to come up with a project plan, from which the establishment of structures and management documentation will commence.
The Corporation must provide marketing support to the defence-related industries		
8.1 Perform study (with the DOD and industry participation) to determine scope and requirements for marketing support	Study Report to be tabled at Armscor's Board of Directors • Goal (2005/2006): - • **Goal (2006/2007): Study Report to be tabled by 31 March 2007** • Goal (2007/2008): Implement findings and recommendations of the report by 31 March 2008	**Goal (2006/2007) was achieved** Study was done and the report thereon compiled and tabled on 26 March 2007. The implementation of the findings is placed on hold until after the transformation of Armscor to ensure that the findings are in line with the envisaged mandate for DASO.

OBJECTIVE	KEY PERFORMANCE INDICATOR	PERFORMANCE AGAINST GOAL
The Corporation must support, maintain and manage strategic and essential defence industrial capabilities, resources and technologies		
9.1 Perform study with the DOD to determine which of the Armscor facilities are strategic and essential defence industrial capabilities, resources and technologies for the DOD and determine the best funding model for these facilities	Study report reflecting: 1. Armscor facilities regarded as strategic and essential 2. Funding model for these identified facilities • Goal (2005/2006) Determine scope of project in cooperation with the DOD To be finalised by 31 March 2006 • **Goal (2006/2007):** **Table report with the appropriate findings, at:** **1. Armscor Management Board** **2. Armscor Board of Directors** **3. Defence Staff Council by 31 March 2007** • Goal (2007/2008): Execute findings and implement funding model by 31 March 2008	**Revised Goal (2006/2007) was achieved** This key performance indicator was changed by the decisions of the Ministers of Defence, Public Enterprises and Science and Technology to establish a National DERI by 1 April 2008. The core facilities that were identified as being strategic and essential defence capabilities and technologies for the DOD are as follows: • Armscor Business – IMT, Protechnik, Hazmat, Ergotech, Defence Institute, Flamengro, Eclipse, Armour Development, Gerotek and Alkantpan • CSIR – DPSS • Denel – OTB (Overberg Test Range) Governance and Migration Management Teams were appointed and drafted the Cabinet Memorandum, establishment and migration plan of the DERI and the migration budget. The two teams are currently busy drafting the business case to be approved by the National Treasury and DPSA.

OBJECTIVE	KEY PERFORMANCE INDICATOR	PERFORMANCE AGAINST GOAL
9.2 Armscor facilities (Alkantpan Test Range, Institute for Maritime Technology and Gerotek Test Facility) that are currently not self-sustainable to achieve self-sustainability by 31 March 2008	Approved breakeven strategy document with implementation plan to measure the success of this objective • Goal (2005/2006): Breakeven strategy / plan document by 31 March 2005 • **Goal (2006/2007): Compliance to breakeven strategy / plan** • Goal (2007/2008): Compliance to breakeven strategy / plan	**Goal was achieved** Compliance to the implementation of the breakeven strategies of Gerotek, Alkantpan and IMT were achieved with Gerotek and Alkantpan showing positive results already. Delivery of some of the capital replacement orders did take place by the end of March 2007 but will be effected during the first quarter of the new financial year. Three more facilities have been identified as loss-making facilities and breakeven strategies were developed and implemented for Protechnik and Hazmat. Presentations were made to the DPBEC to highlight the critical position of Protechnik, Hazmat and DMD, but no funding was made available. All three facilities achieved positive results for the year.
The Corporation must provide defence operational support		
10.1 Develop and maintain Defence Operational Support capabilities	Establish baseline for Defence Operational Support capabilities in a changing Defence Services environment • Goal (2005/2006): Determine capabilities for the medium term and capture in a baseline by 31 March 2006 • **Goal (2006/2007): Design / develop capability management model by 31 March 2007** • Goal (2007/2008): Implement capability management model for defence operational support by 31 March 2008	This goal should now be incorporated with 9.1 above and will be reported on accordingly. The working group will study all operational support requirements and make a recommendation.

OBJECTIVE	KEY PERFORMANCE INDICATOR	PERFORMANCE AGAINST GOAL
The Corporation must establish a Defence Industrial Participation Programme Management System		
11.1 Manage Defence Industrial Participation obligations	Approval of DIP credits in line with Strategic Defence Packages and other acquisition contracts • Goal (2005/2006): R1.3 billion credits to be approved • **Goal (2006/2007): R1.8 billion credits to be approved** • Goal (2007/2008): R1.3 billion credits to be approved	**Goal (2006/2007) was achieved** The initial target of R1,8b for 31 March 2007 was adjusted to R1,6b mainly due to the extension of a significant portion of the Thales Naval France obligation to 2010. DIP credits to the value of R2,2 billion have been awarded.
Corporate governance		
12.1 Comply with statutory requirements as contained in the Public Finance Management Act	Audit to be done by Armscor's Internal Auditors to ensure Armscor complies with the PFMA • Goal (2005/2006): Zero significant findings by 31 March 2006 • **Goal (2006/2007): Zero significant findings by 31 March 2007** • Goal (2007/2008): Zero significant findings by 31 March 2008	**Goal (2006/2007) was achieved** Except for the Shareholder's Compact that was not formalised for the review period, Armscor has complied with statutory requirements and good corporate governance.

OBJECTIVE	KEY PERFORMANCE INDICATOR	PERFORMANCE AGAINST GOAL
12.2 Manage Armscor's finances and assets in line with GAAP and national prescriptions for Public Entities	Armscor's external audit report to contain zero significant findings • Goal (2005/2006): Zero significant external audit findings in the external audit report for the financial year 2004/2005 • **Goal (2006/2007): Zero significant external audit findings in the external audit report for the financial year 2005/2006** • Goal (2007/2008): Zero significant external audit findings in the external audit report for the financial year 2006/2007	**Goal (2006/2007) was achieved** Armscor received an unqualified audit report for the 2006/2007 financial year. Without qualifying the audit opinion, three policies that were not formally approved were mentioned for further management action.
13.1 Improvement of Armscor's Black Economic Empowerment initiatives	Increase Armscor's spending in respect of the Armscor operating budget and the SDA and GDA accounts on BEE companies • Goal (2005/2006): Operating Budget: 45% to be spent on BEE Companies by 31 March 2007 SDA & GDA: 25% to be spent on BEE Companies by 31 March 2007 • **Goal (2006/2007): Operating Budget: 45% to be spent on BEE Companies by 31 March 2007 SDA & GDA: 25% to be spent on BEE Companies by 31 March 2007** • Goal (2007/2008): Operating Budget: 45% to be spent on BEE Companies by 31 March 2008 SDA & GDA: 27% to be spent on BEE Companies by 31 March 2008	**Goal (2006/2007)** **Operating Budget (achieved)** A total of 66.62% was spent on Armscor's operating budget for business purchases between 1 April 2006 and 31 March 2007. Total purchases excluding parastatals were R44 051 350.76. The total spent on BEE companies was R29 347 259.46. **SDA and GDA (not achieved)** The total value of acquisition activities related to the Special Defence Account (SDA) and the General Defence Account (GDA) amounted to R1,225 292 594.00, excluding SDP's, A400m, maritime helicopter and Parastatals. In respect of expenditure on BEE companies an amount of R256 703 194.00 was spent. This represents 20.95% spending on BEE entities.

OBJECTIVE	KEY PERFORMANCE INDICATOR	PERFORMANCE AGAINST GOAL
13.2 Improve the demographic profile of Armscor to reflect the national and regional demographic profile	• At least 80% of all external appointees in Armscor to be black • At least 20% of external appointees in the technical functional groups to be women • At least 62% of external appointees in the non-technical functional groups to be women • At least 29,2% of employees on the supervisory level and above to be women • Goal (2005/2006): Performance indicator to be achieved / maintained by 31 March 2006 In addition at least one more person with a disability to be appointed by 31 March 2006 • **Goal (2006/2007): Performance indicator to be achieved / maintained by 31 March 2007** • Goal (2007/2008): Performance indicator to be achieved / maintained by 31 March 2008	**Goal (2006/2007): performance against goal** • A total 95 % of the appointees were black. **(Achieved)** • Only 12% of external appointees in the technical functional groups are women. This target was not achieved due to the scarcity of women with technical skills in the labour market. **(Not achieved)** • A total of 81,08% of external appointees in the non-technical functional groups are women. **(Achieved)** • 28% of employees in the STS and above broad bands are women. The organisation underachieved as a result of some positions having been frozen. **(Not achieved)**

Post-balance sheet events

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

Group five year review

at 31 March 2007

	2007 Rm	2006 Rm	2005 Rm	2004 Rm	2003 Rm
BALANCE SHEETS					
ASSETS					
Property, plant and equipment	197,9	194,6	200,2	206,7	192,2
Intangible assets	0,2	-	-	-	-
Net current assets	272,5	218,0	197,6	195,2	189,1
	470,6	412,6	397,8	401,9	381,3
EQUITY AND LIABILITIES					
Ordinary shareholders' interest	470,6	412,6	397,8	401,9	381,3
INCOME STATEMENTS					
REVENUE					
Sale of goods	1 236,9	736,2	760,5	807,1	666,6
Allocation from the State budget for operating and technology expenditure	347,6	315,4	284,1	249,6	209,4
Interest received	25,7	19,7	21,7	26,9	31,0
Rental income	23,8	21,6	19,7	17,9	16,3
	1 634,0	1 092,9	1 086,0	1 101,5	923,3
SURPLUS/(DEFICIT) FOR THE YEAR	58,0	14,8	(4,1)	9,8	31,0
TOTAL VALUE OF ACQUISITION ACTIVITIES					
Special Defence Account	8 003,5	7 408,3	6 549,0	7 443,8	6 563,3
General Defence Account	832,1	834,0	728,5	783,0	1 054,3
Other	195,3	163,6	109,3	111,6	251,1
	9 030,9	8 405,9	7 386,8	8 338,4	7 868,7

Group value-added statement

for the year ended 31 March 2007

The statement shows the wealth the group has created through its acquisition, maintenance and disposal activities aimed at meeting the defence matériel 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 re-invested in the group for the replacement of assets, the development of operations and the maintenance of required capabilities.

	2007 Rm	%	2006 Rm	%
Revenue	1 608,3		1 073,2	
Other income not included in revenue	19,6		14,5	
Income from investments	25,7		19,7	
Less: Paid to suppliers for materials and services	(1 220,3)		(726,1)	
TOTAL VALUE ADDED	433,3	100	381,3	100
DISTRIBUTED AS FOLLOWS:				
To employees as salaries, wages and other benefits	350,0	85	339,7	81
To Government as taxation	8,2	2	6,5	2
TOTAL VALUE ADDED DISTRIBUTED	**358,2**	**87**	**346,2**	**83**
Portion of value added reinvested to sustain and expand the business	75,1	13	35,1	17
TOTAL VALUE ADDED DISTRIBUTED AND REINVESTED	433,3	100	381,3	100
TAXATION				
Paid in taxes to Government	8,2		6,5	
• Regional Services Council Levies	0,3		1,1	
• Rates and taxes to local authorities	7,9		5,4	
Collected on behalf of, and paid over to Government	117,6		119,5	
• Employees taxation deducted from remuneration paid	83,5		80,3	
• Unemployment Insurance Fund	1,3		1,1	
• Net value added taxation (VAT)	32,8		38,1	

Financial results

for the year ended 31 March 2007

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 R470,6 million shows an increase compared with the previous year's figure of R412,6 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 2006/2007 financial year Armscor Corporation received R347,6 million (2006: R315,4 million), VAT excluded, from the State in the form of a transfer payment. Of this amount R335,9 million (2006: R312,8 million) was used to defray operating expenditure and R11,7 million (2006: R2,6 million) for the acquisition of assets.

The surplus of the group increased by R43,2 million, compared with an increase of R18,9 million, the previous year.

The most significant reasons for the increase in the surplus are as follows:

	2007 Rm	2006 Rm
• Increase in Government allocation	32,2	31,3
• Increase in net operating expenditure of Armscor	(28,7)	(23,9)
• Increase in rental income	2,3	1,9
• Increase in profit of subsidiaries	34,0	9,0
• Increase in net interest received	3,4	0,6
NET INCREASE	43,2	18,9

The increase in the Government grant is to defray the cost of the group's operations for the year under review and 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. Armscor's operating expenditure was lower than what was budgeted for mainly due to concerted efforts to reduce cost and personnel appointments not materialising as planned, as well as savings on subsistence and travel as acquisition projects were delayed. The surplus for post retirement medical benefits also contributed significantly towards the surplus.

The surplus of the subsidiaries for the year under review was R27,8 million compared to a loss of R6,2 million for the previous year and is detailed as follows:

	2007 Rm	2006 Rm
• Surplus/(Deficit) from operations	19,9	(11,5)
• Net finance income	7,9	5,3
	27,8	(6,2)

Armscor Business has exceeded its budgeted targets and this can be attributed to increased sales of excess and redundant defence matériel after receipt of NCACC approvals, additional funding received from the DOD and increase in freight business due to earlier delivery of Strategic Defence Packages. The surplus for post retirement medical benefits also contributed significantly towards the surplus.

Income statements

for the year ended 31 March 2007

CORPORATION				GROUP	
2006 Rm	2007 Rm		NOTE	2007 Rm	2006 Rm
359,2	399,6	**REVENUE**	4	1 634,0	1 092,9
359,2	399,6	ARMSCOR OPERATING INCOME		389,2	351,4
-	-	SALES GENERATED BY SUBSIDIARIES		1,127,5	687,7
-	-	DEFENCE MATÉRIEL DISPOSAL		117,3	53,8
-	-	**COST OF GOODS SOLD**		(1 099,6)	(604,9)
-	-	CORPORATION		-	-
-	-	SUBSIDIARIES		(1 002,1)	(562,6)
-	-	DEFENCE MATÉRIEL DISPOSAL		(97,5)	(42,3)
359,2	399,6	**GROSS MARGIN**		534,4	488,0
359,2	399,6	CORPORATION		389,2	351,4
-	-	SUBSIDIARIES		125,4	125,1
-	-	DEFENCE MATÉRIEL DISPOSAL		19,8	11,5
(332,9)	(361,6)	**NET OPERATING EXPENDITURE**		(476,4)	(473,2)
(332,9)	(361,6)	CORPORATION		(359,0)	(330,4)
-	-	SUBSIDIARIES		(103,8)	(122,3)
-	-	DEFENCE MATÉRIEL DISPOSAL		(13,6)	(20,5)
26,3	38,0	**SURPLUS FROM OPERATIONS**	5	58,0	14,8
26,3	38,0	CORPORATION		30,2	21,0
-	-	SUBSIDIARIES		21,6	2,8
-	-	DEFENCE MATÉRIEL DISPOSAL		6,2	(9,0)
(5,3)	(7,8)	FINANCE CHARGES	6	-	-
21,0	30,2	SURPLUS FOR THE YEAR		58,0	14,8

Balance sheets

as at 31 March 2007

CORPORATION				GROUP	
2006 Rm	2007 Rm		NOTE	2007 Rm	2006 Rm
		ASSETS			
		NON-CURRENT ASSETS			
11,4	19,5	PROPERTY, PLANT AND EQUIPMENT	8	197,9	194,6
-	-	INTANGIBLE ASSETS	9	0,2	-
529,8	580,7	**CURRENT ASSETS**		465,0	419,2
236,5	236,5	Investments in subsidiaries	10	-	-
0,8	0,8	Inventories	11	2,3	3,0
19,7	52,2	Accounts receivable	12	174,7	147,7
23,8	24,7	Cash allocated to insurance reserve	13	24,7	23,8
249,0	266,5	Cash and cash equivalents	13	263,3	244,7
541,2	600,2	TOTAL ASSETS		663,1	613,8
		EQUITY AND LIABILITIES			
		CAPITAL AND RESERVES			
75,0	75,0	ORDINARY SHARE CAPITAL	14	75,0	75,0
298,3	328,5	NON-DISTRIBUTABLE RESERVES		395,6	337,6
373,3	403,5	ORDINARY SHAREHOLDERS' INTEREST		470,6	412,6
167,9	196,7	**CURRENT LIABILITIES**		192,5	201,2
86,2	108,9	Short term loan	15	-	-
67,7	72,5	Accounts payable	16	170,3	180,4
14,0	15,3	Provisions	17	22,2	20,8
541,2	600,2	TOTAL EQUITY AND LIABILITIES		663,1	613,8

Statements of changes in equity

for the year ended 31 March 2007

	ORDINARY SHARE CAPITAL	GENERAL RESERVE	MARKETING PROMOTION RESERVE	CAPITAL AND BUILDING MAINTENANCE RESERVE	COMPUTER UPGRADING RESERVE	INTERNAL INSURANCE RESERVE	TOTAL
	Rm	Rm	Rm	Rm	Rm	Rm	Rm
CORPORATION							
Balance at 1 April 2005	75,0	205,5	9,5	22,6	15,0	24,7	352,3
Surplus for the year	-	21,0	-	-	-	-	21,0
Transfer to/(from) non-distributable reserves	-	0,9	-	-	-	(0,9)	-
Balance at 31 March 2006	75,0	227,4	9,5	22,6	15,0	23,8	373,3
Surplus for the year	-	30,2	-	-	-	-	30,2
Transfer to/(from) non-distributable reserves	-	(1,1)	0,2	-	-	0,9	-
Balance at 31 March 2007	75,0	256,5	9,7	22,6	15,0	24,7	403,5
GROUP							
Balance at 1 April 2005	75,0	245,9	9,5	27,7	15,0	24,7	397,8
Surplus for the year	-	14,8	-	-	-	-	14,8
Transfer to/(from) non-distributable reserves	-	2,7	-	(1,8)	-	(0,9)	-
Balance at 31 March 2006	75,0	263,4	9,5	25,9	15,0	23,8	412,6
Surplus for the year	-	58,0	-	-	-	-	58,0
Transfer to/(from) non-distributable reserves	-	(1,1)	0,2	-	-	0,9	-
Balance at 31 March 2007	75,0	320,3	9,7	25,9	15,0	24,7	470,6

All reserves are considered to be non-distributable. The reserves are required for the total net capital requirement of the group.

Cash-flow statements

for the year ended 31 March 2007

CORPORATION				GROUP	
2006 Rm	2007 Rm		NOTE	2007 Rm	2006 Rm
4,7	30,1	**CASH FLOW FROM OPERATING ACTIVITIES:**		40,0	14,9
315,4	347,6	Cash receipts from customers		1 577,9	1,032,5
(330,4)	(343,1)	Cash paid to suppliers and employees		(1 563,6)	(1 037,3)
(15,0)	4,5	Cash utilised by operations	A	14,3	(4,8)
19,7	25,6	Net finance income		25,7	19,7
		CASH FLOW FROM INVESTING ACTIVITIES:			
(3,9)	(11,7)	Investment to maintain operations		(20,5)	(14,6)
(3,9)	(11,7)	Assets purchased		(20,5)	(14,8)
-	-	Proceeds from sale of assets		0,2	0,2
-	-	Intangible assets acquired		(0,2)	-
0,8	18,4	**NET INCREASE IN CASH AND CASH EQUIVALENTS FOR THE YEAR**		19,5	0,3
272,0	272,8	**CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR**		268,5	268,2
272,8	291,2	**CASH AND CASH EQUIVALENTS AT END OF YEAR**	B&13	288,0	268,5

Notes to the cash-flow statements

for the year ended 31 March 2007

CORPORATION			GROUP	
2006 Rm	2007 Rm		2007 Rm	2006 Rm
		A.CASH (UTILISED)/GENERATED BY OPERATIONS		
21,0	30,2	Surplus for the year	58,0	14,8
4,1	3,6	Adjustments for:	17,0	20,2
2,8	3,6	Depreciation	16,6	18,4
1,3	-	Assets written off	0,6	1,9
-	-	(Profit) on disposal of fixed assets	(0,2)	(0,1)
(19,7)	(25,6)	Net finance income	(25,7)	(19,7)
5,4	8,2	Operating surplus before working capital changes	49,3	15,3
(20,4)	(3,7)	Working capital changes	(35,0)	(20,1)
(9,6)	(32,5)	(Increase) in accounts receivable	(27,0)	(19,2)
0,1	-	Decrease in inventories	0,7	0,2
(10,8)	22,7	Increase/(Decrease) in short term loans	-	-
(0,1)	6,1	Increase/(Decrease) in accounts payable and provisions	(8,7)	(1,1)
(15,0)	4,5		14,3	(4,8)
		B.CASH AND CASH EQUIVALENTS		
272,8	291,2	Cash on hand and balances with banks	288,0	268,5
23,8	24,7	Cash allocated to insurance reserve	24,7	23,8
249,0	266,5	Cash and cash equivalents	263,3	244,7

1. Mandate

Armscor receives its mandate for the period under review from the Armaments Corporation of South Africa, Limited Act (Act No 51 of 2003) and the Armaments Corporation of South Africa, Limited Amendment Act (Act No 16 of 2005), which came into effect from 8 May 2006 by proclamation 20 published in Government Gazette 28779 of 5 May 2006 in terms of which the Corporation is empowered to meet:

- the defence matériel requirements of the Department of Defence (DOD) effectively, efficiently and economically; and
- the defence technology, research, development, analysis, test and evaluation requirements of the Department of Defence effectively, efficiently and economically.

The Act furthermore provides that Armscor must adhere to accepted corporate governance principles, best business practices and generally accepted accounting practices within a framework of established norms and standards that reflect fairness, equity, transparency, economy, efficiency, accountability and lawfulness.

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 and maintenance 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, as well as additional funding received from the DOD if required.

2.3 Procurement of armaments

Armaments purchases and maintenance 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) and the General Defence Account. Strategic Defence Packages are financed wholly or partially by means of draw downs against credit facilities supplied by National Treasury.

3. Accounting policy

The principal accounting policies adopted by the group, of which the year ends of the different subsidiary companies are the same and 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 have been prepared on a historical cost basis, except for some financial instruments that have been measured at fair value.

The financial statements are presented in rand and all values are rounded to the nearest million.
New standards, amendments and interpretations not yet effective.

At the date of these financial statements, the following standards, amendments and interpretations were in issue but not yet effective:

	Effective date for year ends commencing after:
AC144 (IFRS 7) - Financial Instruments: Disclosures	01/01/2007
AC145 (IFRS 8) - Operating Segments	01/01/2009
AC101 (IAS 1) - Amendment - Capital Disclosures	01/01/2007
AC441 (IFRIC 8) - Scope of IFRS2	01/05/2006
AC442 (IFRIC 9) - Reassessment of Embedded Derivatives	01/06/2006
AC443 (IFRIC 10) - Interim Financial Reporting and Impairment	01/11/2006
AC444 (IFRIC 11) - (IFRS2) - Group and Treasury Transactions	01/03/2007
AC445 (IFRIC 12) - Service Concession Arrangements	01/01/2008

Except for additional disclosures in the financial statements, the adoption of these standards and amendments is not expected to materially affect the results of the financial position of the group.

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 inter company 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 in the financial statements.

3.3 Significant accounting judgements and estimates

3.3.1 Judgements

In the process of applying the group's accounting policies, management has made the following judgements, apart from those involving estimates, which have the most significant effect on the amounts recognised in the financial statements:

Plant and equipment utilised by contractors

The Corporation owns certain plant and equipment that are utilised by its contractors for the maintenance, manufacturing or supply of goods and services for the benefit of its clients. These assets are fully depreciated as the period of use varies between three and ten years. These assets are mainly kept for strategic purposes, therefore no adjustment has been made and the assets are carried at zero book value.

Plant and equipment transferred during origination of Armscor Business (Pty) Ltd

During the origination of Armscor Business (Pty) Ltd on 1 April 2003, the plant and equipment of separate strategic subsidiaries were transferred to Armscor Business (Pty) Ltd at their ruling book values. As the group applies the cost model for recognition, assets were not revalued and assets transferred at a zero book value, are still reflected at such values.

Pension and other post employment benefits

The cost of defined post employment medical benefits is determined using actuarial valuations. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates and future pension increases. Due to the long term nature of these plans, such estimates are subject to significant uncertainty. (Further details are given in note 20)

3.4 Property, plant and equipment

3.4.1 Land and buildings

3.4.1.1 Buildings on freehold land

Land is stated at cost and is not depreciated. Buildings are stated at cost less accumulated depreciation on buildings and accumulated impairment. Depreciation is calculated on a straight line basis over the useful life of the buildings over periods that vary between twenty and fifty years.

3.4.1.2 Buildings on State property

Buildings are stated at cost less accumulated depreciation and accumulated impairment in value. Depreciation is calculated on a straight line basis over the useful life of the assets which is estimated as fifty years.

3.4.1.3 The buildings' residual values, useful lives and depreciation methods are reviewed, and adjusted if appropriate, at each financial year end.

3.4.2 Plant and equipment (including plant, machinery, equipment, office equipment, furniture, computers, vehicles and vessels)

3.4.2.1 Plant and equipment is stated at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and accumulated impairment in value. The cost of replacing part of such plant and equipment is capitalized when that cost is incurred if the recognition criteria are met. 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 three and ten years.

3.4.3 An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognising of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the income statement in the year the asset is derecognised.

3.4.4 The assets' residual values, useful lives and depreciation methods are reviewed, and adjusted if appropriate, at each financial year end.

3.4.5 Non-current assets held for sale

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification. Non-current assets (and disposal groups) classified as held for sale are measured at the lower of the assets' previous carrying amount and fair value less costs to sell.

3.5 Intangible assets

A patent have been granted for an indefinite period by the relevant Government agency with the option of annual renewal.

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

The useful lives of intangible assets are assessed to be finite. Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life is reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortisation period or method, as appropriate, and treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in the income statement in the expense category consistent with the function of the tangible asset.

Gains or losses arising from de-recognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the income statement when the asset is derecognised. Depreciation is calculated to write off the cost of capitalised intangible assets on a straight line basis over their expected useful lives over ten years.

3.6 Inventories

Inventories are stated at the lower of cost (purchase cost) and net realisable value. Raw materials are calculated using the first in, first out method, except in the case of Hazmat Protective Systems where it is calculated at weighted average. Write downs to net realizable value and inventory losses are expensed in the period in which the write down or losses occur. Finished goods and work in progress are stated at actual cost of direct materials and labour and a proportion of manufacturing overheads based on normal operating capacity but excluding borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

3.7 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.

Capital and building maintenance reserve

The reserve was established for comprehensive upgrading and replacement of obsolete capital equipment and maintenance of major building systems.

Computer upgrading reserve

The purpose of this reserve is for the upgrading and replacement of obsolete, outdated computer technology.

Marketing promotion reserve

The reserve was established for the financing of exhibition costs in order to promote the local weapons industry which is part of Armscor's mandate, but which is not provided for via the transfer payment from the Department of Defence.

Internal Insurance Reserve

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 and an amount is held in an internal insurance fund to cover these risks.

3.8 Foreign currency conversion

Transactions and balances

Transactions denominated in foreign currencies are converted at the rate of exchange ruling at the transaction date. Monetary items denominated in foreign currencies are converted at the rate of exchange ruling at the balance sheet date. Gains or losses arising on conversion are recognised in the income statement.

3.9 Revenue recognition

Revenue

Revenue comprises net invoiced sales to customers excluding VAT and all discounts. 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 actual cost of work performed on the contract at balance sheet date.

Interest 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

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

Rental income

Rental income arising on properties is accounted for on a straight-line basis over the lease terms on ongoing leases.

Government grant

Armscor's operating funds are obtained via the defence budget and recognized as a grant as and when received 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.

3.10 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 are identified and insured while paying specific attention to the specialised nature of the group's various activities and exposures. 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 (2006: R23,8 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.

3.11 Financial instruments

Financial assets and liabilities are recognised on the group's balance sheet when it becomes a party to the contractual provisions of the instrument.

3.11.1 Measurement

Financial instruments are initially measured at fair value, which includes transaction costs that are directly attributable to acquisition or issue of the financial asset. Subsequent to initial recognition these instruments are measured as set out below.

3.11.1.1 Investments

Marketable securities are carried at fair 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 carried at cost less accumulated impairment losses. Fixed deposits with a maturity date greater than three months are classified as held to maturity investments.

3.11.1.2 Trade and other receivables

Trade and other receivables are non-derivative assets that arise from transactions with providers, recognised and carried at original invoice amount less an allowance for any uncollectable amounts. Subsequent to initial recognition, they are measured at cost less impairment provision. Provision for impairment of trade receivables is established when there is objective evidence that the group will not be able to collect all amounts due according to the original terms of the receivables. Bad debts are written off when identified.

Personal loans are interest bearing over periods that vary between one and twelve months in terms of general terms and conditions of employment.

3.11.1.3 Cash and cash equivalents

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

For the purpose of the cash flow statement, cash and cash equivalents comprise of cash on hand, deposits held on call and investment instruments all of which are readily convertible (within 3 months) to cash, available for use by the group unless otherwise stated and are subject to an insignificant risk of change in value.

3.11.1.4 Financial liabilities

Financial liabilities are initially recognised at fair value net of transaction costs incurred. The fair value would be determined as the present value of cash flows required to settle the liabilities. The group has no long term financial liabilities. As a result, no fair value adjustments arise.

3.11.1.5 Financial guarantees

Financial guarantees issued are carried at fair value. The fair value would be determined as the present value of future cash flows to settle the liabilities. However, due to the short-term maturities, their fair values approximate cost.

3.11.2 Derecognition of financial assets and liabilities

3.11.2.1 Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised where the rights to receive cash flows from the asset have expired.

3.11.2.2 Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

3.11.2.3 Gains and losses

The difference in the respective carrying amounts on the derecognition of financial assets and liabilities is recognised in the income statement.

3.11.2.4 Financial guarantees

Financial guarantees issued are derecognised when the obligations under the liability are discharged.

3.11.3 Impairment of financial assets

Financial assets carried at amortised cost

The group assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (a "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

If there is objective evidence that an impairment loss has been incurred on a financial asset, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The amount of the impairment shall be recognised in the income statement.

When a receivable is uncollectible, it is written off against the related provision for impairment. Such receivables are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the income statement.

3.12 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. The expense relating to any provision is presented in the income statement, net of any reimbursement.

3.13 Retirement benefits

The group 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 group also provides post-retirement health care benefits to its 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.

3.14 Discontinued operations

A discontinued operation is a component of the group's business that represents a separate major line of business or geographical area of operations that has been disposed of or is held for sale, or is a subsidiary acquired exclusively with a view to resale. Classification as a discontinued operation occurs upon disposal or when the operation meets the criteria to be classified as held for sale, if earlier. When an operation is classified as a discontinued operation, the comparative income statement is restated as if the operation had been discontinued from the start of the comparative period.

3.15 Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at inception date of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset. A reassessment is made after inception of the lease only if one of the following applies:

a) There is a change in contractual terms, other than a renewal or extension of the arrangement;
b) A renewal option is exercised or extension granted, unless the term of the renewal or extension was initially included in the lease term;
c) There is a change in the determination of whether fulfilment is dependant on a specified asset; or
d) There is a substantial change to the asset.

Where a reassessment is made, lease accounting shall commence or cease from the date when the change in circumstances gave rise to the reassessment for scenarios a), c) or d) and at the date of renewal or extension period for scenario b).
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.

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee.

3.16 Research and development costs

Research and development 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.

3.17 Impairment of tangible and intangible 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 fair value less cost to sell and value in use.

Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its 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.

3.18 Fruitless and wasteful expenditure

Fruitless and wasteful expenditure means expenditure which was made in vain as well as penalties levied on late deliveries and would have been avoided had reasonable care been exercised.

Notes to the annual financial statements

for the year ended 31 March 2007 *continued*

CORPORATION			GROUP	
2006 Rm	2007 Rm		2007 Rm	2006 Rm
		4.Revenue		
-	-	Sale of goods and services	1 236,9	736,2
315,4	347,6	Government grant (Allocation from the State budget for operating and technology expenditure)	347,6	315,4
19,7	25,6	Interest received	25,7	19,7
24,1	26,4	Rental income	23,8	21,6
359,2	399,6		1 634,0	1 092,9
		5.Surplus from operations		
		Is arrived at after taking into account		
199,1	206,0	Salaries, wages and other benefits	304,6	296,6
28,3	30,3	Post Retirement Benefits	45,4	43,1
21,8	37,3	Subsidiary support (Transfer payment to Armscor Business)	-	-
(7,3)	(7,4)	Income: Service Level Agreement with Armscor Business	-	-
8,8	8,3	Rent for machinery and equipment	9,1	8,8
0,8	0,9	Auditors' remuneration	1,4	1,5
0,8	0,9	Audit	1,4	1,3
-	-	Other services	-	0,2
4,1	3,6	Depreciation and fixed assets written off on acquisition (see note 8.7)	17,2	20,3
-	-	Net foreign exchange loss/(gain)	(6,2)	0,6
-	-	Income from the realisation of fixed assets	(0,2)	(0,1)
		6.Finance charges		
5,3	7,8	Interest paid to subsidiaries	-	-
		7.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:		
7 408,3	8 003,5	Special Defence Account	8 003,5	7 408,3
834,0	832,1	General Defence Account	832,1	834,0
159,3	175,9	SA Police Service	175,9	159,3
4,3	19,4	Other	19,4	4,3
8 405,9	9 030,9		9 030,9	8 405,9

CORPORATION			GROUP	
2006 Rm	2007 Rm		2007 Rm	2006 Rm
		8.Property, plant and equipment		
-	-	8.1 Land	12,7	12,7
-	-	Cost	12,7	12,7
-	-	Accumulated depreciation	-	-
-	-	8.2 Buildings	143,7	146,7
-	-	Cost	192,2	190,4
-	-	Accumulated depreciation	(48,5)	(43,7)
-	-	8.3 Plant, machinery, equipment	8,5	10,4
6,2	6,0	Cost	30,5	28,8
(6,2)	(6,0)	Accumulated depreciation	(22,0)	(18,4)
10,6	18,8	8.4 Office equipment, furniture & computers	25,4	15,6
28,0	39,0	Cost	58,5	45,1
(17,4)	(20,2)	Accumulated depreciation	(33,1)	(29,5)
0,8	0,7	8.5 Vehicles & vessels	7,6	9,2
1,6	1,6	Cost	15,2	14,8
(0,8)	(0,9)	Accumulated depreciation	(7,6)	(5,6)
11,4	19,5		197,9	194,6

Certain buildings are erected on leasehold premises. Detail pertaining to land and buildings is available at the registered office of the Corporation.

8.6 RECONCILIATION OF CARRYING AMOUNT

	LAND	BUILDINGS	PLANT, MACHINERY & EQUIPMENT	OFFICE EQUIPMENT, FURNITURE & COMPUTERS	VEHICLES & VESSELS	TOTAL
	2007					
CORPORATION	**RM**	**RM**	**RM**	**RM**	**RM**	**RM**
Net book value	-	-	-	18,8	0,7	19,5
Opening balance	-	-	-	10,6	0,8	11,4
Additions	-	-	-	11,7	-	11,7
Assets written off on acquisition	-	-	-	-	-	-
Assets written off/realised	-	-	-	-	-	-
Depreciation	-	-	-	(3,5)	(0,1)	(3,6)
	2006					
Net book value	-	-	-	10,6	0,8	11,4
Opening balance	-	-	-	10,9	0,7	11,6
Additions	-	-	-	3,8	0,1	3,9
Assets written off on acquisition	-	-	-	(1,3)	-	(1,3)
Assets written off/realised	-	-	-	-	-	-
Depreciation	-	-	-	(2,8)	-	(2,8)
	2007					
GROUP	**RM**	**RM**	**RM**	**RM**	**RM**	**RM**
Net book value	12,7	143,7	8,5	25,4	7,6	197,9
Opening balance	12,7	146,7	10,4	15,6	9,2	194,6
Additions	-	1,8	2,4	15,7	0,7	20,6
Assets written off on acquisition	-	-	(0,3)	(0,2)	(0,1)	(0,6)
Assets written off/realised	-	-	-	-	(0,1)	(0,1)
Depreciation	-	(4,8)	(4,0)	(5,7)	(2,1)	(16,6)
	2006					
Net book value	12,7	146,7	10,4	15,6	9,2	194,6
Opening balance	12,7	144,8	13,7	19,3	9,7	200,2
Additions	-	6,5	1,9	5,1	1,3	14,8
Assets written off on acquisition	-	-	(0,4)	(1,5)	-	(1,9)
Assets written off/realised	-	-	-	(0,1)	-	(0,1)
Depreciation	-	(4,6)	(4,8)	(7,2)	(1,8)	(18,4)

CORPORATION			GROUP	
2006 Rm	2007 Rm		2007 Rm	2006 Rm
		8.7 Depreciation		
2,8	3,6	Buildings, installations, machinery, equipment and vehicles	16,6	18,4
1,3	-	Assets written off on acquisition	0,6	1,9
4,1	3,6		17,2	20,3
		8.8 Other matters		
		Included in the Corporation's value of plant, machinery and equipment are assets at contractors with a cost of R6,0 million (2006: R6,2 million) that are fully depreciated. In addition the groups figures include assets of the subsidiaries that are carried at zero book value.		
		9. Intangible assets		
-	-	Cost	0,2	-
-	-	Accumulated depreciation	-	-
-	-		0,2	-
		Reconciliation of carrying amount		
-	-	Additions	0,2	-
		10. Investment in subsidiaries		
-	-	Shares at cost	-	-
236,5	236,5	Loans to subsidiaries	-	-
236,5	236,5		-	-

Mutually agreed interest-bearing, unsecured loans without fixed conditions of repayment. Although there are no fixed terms of repayment, the intention is not to recall this loan within twelve months.

Included in the loans to subsidiaries are the loans of Armscors' property companies of which companies all income and expenses (if any) are reflected in the financial statement of the Corporation.

10. Investment in subsidiaries (continued)

SOUTH AFRICAN SUBSIDIARIES (At 100% Holdings)	ISSUED SHARE CAPITAL	SHARES AT COST		NET LOANS DUE BY/ (DUE TO) SUBSIDIARIES	
		2007 R	2006 R	2007 Rm	2006 Rm
ARMSCOR BUSINESS (PTY) LTD	4 000	4 000	4 000	(11,4)	11,3
ERASMUSRAND PROPERTIES (PTY) LTD	1	1	1	135,9	135,9
INSTITUTE FOR MARITIME TECHNOLOGY (PTY) LTD*	4	4	4	-	-
OVERBERG TOETSBAAN (PTY) LTD*	5	5	5	-	-
OOSPARK (PTY) LTD	1	1	1	1,1	1,1
SPORTRAND (PTY) LTD	1	1	1	2,0	2,0
	4 012	4 012	4 012	127,6	150,3

*Dormant Subsidiary

The amount of net loans due by/(due to) subsidiaries of R127,6 million (2006: R150,3 million) is the net amount between investments in subsidiaries and short term loans from subsidiaries (Notes 10 (first part) and 15).

The attributable interest of the Corporation in the net surplus of its subsidiaries amounted to R27,8 million (2006 : R6,2 million)

11. Inventories

CORPORATION			GROUP	
2006 Rm	2007 Rm		2007 Rm	2006 Rm
-	-	Raw materials	0,7	0,4
-	-	Work in progress	0,6	1,5
0,8	0,8	Consumables	0,8	0,9
-	-	Finished goods	0,2	0,2
0,8	0,8		2,3	3,0

The amount of write-down of inventories to net realizable value and all losses of inventory during the year is R Nil (2006: R Nil)
The amount of inventories recognized as an expense during the year is R0,2 million (2006: R0,3 million)

CORPORATION			GROUP	
2006 Rm	2007 Rm		2007 Rm	2006 Rm
		12. Accounts receivable		
-	-	Trade receivables	65,3	91,9
7,7	24,8	Other receivables	31,7	9,9
7,2	21,9	Surplus on post-retirement medical benefit	33,5	13,1
0,2	0,1	Personnel loans	0,4	0,4
1,6	2,0	Interest receivable on investments	2,0	1,6
3,0	3,4	Related parties	41,8	30,8
19,7	52,2		174,7	147,7

Terms and conditions of the above financial assets:

Trade receivables are non-interest bearing and are generally on thirty to ninety days terms.
Other receivables are non-interest bearing and have an average term of six months.
Surplus on post-retirement medical benefit, refer to note 21.2.
Personal loans are interest bearing over periods that vary between one to twelve months in terms of terms and conditions of employment.
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.
For terms and conditions relating to related party receivables, refer to note 27.

Accounts receivable are reduced by provision for doubtful debts of R14,0 million (2006: R4,4 million) and for the Group R14,6 million (2006: R4,7 million).

CORPORATION			GROUP	
2006 Rm	2007 Rm		2007 Rm	2006 Rm
		13. CASH AND CASH EQUIVALENTS		
10,8	23,6	Cash at banks and in hand	20,6	6,5
262,0	267,6	Short-term deposits	267,7	262,0
272,8	291,2		288,3	268,5
23,8	24,7	Less: Cash allocated to insurance reserve	24,7	23,8
249,0	266,5		263,6	244,7

Cash at banks earns interest at floating rates based on daily bank deposit rates. Short-term deposists are made for varying periods of between one day and six months depending on the immediate cash requirements of the group, and earn interest at the respective short-term deposit rates.

CORPORATION			GROUP	
2006 Rm	2007 Rm		2007 Rm	2006 Rm
		14. Share capital		
		Authorised		
1 000	1 000	• 1 000 000 000 ordinary shares of R1 each	1 000	1 000
		Issued to the State		
75,0	75,0	• 75 000 000 shares at R1 per share	75,0	75,0
		Share Capital is under the control of the executive authority.		
		15. Short term loan		
86,2	108,9	LOAN FROM SUBSIDIARY: ARMSCOR BUSINESS (PTY) LTD	-	-
		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.		
		16. Accounts payable		
18,0	11,8	Trade payables	36,5	33,3
16,4	27,8	Other payables	22,1	71,3
33,3	32,9	Liability for leave and bonusses	45,7	46,2
-	-	Related parties	66,0	29,6
67,7	72,5		170,3	180,4

Terms and conditions of the above financial liabilities:

Trade payables are non-interest bearing and are normally settled on sixty day terms.
Other payables are non-interest bearing and have an average term of six months.
Leave and bonuses are controlled by general terms and conditions of employment.
For terms and conditions relating to related parties, refer to note 27.

17. Provisions

	PROVISION FOR POST-RETIREMENT MEDICAL LIABILITY	PROVISION FOR PERFORMANCE REMUNERATION	TOTAL
CORPORATION	Rm	Rm	Rm
Balance at 1 April 2005	-	13,1	13,1
Provisions made during the year	-	14,0	14,0
Provisions utilised during the year	-	(13,1)	(13,1)
Balance at 31 March 2006	-	14,0	14,0
Provisions made during the year	-	15,3	15,3
Provisions utilised during the year	-	(14,0)	(14,0)
Balance at 31 March 2007	-	15,3	15,3
GROUP	**Rm**	**Rm**	**Rm**
Balance at 1 April 2005	0,2	19,8	20,0
Provisions made during the year	-	20,7	20,7
Provisions utilised during the year	(0,2)	(19,7)	(19,9)
Balance at 31 March 2006	-	20,8	20,8
Provisions made during the year	-	22,2	22,2
Provisions utilised during the year	-	(20,8)	(20,8)
Balance at 31 March 2007	-	22,2	22,2

Performance remuneration will be paid after performance evaluation and is due in June 2007.

CORPORATION			GROUP	
2006 Rm	2007 Rm		2007 Rm	2006 Rm
		18. Contractual liabilities		
97,3	432,8	Projected outstanding commitments in respect of orders placed for expected deliveries	432,8	97,3
		19. Capital commitments		
-	-	Capital expenditure approved but not yet contracted for plant and equipment	14,5	9,2

20. Contingent liabilities

20.1 Guarantees

20.1.1 Bank guarantees have been issued for Armscor Business in favour of local contractors amounting to R1,1 million (2006: R1,1 million) in respect of marketing transactions and for Armscor to a foreign contractor amounting to USD 1,0 million (2006: USD nil) for an advance payment received.

20.1.2 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.

20.1.3 Bank guarantees have been issued on behalf of Armscor Business in favour of the South African Revenue Services: Customs and Excise and other creditors amounting to R11,1 million (2006: R6,7 million) with regard to local guarantees.

20.2 Other

At 31 March 2007 the group had a contingent liability in respect of rehabilitation of the test range at Alkantpan (Pty) Ltd.

In terms of the National Environmental Management Act (Act 107 of 1998), section 28 (1) which came into effect on 29 January 1999, Alkantpan must take reasonable steps to avoid, stop or minimize degradation of the environment. The following options were investigated during the previous financial year, using reputable companies specialising in this field:

- Closing down and clearing

  Alkantpan will be responsible for the initial phase whereafter a contractor will do the clearing. Estimated cost would have been R48,3 million and it would take an estimated seven years.

- Clearing with continued operations

  This option would cause a huge loss of income as areas of the range would have to be closed for clearing operations resulting in clients requirements not being met.

- Fencing affected areas

  The affected area would be fenced off, maintained and a trust fund established to cover the risk. The estimated cost would have been R16,8 million.

- Manage the range in compliance with the Act

  To form a steering committee with Government in order to ensure legislative and ecological compliance with the Act, with no additional cost implication.

As no intention currently exists to cease activities at Alkantpan, Alkantpan has elected to manage the range in compliance with the Act and to continue with its day to day clearing actions.

During the period under review, a steering committee was formed between Alkantpan and the Department of Tourism, Environment and Conservation of which the first meeting took place on 5 September 2006. It was confirmed at this meeting that the committee is to guide and advise Alkantpan on the environmental way forward and to ensure legislative compliance to the Act.

20.3 Operating lease commitments – Group as lessee

The group has entered into operational leases on certain motor vehicles and items of machinery and equipment. These leases have an average life of between 1 and 10 years. There are no restrictions placed upon the lessee by entering into these leases.

Future minimum rentals payable under non-cancellable operating leases as at 31 March 2007 are as follows:

CORPORATION			GROUP	
2006 Rm	2007 Rm		2007 Rm	2006 Rm
5,6	3,9	Within one year	4,8	5,9
4,4	0,4	After one year but not more than five years	3,6	4,6
-	-	After five years	5,4	-
10,0	4,3		13,8	10,5

21. Retirement benefits

21.1 Pension and provident schemes

The group 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 954 (2006: 968) members, is registered and controlled in terms of the Pension Funds Act No 24 of 1956, as amended.

At the time of establishment of the Armscor Defined Contribution Pension Fund, Armscor guaranteed pensioners that were transferred from the previous pension fund to the current pension fund to receive a pension at least equal to the pension received in terms of the previous fund. Armscor's liability in this regard for the remaining 18 members is Nil (2006: Nil) as the pensioners account in the pension fund is sufficiently funded.

CORPORATION			GROUP	
2006 Rm	2007 Rm		2007 Rm	2006 Rm
18,5	20,0	The amount of contributions to the above scheme	29,4	28,1
18,5	20,0	The total amount expended during the year	29,4	28,1

21.2 Post-retirement medical benefits

The group 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.

The IAS19 (AC116) valuation of the group's post-employment benefits was carried out at 31 March 2007. Based on the latest projection performed at 31 March 2007 the present value of the obligation is R239,7 million (2006: R199,4 million) and the fair value of plan assets is R340,0 million (2006: R263,2 million).

Provision is being made for the projected obligation, spread over five years.

CORPORATION			GROUP	
2006 Rm	2007 Rm		2007 Rm	2006 Rm
		Amounts recognised in the balance sheet		
162,4	194,3	Present value of funded obligations	239,7	199,4
(209,5)	(267,9)	Fair value of the plan assets	(340,0)	(263,2)
(47,1)	(73,6)	Present value of obligations in excess of plan assets	(100,3)	(63,8)
34,8	47,3	Unrecognised actuarial gains	60,8	43,7
5,1	4,4	Unrecognised past service gains	6,0	7,0
(7,2)	(21,9)	Net asset in balance sheet	(33,5)	(13,1)
		Reconciliation of net liability in the balance sheet and amounts recognised in the income statement		
0,2	(7,2)	Opening balance	(13,1)	0,2
3,5	(3,4)	Expense recognised in employee remuneration costs	(3,8)	2,5
4,2	4,3	Current service cost	6,4	3,5
10,4	11,9	Interest cost	14,6	12,9
(13,6)	(17,8)	Expected return on plan assets	(22,4)	(17,0)
5,1	-	Transitional liability recognised	-	6,0
(1,9)	(1,1)	Actuarial (gain) recognised	(1,4)	(1,9)
(0,7)	(0,7)	Past service loss recognised	(1,0)	(1,0)
(5,0)	(5,1)	Employer benefit payments	(5,4)	(5,1)
(10,2)	(10,9)	Employer prefunding contributions	(15,9)	(15,0)
4,3	4,7	Payments from plan assets	4,7	4,3
(7,2)	(21,9)	Closing balance	(33,5)	(13,1)

CORPORATION			GROUP	
2006 Rm	2007 Rm		2007 Rm	2006 Rm
		Reconciliation of change in plan assets		
148,8	209,5	Fair value of assets at beginning of year	263,2	184,3
64,1	65,9	Actual return on assets	82,0	79,4
9,9	10,3	Contributions	16,0	15,0
(4,3)	(4,7)	Benefits paid	(4,7)	(4,3)
(9,0)	(13,1)	Other expenses	(16,5)	(11,2)
209,5	267,9	Fair value of assets at end of year	340,0	263,2

The main actuarial assumptions are:

	2007	2006
Discount rate	7,75%	7,5%
Health care cost inflation	6,75%	6,5%
Rate of interest	7,5%	7,5%
Average retirement age	60	60
Expected return on plan assets	8,5%	8,5%
Future salary increases	6,0%	6,0%

22. Financial instruments

22.1 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.

22.2 Credit Risk Management

Trade debtors comprise a large, wide spread base. The granting of credit is controlled by well established criteria, which are reviewed and updated on an ongoing basis. At 31 March 2007 the group did not consider there to be any significant concentration of credit risk which had not been adequately provided for.

22.3 Liquidity Risk

The group has no overdraft facilities.

22.4 Fair Values

The fair values of all financial instruments are substantially identical to the carrying values reflected in the balance sheet, except for certain loans to subsidiaries which are carried at cost.

23. Income tax

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

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

24.1 An amount of R50 014 (2006: R21 937) relating to unrecoverable debts was written off during the year.

24.2 Fruitless and wasteful expenditure of an immaterial amount of R26 709 was incurred as a result of penalties levied on late deliveries. Negotiations are in progress to recover the latter amount.

25. Comparative figures

Comparative figures have been regrouped where necessary.

26.Directors'/ Executive members' emoluments 31 March 2007

	Notes	FEES	BASIC SALARY	OTHER BENEFITS	ALLOWANCES	RETIREMENT AND OTHER CONTRIBUTIONS	TOTAL
				(7)	(8)	(9)	
		R	R	R	R	R	R
Directors' emoluments							
Executive directors							
H S Thomo			1 138,779	214,582	187,680	201,797	1 742,838
C J Hoffmann			751,962	137,281	116,670	140,824	1 146,737
Subtotal			1 890,741	351,863	304,350	342,621	2 889,575
Non-Executive directors							
CWN Molope	12	87,600	-	-	-	-	87,600
P Riba		121,800	-	-	-	-	121,800
G N Ramaremisa		99,000	-	-	-	-	99,000
C V Gamede		102,800	-	-	-	-	102,800
A S Human		125,600	-	-	-	-	125,600
R P Meyer		95,200	-	-	-	-	95,200
P S Molefe		200,000	-	-	-	-	200,000
Subtotal		832,000	-	-	-	-	832,000
TOTAL DIRECTORS' EMOLUMENTS		832,000	1 890,741	351,863	304,350	342,621	3 721,575
Management Board emoluments							
Executive members							
G J Smith	11		338,534	114,439	19,919	54,677	527,569
T N Msomi	2		175,953	-	19,983	33,482	229,418
T T Goduka			527,994	102,945	133,932	125,783	890,654
X Magojo			653,151	117,826	94,332	115,584	980,893
N R M Borotho			861,096	154,817	104,028	112,387	1 232,328
J S Mkwanazi			737,859	124,518	87,456	145,368	1 095,201
M M Matibe	13		239,238	45,461	58,590	60,861	404,150
TOTAL			3 533,825	660,006	518,240	648,142	5 360,213
Directors' emoluments Armscor Business (Pty) Ltd							
J A J de Necker			684,903	130,661	123,600	153,263	1 092,427
E Hurter			592,668	108,863	96,780	130,364	928,675
TOTAL			1 277,571	239,524	220,380	283,627	2 021,102

Directors'/ Executive members' emoluments 31 March 2006 (continued)

	Notes	FEES	BASIC SALARY	OTHER BENEFITS	ALLOWANCES	RETIREMENT AND OTHER CONTRIBUTIONS	TOTAL
				(7)	(8)	(9)	
		R	R	R	R	R	R
Executive director							
H S Thomo			968,714	207,381	271,190	198,294	1 645,579
C J Hoffmann			630,014	131,483	167,514	154,659	1 083,670
Subtotal			1 598,728	338,864	438,704	352,953	2 729,249
Non-Executive directors							
CWN Molope		68,600	-	-	-	-	68,600
P Riba		80,000	-	-	-	-	80,000
G N Ramaremisa		87,600	-	-	-	-	87,600
C V Gamede		87,600	-	-	-	-	87,600
A S Human		87,600	-	-	-	-	87,600
R P Meyer		64,800	-	-	-	-	64,800
P S Molefe	1	259,544	-	-	-	-	259,544
Subtotal		735,744	-	-	-	-	735,744
TOTAL DIRECTORS' EMOLUMENTS		735,744	1,598,728	338,864	438,704	352,953	3,464,993
Management Board emoluments							
Executive members							
G J Smith			770,340	126,512	19,596	133,129	1 049,577
J C Oosthuizen	3		238,465	106,008	52,074	48,538	445,085
C V V Ramphele	4		86,028	-	18,322	12,416	116,766
T T Goduka	5		495,969	100,906	111,932	127,043	835,850
X Magojo			542,754	110,748	157,285	115,005	925,792
NRM Borotho			715,633	112,054	127,392	108,899	1 063,978
JS Mkwanazi	6		126,879	-	27,942	29,725	184,546
TOTAL			2 976,068	556,228	514,543	574,755	4 621,594
Directors' emoluments							
Armscor Business (Pty) Ltd							
J A J de Necker			621,832	125,101	123,600	143,813	1 014,346
E Hurter			535,324	105,248	96,780	128,013	865,365
TOTAL			1 157,156	230,349	220,380	271,826	1 879,711

Notes applicable to note 26

1 Appointed as Chairman of the Board for a period of three years from 1 October 2004.
2 Appointed on 1 January 2007 to Management Board.
3 Retired on 29 August 2005 as Management Board member.
4 Resigned on 30 June 2005 as Management Board member.
5 Resigned on 13 July 2005 as Executive Director from the Armscor Business Board of Directors.
6 Appointed on 1 January 2006 to Management Board.
7 Include bonus and performance related payments.
8 Include sums paid by way of expense allowances, i.e. Computer, club, motor, cellphone allowances and long service grant.
9 Include contributions made to any pension fund; medical benefit fund; medical aid; unemployment and funeral funds.
10 No emoluments are paid to Armscor Business ex-officio Directors: Mr HS Thomo, Mr CJ Hoffmann and Mr X Magojo.
11 Retired on 31 August 2006 as Management Board member.
12 Directors' fees of Ms N Molope are paid to the Financial Services Board.
13 Appointed on 1 October 2006 to Management Board. (Acting).

Share options

No share options exists and therefore no share option 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 defined contributory pension schemes.

27. Related-party disclosures

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

To execute its mandate, Armscor received a Government grant of R347,6 million (2006: R315,4 million) from the State through the Department of Defence (DOD).

The consolidated financial statements of the Armscor Group include the financial statements of the subsidiaries as set out in note 10 (Investment in subsidiaries).

Investment in subsidiaries and loans from subsidiaries are set out in notes 10 and 15 of the financial statements.

The following table provides the total amount of transactions which have been entered into by Armscor with related parties for the relevant financial year.

	Sales of goods and services to related parties		Purchases of goods from related parties		Amounts owed by related parties		Amounts owed to related parties	
	2007 Rm	2006 Rm	2007 Rm	2006 Rm	2007 Rm	2006 Rm	2007 Rm	2006 Rm
Armscor Business	14,7	37,3	69,3	41,5	-	-	-	-
Erasmusrand Properties (Pty) Ltd	0,1	-	-	-	-	-	-	-
Department of Defence	5,2	2,9	-	-	1,5	3,0	-	-
Other related party transactions carried out by the group:								
State controlled entities								
Major national public entities (Shedule 2 and 3 public entities	122,5	106,2	1 101,9	646,1	14,3	10,0	3,7	3,4
National Government	21,1	18,9	0,2	0,3	0,3	0,9	-	-

Terms and conditions of transactions with related parties

The sales to and purchases from related parties are made at normal market prices. Outstanding balances at the year-end are unsecured, interest free and settlement occurs in cash. There have been no guarantees provided or received for any related-party receivables or payables. For the year ended 31 March 2007, the group has made provision for doubtful debts of R14,0 million (2006: R4,2 million) relating to amounts owed by related parties.

Included in the above figures are payments of R7,4 million (2006: R7,3 million) in respect of a service level agreement paid by Armscor Business to Armscor, an amount of R37,3 million (2006: R21,8 million) paid by Armscor to Armscor Business for subsidiary support and rent of R2,6 million (2006: R2,5 million) paid by Armscor Business to Armscor.

In accordance with Armscor's mandate, acquisition was undertaken on behalf of the Department of Defence. These transactions are set out in note 7 of the financial statements.

Armscor Business had the following business with the DOD, as stated below.

	Sales of goods to related parties		Purchases of goods from related parties		Amounts owed by related parties		Amounts owed to related parties	
	2007 Rm	2006 Rm	2007 Rm	2006 Rm	2007 Rm	2006 Rm	2007 Rm	2006 Rm
Special and General Defence Account	890,0	474,3	-	4,5	25,7	16,9	14,8	12,9
DMD (Stock Sales)	-	-	97,2	39,2	-	-	47,5	13,3

Directors

Directors' interests in related parties: No interests in related parties have been declared by Armscor Directors.

Two of Armscor's Directors and one Armscor Management Board Member are ex-officio directors of the Armscor Business Board of Directors. One director is also ex-officio director on the Boards of Erasmusrand Eiendomme (Pty) Limited, Sportrand (Pty) Limited and Oospark (Pty) Limited.

Key management personnel

Information on the remuneration of all key management personnel is disclosed in note 26.

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