



CONSOLIDATED DEPARTMENTAL FINANCIAL STATEMENTS 2016-2017 (UNAUDITED)



National
Defence

Défense
nationale

Canada



Responsibility for the integrity and objectivity of the accompanying financial statements for the year ended March 31, 2017, and all information contained in these statements rests with the management of the Department of National Defence (Department). These financial statements have been prepared by management using the Government's accounting policies, which are based on Canadian public sector accounting standards (PSAS), with the exception of the accounting for pension benefits where the presentation and results using the stated accounting policies do not result in any significant differences from PSAS.

Management is responsible for the integrity and objectivity of the information in these financial statements. Some of the information in the financial statements is based on management's best estimates and judgment, and gives due consideration to materiality. To fulfill its accounting and reporting responsibilities, management maintains a set of accounts that provides a centralized record of the Department's financial transactions. Financial information submitted in the preparation of the *Public Accounts of Canada*, and included in the Department's *Departmental Results Report*, is consistent with these financial statements.

Management is also responsible for maintaining an effective system of Internal Control over Financial Reporting (ICFR) designed to provide reasonable assurance that financial information is reliable, that assets are safeguarded and that transactions are properly authorized and recorded in accordance with the *Financial Administration Act* and other applicable legislation, regulations, authorities and policies.

Management seeks to ensure the objectivity and integrity of data in its financial statements through careful selection, training, and development of qualified staff; through organizational arrangements that provide appropriate divisions of responsibility; through communication programs aimed at ensuring that regulations, policies, standards, and managerial authorities are understood throughout the Department; and through conducting an annual assessment of the effectiveness of ICFR.

The system of ICFR is designed to mitigate risks to a reasonable level based on an on-going process to identify, assess effectiveness and adjust as required key risks and associated key controls.

A risk-based assessment of the system of ICFR for the year ended March 31, 2017 was completed in accordance with the Treasury Board *Policy on Internal Control*. The Department successfully reached the ongoing monitoring phase one year earlier than the initial plan and the results and action plans are summarized in the annex.

The effectiveness and adequacy of the Department's system of internal control is reviewed by the work of internal audit staff, who conduct periodic audits of the different areas of the Department's operations, and by the Departmental Audit Committee, which oversees management's responsibilities for maintaining adequate control systems and the quality of financial reporting.

The financial statements of the Department have not been audited.

Signed by,

John Forster

Deputy Minister
Ottawa, Canada

Date: August 24, 2017

Signed by,

Claude Rochette CPA, CMA

Chief Financial Officer

CONSOLIDATED STATEMENT OF FINANCIAL POSITION (UNAUDITED)



As at March 31

(in thousands of dollars)	2017	2016 (Restated note 21)
Liabilities		
Accounts payable and accrued liabilities (note 4)	2,126,892	2,604,294
Vacation pay and compensatory leave	178,276	176,928
Deposits and trust accounts (note 6)	4,350	4,272
Deferred revenue (note 7)	12,200	12,817
Canadian Forces pension and insurance accounts (note 8)	709,293	695,218
Lease obligations for tangible capital assets (note 9)	241,012	307,992
Employee future benefits (note 10)	772,285	900,801
Remediation liabilities (note 5)	536,640	519,371
Future asset restoration liabilities (note 5)	183,849	272,073
Total liabilities	4,764,797	5,493,766
Financial assets		
Due from Consolidated Revenue Fund	2,314,969	2,797,865
Accounts receivable (note 11)	449,594	403,001
Loans and advances (note 12)	50,326	39,052
Total gross financial assets	2,814,889	3,239,918
Financial assets held on behalf of Government		
Accounts receivable (note 11)	(5,232)	(11,898)
Total financial assets held on behalf of Government	(5,232)	(11,898)
Total net financial assets	2,809,657	3,228,020
Departmental net debt	1,955,140	2,265,746
Non-financial assets		
Prepaid expenses (note 13)	728,397	644,158
Inventory (note 14)	5,810,642	6,064,117
Tangible capital assets (note 15)	32,640,145	32,559,154
Total non-financial assets	39,179,184	39,267,429
Departmental net financial position	37,224,044	37,001,683

Contingent liabilities (note 16)
Contractual obligations (note 17)

The accompanying notes form an integral part of these financial statements.

Signed by,

John Forster

Deputy Minister
Ottawa, Canada

Date: August 24, 2017

Signed by,

Claude Rochette CPA, CMA

Chief Financial Officer

CONSOLIDATED STATEMENT OF OPERATIONS AND DEPARTMENTAL NET FINANCIAL POSITION (UNAUDITED)



For the year ended March 31

(in thousands of dollars)	2017 Planned Results	2017	2016* (Restated note 21)
Expenses			
Defence Combat and Support Operations	1,467,778	1,527,724	1,523,391
Defence Services and Contributions to Government	410,730	435,910	488,075
Defence Ready Force Element Production	3,158,441	3,862,060	3,580,878
Defence Capability Element Production	13,187,421	12,922,177	13,559,781
Defence Capability Development and Research	368,552	453,908	441,809
Internal Services	453,087	422,064	414,942
Total expenses	19,046,009	19,623,843	20,008,876
Revenues			
Sale of goods and services	407,670	409,778	449,750
Gains on disposals of assets	65,685	18,291	17,771
Other	21,625	14,779	108,865
Interest and gains on foreign exchange	10,595	15,170	20,758
Revenues earned on behalf of Government	(22,652)	(10,192)	(18,251)
Total revenues	482,923	447,826	578,893
Net cost from continuing operations	18,563,086	19,176,017	19,429,983
Transferred operations			
Expenses	0	0	1,338
Net cost of transferred operations	0	0	1,338
Net cost of operations before government funding and transfers	18,563,086	19,176,017	19,431,321
Government funding and transfers			
Net cash provided by Government		19,107,537	18,395,768
Change in due from Consolidated Revenue Fund		(482,896)	180,554
Services provided without charge by other government departments (note 18)		773,556	735,364
Transfer of accounts receivable to Public Services and Procurement Canada (note 19)		(14)	(307)
Transfer of assets and liabilities from (to) other government departments (note 15)		195	(528)
Net cost of operations after government funding and transfers		(222,361)	120,470
Departmental net financial position — beginning of year		37,001,683	37,122,153
Departmental net financial position — end of year		37,224,044	37,001,683

Segmented information (note 20)

The accompanying notes form an integral part of these financial statements.

* Comparative figures have been reclassified to conform to the current year's presentation.

CONSOLIDATED STATEMENT OF CHANGE IN DEPARTMENTAL NET DEBT (UNAUDITED)



For the year ended March 31

(in thousands of dollars)	2017	2016 (Restated note 21)
Net cost of operations after government funding and transfers	(222,361)	120,470
Change due to tangible capital assets		
Acquisition of tangible capital assets	2,757,236	2,763,740
Amortization of tangible capital assets	(2,545,517)	(2,490,333)
Proceeds from disposal of tangible capital assets	(18,274)	(12,706)
Loss on disposal of tangible capital assets	(167,918)	(420,222)
Adjustments of tangible capital assets	55,269	377,869
Transfer to other government departments	195	(528)
Total change due to tangible capital assets	80,991	217,820
Change due to inventories	(253,475)	(108,370)
Change due to prepaid expenses	84,239	(133,661)
Net increase (decrease) in departmental net debt	(310,606)	96,259
Departmental net debt — beginning of year	2,265,746	2,169,487
Departmental net debt — end of year	1,955,140	2,265,746

The accompanying notes form an integral part of these financial statements.

CONSOLIDATED STATEMENT OF CASH FLOW (UNAUDITED)



For the year ended March 31

(in thousands of dollars)	2017	2016 (Restated note 21)
Operating activities		
Net cost of operations before government funding and transfers	19,176,017	19,431,321
Non-cash items included in net cost of operations		
Amortization of tangible capital assets	(2,545,517)	(2,490,333)
Loss on disposal of tangible capital assets	(167,918)	(420,222)
Adjustments of tangible capital assets	55,269	377,869
Services provided without charge by other government departments (note 18)	(773,556)	(735,364)
Transition payments for implementing salary payments in arrears (note 19)	14	307
Variations in Statement of Financial Position		
Increase (decrease) in accounts receivable	53,259	159,058
Increase (decrease) in loans and advances	11,274	2,812
Increase (decrease) in prepaid expenses	84,239	(133,661)
Increase (decrease) in inventories	(253,475)	(108,370)
Decrease (increase) in accounts payable and accrued liabilities	477,402	(264,227)
Decrease (increase) in vacation pay and compensatory leave	(1,348)	6,128
Decrease (increase) in deposits and trust accounts	(78)	1,521
Decrease (increase) in deferred revenue	617	(2,488)
Decrease (increase) in Canadian Forces pension and insurance accounts	(14,075)	46,737
Decrease (increase) in employee future benefits	128,516	74,705
Decrease (increase) in remediation liabilities	(17,269)	(93,983)
Decrease (increase) in future asset restoration liabilities	88,224	(270,760)
Cash used by operating activities	16,301,595	15,581,050
Capital investing activities		
Acquisition of tangible capital assets (note 15)	2,757,236	2,763,740
Proceeds from disposal of tangible capital assets	(18,274)	(12,706)
Cash used by capital investing activities	2,738,962	2,751,034
Financing activities		
Payments against / adjustments to capital lease obligations	66,980	63,684
Cash used by financing activities	66,980	63,684
Net cash provided by Government of Canada	19,107,537	18,395,768

The accompanying notes form an integral part of these financial statements.



For the year ended March 31

1. Authority and Objectives

> AUTHORITIES

The Department of National Defence (DND) was established by the *National Defence Act (NDA)*. Under section 3 of the *NDA*, the Minister of National Defence presides over the Department. Under section 4 of the *NDA*, the Minister has the management and direction of the Canadian Forces and of all matters relating to National Defence, as well as being responsible for the construction and maintenance of all defence establishments and works for the defence of Canada, and research relating to the defence of Canada and to the development of and improvements in materiel.

> OBJECTIVES

On behalf of the people of Canada, the Canadian Armed Forces (CAF), the DND, and several related organizations and agencies in the Defence Portfolio (collectively “the Department”) stand ready to perform three key roles:

- Protecting Canada and defending our sovereignty;
- Defending North America in cooperation with the United States, Canada’s closest ally; and
- Contributing to international peace and security through operations around the world, most often in partnership with allies from other countries.

Effective fiscal year 2014-15, Defence implemented a new Program Alignment Architecture (PAA) that more accurately represents and articulates the “Business of Defence”. It describes what Defence provides to and for Canadians while also illustrating how those effects are created and delivered. This revised structure better positions Defence to address program granularity and interdependencies required for strategic reviews and to institutionalize a “Management for Results” paradigm that supports the strategic management of Defence. It also provides a structure that better lends itself to conveying Defence’s performance story and demonstrating results.

The activities associated with the Programs were aligned, and in many cases regrouped, in the new PAA as:

(a) Defence Combat and Support Operations

The Defence Combat and Support Operations Program delivers military power in combat, security, stability and surveillance operations in response to armed threats, or potential armed aggression, for the purpose of protecting Canadian sovereignty, upholding the values of Canadians, and defending the interests of the Government of Canada. Results are achieved through this Program by the application of Defence capabilities in domestic, continental and international domains, either independently or in combination with allies, where the primary focus is to inflict military effects against threats.

The term Defence capability is a collective term that refers to the ability of a military force to achieve a desired effect against a threat during the execution of a Defence operation (or the delivery of a Defence service) by executing tasks according to understood concepts, doctrines and standards. The military forces delivered by Defence are composed of force elements which are organizational entities that are in-turn composed of members of the CAF, and in some cases personnel from the DND.

Force elements integrate people, with specialized information and expertise, materiel (e.g., equipment, platforms, and weapon systems) and in some cases real property, so that capabilities can be applied against threats. Force elements have different sizes and compositions according to the capabilities they must apply during an operation.

This Program is underpinned by the *NDA*, defence policy, international treaties and agreements, membership in international organizations, and direction received by the Government of Canada. The sub-programs beneath this Program target a range of threats across a variety of operational contexts via different delivery mechanisms in different geographic regions.



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(b) Defence Services and Contributions to Government

The Defence Services and Contributions to Government Program aims to support the delivery of Canadian Government safety and security initiatives and encourage recognition and pride in Canada and the Canadian military. This is accomplished through the provision of unique Defence services in support of other elements of Government or the Canadian public.

To encourage and share pride and awareness of Canada's military heritage, contributions, and leadership, Defence provides unique services and opportunities for outreach, awareness, preservation and development. Defence's unique services also include operations conducted to ensure or enhance the security, safety, stability and/or well-being of Canadians, or international populations in peril, in accordance with Canadian values and the interests of the Canadian Government, in situations where there may be a need to defend against armed threats but where this is not the primary focus.

The operations are delivered through the employment of force elements to achieve a desired effect within specific contexts through execution of tasks according to understood concepts, doctrines and standards. The force elements delivered by Defence are organizational entities which are composed of members of the CAF and in some cases personnel from the DND. Force elements have different sizes and compositions according to the capabilities they must apply during an operation.

Defence remains consistently ready to employ force elements under this Program; however, significant operations do not always occur every fiscal year.

(c) Defence Ready Force Element Production

The Defence Ready Force Element Production Program produces and renews force elements on a continual basis for use in Defence Combat and Support Operations, as well as for the delivery of Defence Services and Contributions to Government, in order to increase the

likelihood of success and decrease risk of failure in the defence of Canada and promotion of Canadian interests. Results are delivered by assembling force elements from the fundamental elements of Defence capability (i.e. military personnel, materiel and information systems, information, and, in some cases, real property), and integrating them through various training and certification programs so that they have the requisite amount of readiness in order to fulfill predefined roles within the operations for which they are destined.

The term readiness refers to the volume, endurance, responsiveness and capability attributes of force elements that are not employed. These attributes are used to determine the degree of risk that would be associated with assigning them to fulfill perspective role(s) within on-going or contingency operations. The force elements produced by the Defence Ready Force Element Production Program are organized into portfolios according to the maritime, land, aerospace and special operations environments in which they operate. There are also portfolios for force elements that operate jointly across these domains and force elements that provide common support functions.

Across these portfolios, force elements are produced to meet readiness targets. These readiness targets ensure that production can be sustained over short- and medium-term time horizons and that the number of force elements available for employment in on-going and contingency operations is in accordance with acceptable levels of operational risk.

(d) Defence Capability Element Production

The Defence Capability Element Production Program aims to sustain Defence by producing and maintaining portfolios of the fundamental Defence capability elements so that they are continuously available in the appropriate quantity, combination and condition to sustain the chain of programs delivered by Defence, from the Defence Capability Development and Research



For the year ended March 31

Program through to the Defence Ready Force Element Production Program.

These programs collectively give Defence the ability to conduct Defence Combat and Support Operations as well as deliver Defence Services and Contributions to Government. The primary elements of Defence capability are military personnel, materiel and information systems, information, and real property. A fundamental focus of the Defence Capability Element Production Program is to provide an adequate and sustained supply of individual military personnel and materiel in the near-term and over long-term time horizons so that they can be integrated to produce force elements within the Defence Ready Force Element Production Program.

Results are achieved through subordinate programs, each of which focuses on a separate portfolio: military personnel and organization; materiel; real property; or information systems. A lifecycle approach is used to manage each portfolio. The essential aspects of the lifecycle approach are sub-sub-programs that provide the principle lifecycle functions: introduction into service; maintenance, upgrade and supply; release from service; portfolio management; and overarching co-ordination and control. The character of activity that occurs within each of these primary functions depends on the portfolio of entities being produced and therefore the desegregation of the lifecycle functions into sub-sub-programs is unique to each portfolio. The authority for this Program is derived from the *NDA*.

(e) Defence Capability Development and Research

The Defence Capability Development and Research Program seeks to provide the analytical basis and knowledge to anticipate foreseeable changes in the threat and security environment and to determine the associated demand for Defence capabilities across near- and long-term time horizons in order to enable evidence-based strategic decisions that align the introduction, modification and divestment of Defence

capabilities and guide the application of existing capabilities with an acceptable level of risk.

Results are achieved by: establishing and monitoring the fulfillment of near-term targets for readying force elements and conducting Defence operations; identifying lessons from past operations; assessing defence and security trends; developing and integrating new knowledge and systems/methods for conducting operations; developing approaches and conducting Defence capability analyses at strategic, operational and tactical levels; present to future capability assessments; designing and assessing defence alternatives; providing Defence capability oversight and expertise; and Defence capability use planning for sustainable Defence capabilities in future time horizons.

As such, this Program sustains Defence by providing key products and services to the Defence Capability Element Production Program, the Defence Ready Force Element Production Program and parts of the Defence Combat and Support Operations, and Defence Services and Contributions to Government Programs.

This Program also directly enables the management and oversight of Defence as a whole.

(f) Internal Services

Internal Services are groups of related activities and resources that are administered to support the needs of programs and other corporate obligations of an organization. Internal services include only those activities and resources that apply across an organization, and not those provided to a specific program. The groups of activities are Management and Oversight Services; Communications Services; Legal Services; Human Resources Management Services; Financial Management Services; Information Management Services; Information Technology Services; Real Property Services; Materiel Services; and Acquisition Services.



For the year ended March 31

2. Summary of significant accounting policies

These financial statements have been prepared using the Government's accounting policies stated below, which are based on Canadian public sector accounting standards (PSAS), with the exception of the accounting for pension benefits where the presentation and results using the stated accounting policies do not result in any significant differences from PSAS. The pension benefits for members of the CAF follow accounting requirements as outlined in the Treasury Board Accounting Standards, as described in note 2(g) (i), which require the actuarial surpluses or deficiencies to be recognized in the financial statements of the Government of Canada, and not the Department. Further disclosure is presented in note 8.

Significant accounting policies are as follows:

(a) Parliamentary authorities

The Department is financed by the Government of Canada through parliamentary authorities. Financial reporting of authorities provided to the Department do not parallel financial reporting according to generally accepted accounting principles since authorities are primarily based on cash flow requirements. Consequently, items recognized in the Consolidated Statement of Operations and Departmental Net Financial Position and in the Consolidated Statement of Financial Position are not necessarily the same as those provided through authorities from Parliament. Note 3 provides a reconciliation between the bases of reporting. The planned results amounts in the "Expenses" and "Revenues" sections of the Consolidated Statement of Operations and Departmental Net Financial Position are the amounts reported in the Future-oriented Statement of Operations included in the 2016-17 Report on Plans and Priorities. Planned results are not presented in the "Government funding and transfers" section of the Consolidated Statements of Operations and Departmental Net Financial Position, nor in the Consolidated Statement of Change in Departmental Net Debt because these amounts were not included in the 2016-17 Report on Plans and Priorities.

(b) Consolidation

These consolidated financial statements include the accounts of the sub-entities for which the Deputy Minister (DM) is accountable. The accounts of these sub-entities have been consolidated with those of the Department and all inter-organizational balances and transactions have been eliminated. The Department is comprised of the DND, the CAF and several related organizations and agencies in the Defence Portfolio, all of which carry out the Defence mission and are part of the Defence Services Program. Organizations and agencies that are part of these consolidated financial statements include the following:

- Canadian Cadet Program and the Junior Canadian Rangers;
- Canadian Forces Housing Agency;
- Defence Research and Development Canada;
- Office of the Ombudsman for the Department of National Defence and Canadian Forces; and
- Office of the Judge Advocate General.

The Military Grievances External Review Committee, the Military Police Complaints Commission, Communications Security Establishment Canada and the Office of the Communications Security Establishment Commissioner are excluded from the consolidation because these organizations are not part of the Defence Services Program, although they fall under the responsibility of the Minister of National Defence.

(c) Net cash provided by Government

The Department operates within the Consolidated Revenue Fund (CRF), which is administered by the Receiver General for Canada. All cash received by the Department is deposited to the CRF and all cash disbursements made by the Department are paid from the CRF. The net cash provided by the Government is the difference between all cash receipts and cash disbursements including transactions between departments of the Government.



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(d) Amounts due from/to the Consolidated Revenue Fund

Amounts due from or to the CRF are the result of timing differences at year-end between when a transaction affects authorities and when it is processed through the CRF. Amounts due from the CRF represent the net amount of cash that the Department is entitled to draw from the CRF without further authorities to discharge its liabilities.

(e) Revenues

- Revenues from regulatory fees are recognized in the accounts based on the services provided in the year.
- Funds received in advance from external parties for the provision of goods, services or the use of assets are recorded upon receipt as deferred revenue. These funds are recognized as revenues in the period in which the related expenses are incurred.
- Other revenues are accounted for in the period in which the underlying transaction or event that gave rise to the revenue takes place.

Revenues that are non-respendable are not available to discharge the Department's liabilities. While the DM is expected to maintain accounting control, he has no authority regarding the disposition of non-respendable revenues. As a result, non-respendable revenues are considered to be earned on behalf of the Government of Canada and are therefore presented in reduction of the entity's gross revenues.

(f) Expenses

Expenses are recorded on an accrual basis:

- Transfer payments are recorded as expenses when authorization for the payment exists and the recipient has met the eligibility (or the entitlements) criteria (for grants) or the performance conditions (for contributions) established for the transfer payment program. In situations where grant payments do not form part of an existing program, payments are

recorded as expenses when the Government announces a decision to make a non-recurring transfer, provided the enabling legislation or authorization for payment receives parliamentary approval prior to the completion of the financial statements.

- Vacation pay and compensatory leave are accrued as the benefits are earned by employees under their respective terms of employment.
- Services provided without charge by other government departments for accommodation, employer contributions to the health and dental insurance plans, worker's compensation coverage and legal services are recorded as operating expenses at their estimated cost.

(g) Employee future benefits

(i) Pension benefits

Eligible civilian employees participate in the Public Service Pension Plan, a multi-employer plan administered by the Government of Canada. The Department's contributions to the Plan are charged to expenses in the year incurred and represent the total departmental obligation to the Plan. The Department's responsibility with regard to the Plan is limited to its contributions as determined by the Chief Actuary of Canada. Actuarial surpluses or deficiencies are recognized in the financial statements of the Government of Canada, as the Plan's sponsor.

The Department administers pension benefits for members of the CAF, both Regular and Reserve forces. The Department contributes towards current and past service of members, and funds any actuarial shortfalls determined by the Chief Actuary of Canada. In addition to the regular contributions, current legislation also requires the Department to make contributions for actuarial deficiencies in the pension plans. These contributions by the Department are expensed in the year they are incurred. This accounting treatment corresponds to the funding provided to departments through Parliamentary authorities. The assets and



For the year ended March 31

liabilities related to the Superannuation Account of the CAF pension plan are not reflected in the Department's financial statements, as the Superannuation Account is the responsibility of the Government and is presented in the consolidated financial statements of the Government of Canada. Actuarial surpluses or deficiencies are recognized in the financial statements of the Government of Canada, as the Plan's sponsor.

(i) Severance benefits

Employees and CAF members entitled to severance benefits under labour contracts or conditions of employment earn these benefits as services necessary to earn them are rendered. The obligation related to the benefits earned by civilian employees is calculated using information derived from the results of the actuarially determined liability for severance benefits for the Government as a whole. The obligation related to the severance benefits earned by CAF members is based on an actuarial valuation calculated using demographic assumptions for CAF members.

(h) Accounts and Loans receivable

Accounts and loans receivable are stated at the lower of cost and net recoverable value. Transfer payments that are unconditionally repayable are recognized as loans receivable. A valuation allowance is recorded for receivables where recovery is considered uncertain.

(i) Contingent liabilities — Claims and Litigations

Contingent liabilities are potential liabilities, which may become actual liabilities when one or more future events occur or fail to occur. To the extent that the future event is likely to occur or fails to occur, and a reasonable estimate of the loss can be made, an estimated liability is accrued and an expense recorded. If the likelihood is not determinable, the contingency is disclosed in the notes to the financial statements.

(j) Environmental liabilities

Environmental liabilities consist of estimated costs related to the remediation of contaminated sites as well as estimated costs related to obligations associated with the retirement of tangible capital assets and other environmental liabilities.

(i) Contaminated sites

A liability for remediation of contaminated sites is recognized when all of the following criteria are satisfied: an environmental standard exists, contamination exceeds the environmental standard, the Government is directly responsible or accepts responsibility, it is expected that future economic benefits will be given up and a reasonable estimate of the amount can be made. The liability reflects the Government's best estimate of the amount required to remediate the sites to the current minimum standard for its use prior to contamination. When the cash flows required to settle or otherwise extinguish a liability is expected to occur over extended future periods, a present value technique is used. The discount rate applied is taken from the Government's CRF monthly lending rates for periods of one year and over. The discount rates used are based on the term rate associated with the estimated number of years to complete remediation. For remediation costs with estimated future cash flows spanning more than 25 years, the 25 year Government of Canada lending rate is used as the discount rate.



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(i) Asset retirement obligations

A liability for an asset retirement obligation is recognized when all of the following criteria are satisfied: there is an agreement, contract, legislation, or a constructive or equitable obligation that obligates the Government to incur retirement costs in relation to a tangible capital asset, the past event or transaction giving rise to the retirement liability has occurred, it is expected that future economic benefits will be given up, and a reasonable estimate of the amount can be made. These costs are normally capitalized and amortized over the asset's estimated useful life based on the Department's best estimates of the cost to retire the tangible asset. If the related asset is fully amortized, the related cost is expensed. The liability reflects the present value of estimated future cash flows required to retire the assets where amounts can be reasonably estimated and is expected to be settled as the related sites, facilities or assets are removed from service.

(i) Other environmental liabilities

A liability for unexploded explosive ordnance (UXO) affected legacy sites is recognized when there is an appropriate basis for measurement and a reasonable estimate can be made. These liabilities are present obligations to others arising from past transactions or events, the settlement of which is expected to result in the future sacrifice of economic benefits.

The recorded environmental liabilities are adjusted each year, as required, for present value adjustments, inflation, new obligations, changes in management estimates and actual costs incurred. If the likelihood of the Department's responsibility is not determinable, a contingent liability is disclosed in the notes to the financial statements. If measurement uncertainty exists, it is also disclosed in the notes to the financial statements.

(k) Inventory

Inventory consists of consumables and ammunition. Inventory is valued using a moving weighted average price methodology. Inventory managed by contractors and not held in the Defence Resource Management Information System (DRMIS) is valued according to the cost method used by the contractors (first-in, first-out (FIFO), last-in, first-out (LIFO), historical cost or moving weighted average). Items identified for disposal are excluded from the value of inventory as no value is expected to be recovered (for details, see note 14).

(l) Foreign currency transactions

Transactions involving foreign currencies are translated into Canadian dollar equivalents using rates of exchange in effect at the time of those transactions. Monetary assets and liabilities denominated in a foreign currency are translated into Canadian dollars using the rate of exchange in effect at year-end. Gains resulting from foreign currency transactions are included as revenues in Interest and gains on foreign exchange, and losses from foreign currency transactions are included in other expenses in the Consolidated Statement of Operations and Departmental Net Financial Position.

(m) Tangible capital assets

All tangible capital assets having an initial cost of \$30,000 or more, including capital leases, betterments, and leasehold improvements, are recorded at their acquisition cost. The Department does not capitalize intangible assets, works of art and historical treasures that have cultural, aesthetic or historical value, assets located on First Nations Reserves and museum collections. Asset pooled items (API) represent those items that support capital assets. These items are grouped in pools and the pools are treated as capital assets from a financial perspective. Individual items within the pools may have capitalization threshold values lower than \$30,000 as the threshold value applies to the pool itself. API values are included in the values of capital assets they support.



For the year ended March 31

Amortization of tangible capital assets is performed on a straight-line basis over the estimated useful life of the capital asset as follows:

Asset Class	Amortization Period
Buildings	10-40 years
Works	5-40 years
Machinery and equipment	3-30 years
Informatics hardware	3-30 years
Informatics software	2-10 years
Arms and weapons	3-30 years
Other equipment	5-30 years
Ships and boats	10-30 years
Aircraft	20-40 years
Non-military motor vehicles	2-30 years
Military vehicles	3-25 years
Other vehicles	4-30 years
Leasehold improvements	Lesser of useful life of the improvement or term of lease
Leased tangible capital assets	Economic life or term of lease

API are amortized at the estimated useful life of the pool.

Assets under construction are recorded in the applicable capital asset class in the year that they become available for use and are not amortized until they become available for use.

(n) Measurement uncertainty

The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses reported in the financial statements. At the time of preparation of these statements, management believes the estimates and assumptions to be reasonable. The most significant items where estimates are used are contingent liabilities, remediation liabilities, the liability for asset retirement obligations, the liability for employee future benefits, allowance for doubtful accounts, allowances to estimate pricing errors and value of dormant inventory and the useful life of tangible capital assets. Actual results could significantly differ from those estimates. Management's estimates are reviewed periodically and, as adjustments become necessary, they are recorded in the financial statements in the year they become known.

Environmental liabilities are subject to measurement uncertainty as discussed in note 5 due to the evolving technologies used in the estimation of the costs for remediation of contaminated sites or asset retirements, the use of discounted present value of future estimated costs, and the fact that not all sites have had a complete assessment of the extent and nature of remediation or retirement. Changes to underlying assumptions, the timing of the expenditures, the technology employed, or the revisions to environmental standards or changes in regulatory requirements could result in significant changes to the environmental liabilities recorded.



For the year ended March 31

3. Parliamentary authorities

The Department receives most of its funding through annual parliamentary authorities. Items recognized in the Consolidated Statement of Operations and Departmental Net Financial Position and the Consolidated Statement of Financial Position in one year may be funded through parliamentary authorities in prior, current or future years. Accordingly, the Department has different net results of operations for the year on a government funding basis than on an accrual accounting basis. The differences are reconciled in the following tables:

(a) Reconciliation of net cost of operations to current year authorities used

(in thousands of dollars)	2017	2016 (Restated note 21)
Net cost of operations before government funding and transfers	19,176,017	19,431,321
Adjustments for items affecting net cost of operations but not affecting authorities		
Amortization of tangible capital assets (note 15)	(2,545,517)	(2,490,333)
Services provided without charge by other government departments (note 18)	(773,556)	(735,364)
Decrease (increase) in employee future benefits	128,516	74,705
Refund of previous year's expenses	41,899	68,818
Decrease (increase) in vacation pay and compensatory leave	(1,348)	6,128
Loss on disposal of capital assets	(167,918)	(420,222)
Adjustments of tangible capital assets	55,269	377,869
Refund of program expenditures	37,225	155,450
Decrease (increase) in deferred revenue	617	(2,488)
Decrease (increase) in accrued liabilities not charged to authorities	(4,080)	(2,010)
Bad debt expense	(40,238)	(155,135)
Decrease (increase) in remediation liabilities (note 5)	(17,269)	(93,983)
Decrease (increase) in future asset retirement liabilities (note 5)	88,224	(251,327)
Proceeds from sale of assets	(18,274)	(12,706)
Miscellaneous	(40,124)	295,266
Total items affecting net cost of operations but not affecting authorities	(3,256,574)	(3,185,332)
Adjustments for items not affecting net cost of operations but affecting authorities		
Acquisition of tangible capital assets (note 15)	2,757,236	2,763,740
Decrease (increase) in lease obligations for tangible capital assets	66,980	63,684
Increase (decrease) in inventory purchases net of usage and adjustments	(253,475)	(108,370)
Increase (decrease) in prepaid expenses	84,239	(133,661)
Transition payments for implementing salary payments in arrears	14	307
Revenues collected from prior year receivables	31,717	(165,616)
Total items not affecting net cost of operations but affecting authorities	2,686,711	2,420,084
Current year authorities used	18,606,154	18,666,073



For the year ended March 31

3. Parliamentary authorities (continued)

(b) Authorities provided and used

(in thousands of dollars)	2017	2016
Vote 1 – Operating expenditures	14,304,176	14,164,552
Vote 5 – Capital expenditures	3,504,238	4,105,468
Vote 10 – Grants & contributions	162,993	165,552
Statutory amounts	1,498,958	1,561,838
Less:		
Authorities available for future years	(807,671)	(1,203,563)
Frozen allotments and other planned lapses	(56,540)	(36,063)
Residual lapse	0	(91,711)
Current year authorities used	18,606,154	18,666,073

4. Accounts payable and accrued liabilities

The following table presents details of the Department's accounts payable and accrued liabilities:

(in thousands of dollars)	2017	2016
Accounts payable – other government departments and agencies	129,051	109,517
Accounts payable – external parties	1,195,125	1,668,479
	1,324,176	1,777,996
Accrued liabilities*	802,716	826,298
Total accounts payable and accrued liabilities	2,126,892	2,604,294

* In Canada's Economic Action Plan 2012, the Government announced savings measures to be implemented by departments over the next three fiscal years starting in 2012-13. As a result, the Department has recorded at March 31, 2017, an obligation for termination benefits for an amount of \$18.5 million (\$22.4 million 2015-16) as part of accrued liabilities to reflect the estimated workforce adjustment costs.



For the year ended March 31

5. Environmental liabilities

(a) Remediation of contaminated sites

The Government has developed a “*Federal Approach to Contaminated Sites*”, which incorporates a risk-based approach to the management of contaminated sites. Under this approach the Government has inventoried the contaminated sites on federal lands that have been identified, allowing them to be classified, managed and recorded in a consistent manner. This systematic approach aids in the identification of the high risk sites in order to allocate limited resources to those sites which pose the highest risk to the environment and human health.

The Department has identified a total of 1,073 sites (1,118¹ sites in 2015-16) where contamination may exist and assessment, remediation and monitoring may be required. Of these, the Department has identified 279 sites (253 sites in 2015-16) where action is possible and for which a liability of \$509,885,970 (\$499,937,631 in 2015-16) has been recorded. This liability estimate has been determined after the sites are assessed and is based on environmental experts reviewing the results of site assessments, and proposing possible remediation solutions.

In addition, a statistical model based upon a projection of the number of sites that will proceed to remediation and upon which current and historical costs are applied is used to estimate the liability for a group of unassessed sites. As a result, there are 226 unassessed sites (304 in 2015-16) where a liability estimate of \$26,753,843 (\$19,432,968 in 2015-16) has been recorded using this model.

These two estimates combined totaling \$536,639,813 (\$519,370,599 in 2015-16), represents management’s best estimate of the costs required to remediate the sites to the current minimum standard for its use prior to contamination, based on the information available at the financial statement date.

On the remaining 568 sites (561 sites in 2015-16), no liability for remediation has been recognized. Some of these sites are at various stages of testing and evaluation and if remediation is required, liabilities will be reported as soon as a reasonable estimate can be determined. For other sites, the Department does not expect to give up any future economic benefits (there is no significant environmental impact or human health threats). These sites will be re-examined and a liability for remediation will be recognized if future economic benefits will be given up.

The following table presents the total estimated amounts of these liabilities by nature and source, the associated expected recoveries and the total undiscounted future expenditures as at March 31, 2017, and March 31, 2016. When the liability estimate is based on a future cash requirement, the amount is adjusted for inflation using a forecast CPI rate of 2%. Inflation is included in the undiscounted amount. The Government of Canada lending rate applicable to loans with similar terms to maturity has been used to discount the estimated future expenditures. The March 2017 rates range from 0.89% for 2 year term to 2.55% for a 25 or greater year term.

¹ 1,184 sites were reported in 2015-16, but this included 66 closed sites that had been remediated or had been assessed and found not to be contaminated. Closed sites are not reported in the current year.



For the year ended March 31

5. Environmental liabilities (continued)

(a) Remediation of contaminated sites (continued)

2017			
Nature and source	Number of sites	Estimated liability	Estimated undiscounted expenditure
Military and former military sites ⁽¹⁾	371	379,324,959	394,376,543
Fuel related practices ⁽²⁾	386	36,109,323	38,228,759
Landfill / waste sites ⁽³⁾	154	37,748,626	39,431,706
Engineered assets / air and land transportation ⁽⁴⁾	10	907,985	1,077,986
Marine facilities / aquatic sites ⁽⁵⁾	20	12,936,991	13,043,182
Office / commercial / industrial operations ⁽⁶⁾	64	19,239,779	19,432,096
Other ⁽⁷⁾	68	50,372,150	53,084,323
Totals	1073	536,639,813	558,674,595

2016 (Restated)			
Nature and source	Number of sites	Estimated liability	Estimated undiscounted expenditure
Military and former military sites ⁽¹⁾	385	415,555,904	433,854,762
Fuel related practices ⁽²⁾	391	43,359,416	44,579,433
Landfill / waste sites ⁽³⁾	165	43,697,871	45,182,149
Engineered assets / air and land transportation ⁽⁴⁾	10	961,733	1,018,834
Marine facilities / aquatic sites ⁽⁵⁾	20	3,382,414	3,444,344
Office / commercial / industrial operations ⁽⁶⁾	72	1,093,217	1,120,804
Other ⁽⁷⁾	75	11,320,044	11,359,000
Totals	1118	519,370,599	540,559,326

As at March 31, 2017 there are no expected recoveries.

(1) Contamination associated with the operations of military and former military sites where activities such as fuel handling and storage activities, waste sites, metals/PCB-based paint used on buildings resulted in former or accidental contamination, e.g. petroleum hydrocarbons, PCBs, heavy metals. Sites often have multiple sources of contamination.

(2) Contamination primarily associated with fuel storage and handling, e.g. accidental spills related to fuel storage tanks or former fuel handling practices, e.g. petroleum hydrocarbons, polyaromatic hydrocarbons and BTEX.

(3) Contamination associated with former landfill/waste site or leaching from materials deposited in the landfill/waste site, e.g. metals, petroleum hydrocarbons, polyaromatic hydrocarbons, BTEX, other organic contaminants, etc.



For the year ended March 31

5. Environmental liabilities (continued)

(a) Remediation of contaminated sites (continued)

(4) Contamination associated with the operations of engineered assets such as airports, railways and roads where activities such as fuel storage/handling, waste sites, firefighting training facilities and chemical storage areas resulted in former or accidental contamination, e.g. metals, petroleum hydrocarbons, polyaromatic hydrocarbons, BTEX and other organic contaminants. Sites often have multiple sources of contamination.

(5) Contamination associated with the operations of marine assets, e.g. port facilities, harbours, navigation systems, light stations, hydrometric stations, where activities such as fuel storage/handling, use of metal based paint (e.g. on light stations) resulted in former or accidental contamination, e.g. metals, petroleum hydrocarbons, polyaromatic hydrocarbons and other organic contaminants. Sites often have multiple sources of contamination.

(6) Contamination associated with the operations of office/commercial/industrial facilities where activities such as fuel storage/handling, waste sites and use of metal based paint resulted in former or accidental contamination, e.g. metals, petroleum hydrocarbons, polyaromatic hydrocarbons, BTEX, etc. Sites often have multiple sources of contamination.

(7) Contamination from other sources, e.g. use of pesticides, herbicides, fertilizers at agricultural sites; use of PCBs, firefighting training areas, firing ranges and training facilities, etc.

(b) Other environmental liabilities

A liability for UXO affected legacy sites is recognized when there is an appropriate basis for measurement and a reasonable estimate can be made. These liabilities present obligations to others arising from past transactions or events, the settlement of which is expected to result in the future sacrifice of economic benefits.

The Department has identified approximately 635 UXO suspected sites (893 sites in 2015-16) for which clearance action may be necessary. Of these sites, 68 sites (61 sites in 2015-16) are confirmed UXO affected sites. Based on the Department's best estimates, a liability of \$184 million (\$272 million in 2015-16) has been recorded for clearance action on 10 sites (10 sites in 2015-16) of the confirmed UXO sites. Remediation has been completed on 1 of the sites (14 in 2015-16) and it will be closed in the next fiscal year. The remaining 624 suspected sites (869 sites in 2015-16) are currently in the assessment stage and a

reasonable estimate cannot yet be determined. Of these sites, the obligation for clearance action is likely for 68 sites, indeterminable for 146 sites and unlikely for 410 sites.

The Department's ongoing efforts to assess contaminated sites, asset retirement obligations and UXO affected sites may result in additional environmental liabilities. Any additional liabilities will be accrued in the year in which they become known and can be reasonably estimated.



For the year ended March 31

6. Deposits and trust accounts

The following table presents details of the Department's deposits and trust accounts:

(in thousands of dollars)	2017	2016
Contractor security deposits		
Deposits, beginning of year	3,498	4,554
Deposits received	7,764	7,188
Refunds	(7,378)	(8,244)
Contractor security deposits, end of year	3,884	3,498
Trust account, estates – Armed Services*		
Trust account, beginning of year	774	1,239
Funds received	925	1,165
Payments	(1,233)	(1,630)
Trust account, estates – Armed Services, end of year	466	774
Closing balance	4,350	4,272

* The Trust Account, Estates – Armed Services was established to record the service estates of deceased members of the Canadian Forces pursuant to section 42 of the *National Defence Act*. Net assets of estates are distributed to legal heirs under the administration of the Judge Advocate General, in his capacity as Director of Estates.

7. Deferred revenue

Deferred revenue represents the balance at year-end of unearned revenues stemming from amounts received from external parties which are restricted to fund the expenditures related to amounts received for fees prior to services being performed. Revenue is recognized in the period that these expenditures are incurred or the service is performed. Details of the transactions related to this account are as follows:

(in thousands of dollars)	2017	2016
Foreign governments		
Beginning of year	6,341	4,539
Funds received	155,394	89,878
Revenue recognized	(155,465)	(88,076)
Foreign governments, end of year	6,270	6,341
Other specified purposes		
Beginning of year	6,476	5,790
Funds received	2,121	3,727
Revenue recognized	(2,667)	(3,041)
Other specified purposes, end of year	5,930	6,476
Closing balance	12,200	12,817



For the year ended March 31

8. Canadian Forces pension and insurance accounts

Established in 1901 under the *Militia Pension Act*, the present Canadian Forces pension plans (the “CF pension plans”) are administered in accordance with the provisions of the *Canadian Forces Superannuation Act*. The Canadian Forces pension plan (CFPP) covers all members of the Regular Force component of the CAF. Reserve Force members who have sufficient qualifying service and pensionable earnings are members of either the CFPP or the Reserve Force pension plan (RFPP), which came into force on March 1, 2007, depending on their employment status and earnings.

The Department maintains accounts to record the transactions pertaining to the CF pension plans, which comprise the Canadian Forces Superannuation Account (the “Superannuation Account”), the Canadian Forces Pension Fund Account (CFPF), the Retirement Compensation Arrangement Account (RCA), and the Reserve Force Pension Fund Account (RFPP). These accounts record transactions such as contributions, benefit payments, interest credits, refundable taxes, actuarial funding adjustments resulting from triennial reviews, and transfers to the Public Sector Pension Investment Board (PSPIB).

The value of the liabilities reported in these financial statements does not include the actuarial value of the liabilities determined by the Chief Actuary of the Office of the Superintendent of Financial Institutions nor the details of the investments that are held by PSPIB. Additional information on the CF pension plans, including audited financial statements, is published in the Annual Report of the Canadian Forces Pension Plans, which is available through the Department. For further information on PSPIB, please visit www.pspib.ca.

The CFPF and the RFPP do not earn interest. The Pension Fund Accounts are merely flow through accounts. At year-end, the balances in the Pension Fund Accounts represent net contributions transferable to PSPIB.

The Department also maintains the Regular Force Death Benefit Account, which provides life insurance to contributing members and former members of the CAF. This account records contribution, premiums, interest, and benefit payments.

The RCA records transactions for pension benefits that are provided in excess of those permitted under the *Income Tax Act*. The RCA is registered with Canada Revenue Agency (CRA) and a transfer is made annually between the RCA Account and CRA to either remit a 50-percent refundable tax in respect of the net contributions and interest credits or to be credited a reimbursement based on the net benefit payments. As at March 31, 2017, the total refundable tax transferred amounts to \$402 million (\$382 million in 2015-16).



For the year ended March 31

8. Canadian Forces pension and insurance accounts (continued)

The following table provides details of the Canadian Forces pension and insurance accounts liability as presented in the Statement of Financial Position:

(in thousands of dollars)	2017	2016
Canadian Forces Pension Fund Account		
Beginning of year	168,858	183,465
Funds received and other credits	1,387,813	1,461,393
Payments and other charges	(723,932)	(626,688)
Transfers to the Public Sector Pension Investment Board	(659,149)	(849,312)
Canadian Forces Pension Fund Account, end of year	173,590	168,858
Reserve Force Pension Fund Account		
Beginning of year	(51,192)	(2,552)
Funds received and other credits	57,155	71,473
Payments and other charges	(68,978)	(120,113)
Reserve Force Pension Fund Account, end of year	(63,015)	(51,192)
Retirement Compensation Arrangements Account		
Beginning of year	392,100	373,531
Funds received and other credits	45,368	46,898
Payments and other charges	(28,250)	(28,329)
Retirement Compensation Arrangements Account, end of year	409,218	392,100
Regular Force Death Benefit Account		
Beginning of year	185,452	187,511
Funds received and other credits	29,416	28,524
Payments and other charges	(25,368)	(30,583)
Regular Force Death Benefit Account, end of year	189,500	185,452
Closing balance	709,293	695,218



For the year ended March 31

8a. Canadian Forces Superannuation Account

The Superannuation Account was created in order to record notional transactions for service prior to April 01, 2000. The Superannuation Account does not hold any investment assets. The amount of interest credited on the account is as though net contributions were invested quarterly in 20-year Government of Canada bonds issued at prescribed rates and held to maturity.

The assets and liabilities related to the Superannuation Account are not reflected in the Department's Financial Statements as the Superannuation Account is the responsibility of the Government of Canada.

Details of the Superannuation Account, including actuarial surpluses or deficiencies, can be found in the Annual Report of the Canadian Forces Pension Plans and in the *Public Accounts of Canada*.

The table below does not include the actuarial value of the liabilities determined by the Chief Actuary of the Office of the Superintendent of Financial Institutions, and is provided for information purposes only to disclose the transactions and account balance.

(in thousands of dollars)	2017	2016
Canadian Forces Superannuation Account		
Beginning of year	45,695,153	46,118,651
Funds received and other credits	1,984,082	2,145,885
Payments and other charges	(2,470,708)	(2,569,383)
Canadian Forces Superannuation Account, end of year	45,208,527	45,695,153



For the year ended March 31

9. Lease obligations for tangible capital assets

The Department has entered into agreements to lease certain tangible capital assets under capital leases with a cost of \$847 million and accumulated amortization of \$654 million as at March 31, 2017 (\$852 million and \$618 million respectively as at March 31, 2016). The obligations for the upcoming years include the following:

(in thousands of dollars)	Total future minimum lease payments	Imputed interest (5.29% to 8.05%)	Balance of obligations 2017	Balance of obligations 2016
Buildings	97,198	(23,174)	74,024	83,091
Aircraft	182,462	(15,474)	166,988	224,901
Total	279,660	(38,648)	241,012	307,992

Future minimum lease payments

(in thousands of dollars)	2017-18	2018-19	2019-20	2020-21	2021-22 and thereafter	Total
Buildings	13,854	11,780	11,185	10,649	49,730	97,198
Aircraft	70,105	70,105	38,652	3,600	0	182,462
Total	83,959	81,885	49,837	14,249	49,730	279,660

The Department has also entered into agreements for buildings and aircraft under capital leases (refer to note 15).

10. Employee future benefits

(a) Pension benefits

The Department's Public Service employees participate in the Public Service Pension Plan (the "Plan"), which is sponsored and administered by the Government of Canada. Pension benefits accrue up to a maximum of 35 years at a rate of 2 percent per year of pensionable service, times the average of the best five consecutive years of earnings. The benefits are integrated with Canada/Québec Pension Plan benefits and they are indexed to inflation.

Both the employees and the Department contribute to the cost of the Plan. Due to the amendment of the *Public Service Superannuation Act* following the implementation of provisions related to *Canada's Economic Action Plan 2012*, employee contributors have been divided into two groups – Group 1 relates to existing plan members as of December 31, 2012 and Group 2 relates to members joining the Plan as of January 1, 2013. Each group has a distinct contribution rate.



For the year ended March 31

10. Employee future benefits (continued)

(a) Pension benefits (continued)

The 2016-17 expense amounts to \$178.0 million (\$178.4 million in 2015-16). For Group 1 members, the expense represents approximately 1.12 times (1.25 times in 2015-16) the contributions by employees and, for Group 2 members, approximately 1.08 times (1.24 times in 2015-16) the contributions by employees.

The Department's responsibility with regard to the Plan is limited to its contributions. Actuarial surpluses or deficiencies are recognized in the financial statements of the Government of Canada, as the Plan's sponsor.

The members of the Canadian Armed Forces Regular Force and eligible members of the Reserve Force participate in the Canadian Forces pension plan, which is sponsored by the Government of Canada and administered by the Department. Pension benefits accrue up to a maximum of 35 years at a rate of 2 percent per year of pensionable service, times the average of the best five consecutive years of earnings. The benefits are integrated with Canada/Québec Pension Plan benefits and are indexed to inflation.

The members of the Canadian Armed Forces Reserve Force who are not eligible for participation in the Canadian Forces pension plan, may be eligible to participate in the Reserve Force pension plan, which is sponsored by the Government of Canada and administered by the Department. Pension benefits accrue at a rate of 1.5 percent of pensionable earnings during the member's service, plus an additional 0.5 percent times the average of the best five consecutive years of earnings for those members who are not yet eligible for Canada/Québec Pension Plan benefits. The benefits are integrated with Canada/Québec Pension Plan benefits and are indexed to inflation.

Both the members and the Department contribute to the cost of the CF pension plans for both current and prior service. The 2016-17 expense amounts to \$947.0 million (\$999.7 million in 2015-16), which represents approximately 1.9 times (2.07 times in 2015-16) the contributions by employees.

The Department is responsible for providing program management and the day-to-day administration of the CF pension plans. The actuarial liability and actuarial surpluses or deficiencies are recognized in the financial statements of the Government of Canada, as the sponsor of the CF pension plans.

As a result of the actuarial funding report by the Office of the Chief Actuary, the President of Treasury Board has approved:

- Annual actuarial adjustments of \$170 million (\$170 million in 2015-16) to fund the deficit in the Canadian Forces Pension Fund Account, and \$4.2 million (\$1.9 million in 2015-16) for the Reserve Force Pension Fund Account until the deficit is funded as per the triennial funding valuation.

For more information on these adjustments, please consult the actuarial reports, available at the Office of the Chief Actuary's website (<http://www.osfi-bsif.gc.ca>).



For the year ended March 31

10. Employee future benefits (continued)

(b) Severance benefits

The Department provides severance benefits to its Public Service employees and CAF members based on eligibility, years of service, final salary and authorized period of service. These severance benefits are not pre-funded. Benefits will be paid from future authorities.

Commencing in 2012, as part of collective agreement negotiations with certain employee groups, and changes to conditions of employment for executives and certain non-represented employees, the accumulation of severance benefits under the employee severance pay program ceased for these employees. Employees subject to these changes have been given the option to be immediately paid the full or partial value of benefits earned to date or collect the full or remaining value of benefits on termination from the public service. These changes have been reflected in the calculation of the outstanding severance benefit obligation disclosed below.

Information about the severance benefits, measured as at March 31, is as follows:

(in thousands of dollars)	2017	2016
Public Service Employees		
Accrued benefit obligation, beginning of year	108,701	113,806
Expenses for the year	(15,131)	9,092
Benefits paid during the year	(10,269)	(14,197)
Accrued benefit obligation, end of year	83,301	108,701
Canadian Armed Forces Members		
Accrued benefit obligation, beginning of year	792,100	861,700
Expenses for the year	(22,182)	13,902
Benefits paid during the year	(80,934)	(83,502)
Accrued benefit obligation, end of year	688,984	792,100
Total accrued benefit obligation, end of year	772,285	900,801



For the year ended March 31

11. Accounts receivable

The following table presents details of accounts receivable:

(in thousands of dollars)	2017	2016
External parties	235,153	389,285
Other government departments and agencies	268,293	175,184
	503,446	564,469
Less: allowance for doubtful accounts on external receivables	53,852	161,468
Gross accounts receivable	449,594	403,001
Accounts receivable held on behalf of Government	(5,232)	(11,898)
Net Receivable	444,362	391,103

12. Loans and advances

The following table presents details of loans and advances:

(in thousands of dollars)	2017	2016
Imprest accounts, standing advances and authorized loans to CAF members	48,119	38,858
Accountable advances (temporary advances)	2,207	194
Total loans and advances	50,326	39,052

13. Prepaid expenses

The following is a breakdown of prepaid expenses:

(in thousands of dollars)	2017	2016
Mercury Global Military Wideband Satellite Communications Project	224,497	184,275
Foreign Military Purchases	201,178	209,300
Sea Sparrow Missiles	132,377	75,461
Airlift Capability Project	77,403	80,168
NATO Flying Training Canada (NFTC)	55,140	53,764
Building rentals	16,035	15,217
Other purchases	21,767	25,973
Total prepaid expenses	728,397	644,158



For the year ended March 31

14. Inventory

The following table presents the details of inventory, measured at cost using the moving weighted average method except for inventory managed by contractors and not held in Defence Resource Management Information System (DRMIS), which is valued according to the cost method used by the contractors:

(in thousands of dollars)	2017	2016 (Restated note 21)*
Ammunition, bombs and missiles	3,360,962	3,484,278
Uniforms and clothing	412,711	376,332
Contractor held inventory	346,720	381,016
Metal	291,017	293,961
Communication, electrical parts/accessories and informatics equipment	248,309	318,835
Engineering, test and technical equipment and machine tools	221,989	246,270
Ship spares	195,282	187,393
Land equipment spares	165,765	177,910
Aircraft spares	135,387	119,766
Sonobuoys, parts and accessories	130,176	136,880
Medical equipment	117,113	105,794
Fuel, petroleum and oil	37,448	64,633
Miscellaneous	147,763	171,049
Total inventory	5,810,642	6,064,117

The cost of consumed inventory recognized as an expense in the Consolidated Statement of Operations and Departmental Net Financial Position is \$795 million in 2016-17 (\$587 million in 2015-16).

The Department is undergoing a review of its business processes related to the valuation of inventory. An analysis completed in 2016-17 resulted in an allowance of \$154 million, which is reflected in the table above.

* In 2016-17 the Department reclassified \$169.9 million of inventory to API with retroactive effect (note 21).



For the year ended March 31

15. Tangible Capital Assets

The following table presents details of the cost of tangible capital assets:

(in thousands of dollars)	Balance beginning of year (Restated note 21)	Adjustments ⁽¹⁾	Acquisitions	Disposals and write-offs	Balance end of year
Land, buildings and works					
Land	86,264	0	0	(5)	86,259
Buildings	9,650,245	459,987	609	(16,944)	10,093,897
Works	2,584,001	68,849	2,943	(26,490)	2,629,303
	12,320,510	528,836	3,552	(43,439)	12,809,459
Machinery and equipment					
Machinery and equipment	7,146,252	176,715	150,051	(16,602)	7,456,416
Informatics hardware	7,282,935	(15,327)	69,288	(108,732)	7,228,164
Informatics software	905,238	3,592	232	(480)	908,582
Arms and weapons	5,535,737	599,663	1,202	(326,290)	5,810,312
Other equipment	436,231	(323,672)	35,298	(2,187)	145,670
	21,306,393	440,971	256,071	(454,291)	21,549,144
Ships, aircraft and vehicles					
Ships and boats	14,088,442	285,523	41,519	(37,319)	14,378,165
Aircraft	18,459,524	486,603	18,032	(210,935)	18,753,224
Non-military motor vehicles	990,059	3,066	74,801	(35,475)	1,032,451
Military vehicles	1,691,539	(9,213)	2,885	(51,853)	1,633,358
Other vehicles	435,828	20,885	18,494	(4,564)	470,643
	35,665,392	786,864	155,731	(340,146)	36,267,841
Leasehold improvements					
Leasehold improvements	76,592	14,660	0	(146)	91,106
	76,592	14,660	0	(146)	91,106
Leased tangible capital assets					
Buildings	155,400	0	0	0	155,400
Other equipment	48	0	0	0	48
Aircraft	696,876	0	0	(5,590)	691,286
	852,324	0	0	(5,590)	846,734
Assets under construction					
Buildings	843,967	(481,092)	464,876	0	827,751
Engineering works	98,028	(59,448)	147,053	0	185,633
Informatics software	201,357	(34,004)	36,777	(3,597)	200,533
Equipment	4,702,463	(1,608,264)	1,693,176	(1,998)	4,785,377
	5,845,815	(2,182,808)	2,341,882	(5,595)	5,999,294
Gross tangible capital assets	76,067,026	(411,477)	2,757,236	(849,207)	77,563,578

(1) Adjustments represent adjustments to asset pooled items (API), assets under construction put into use and reclassifications.

During 2016-17, the Department transferred out land (book value of one dollar) to Fisheries and Oceans Canada. Also during 2016-17, the Department transferred in land (net book value of one dollar) and works and infrastructure (net book value of one dollar) from Fisheries and Oceans Canada, a non-military motor vehicle (net book value of \$100.33 thousands) from Global Affairs Canada and machinery and equipment (net book value of \$99.06 thousands) from Environment and Climate Change Canada. These transfers are included in the adjustments column.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)



For the year ended March 31

15. Tangible capital assets (continued)

The following table presents details of the amortization of tangible capital assets and its net book value:

(in thousands of dollars)	Balance beginning of year (Restated note 21)	Adjustments	Amortization	Disposals and write-offs	Balance end of year	Net Book Value	
						2017	2016 (Restated note 21)
Land, buildings and works							
Land	0	0	0	0	0	86,259	86,264
Buildings	4,203,118	1,323	251,966	(11,240)	4,445,167	5,648,730	5,447,127
Works	1,448,753	1,633	72,870	(23,472)	1,499,784	1,129,519	1,135,248
	5,651,871	2,956	324,836	(34,712)	5,944,951	6,864,508	6,668,639
Machinery and equipment							
Machinery and equipment	5,358,912	6,915	228,218	(7,029)	5,587,016	1,869,400	1,787,340
Informatics hardware	6,535,409	(71,189)	142,087	(102,568)	6,503,739	724,425	747,526
Informatics software	525,077	627	77,140	(93)	602,751	305,831	380,161
Arms and weapons	3,027,243	(13,381)	179,458	(193,452)	2,999,868	2,810,444	2,508,494
Other equipment	382,543	(290,493)	30,367	(1,858)	120,559	25,111	53,688
	15,829,184	(367,521)	657,270	(305,000)	15,813,933	5,735,211	5,477,209
Ships, aircraft and vehicles							
Ships and boats	8,948,788	(142,026)	650,232	(20,921)	9,436,073	4,942,092	5,139,654
Aircraft	10,160,643	49,423	721,273	(208,732)	10,722,607	8,030,617	8,298,881
Non-military motor vehicles	637,901	(6,476)	61,015	(34,670)	657,770	374,681	352,158
Military vehicles	1,327,582	(12,555)	65,783	(50,132)	1,330,678	302,680	363,957
Other vehicles	295,782	9,258	18,023	(4,157)	318,906	151,737	140,046
	21,370,696	(102,376)	1,516,326	(318,612)	22,466,034	13,801,807	14,294,696
Leasehold improvements							
Leasehold improvements	38,406	0	6,525	(143)	44,788	46,318	38,186
	38,406	0	6,525	(143)	44,788	46,318	38,186
Leased tangible capital assets							
Buildings	80,636	0	6,803	0	87,439	67,961	74,764
Other equipment	48	0	0	0	48	0	0
Aircraft	537,031	0	33,757	(4,548)	566,240	125,046	159,845
	617,715	0	40,560	(4,548)	653,727	193,007	234,609
Assets under construction							
Buildings						827,751	843,967
Engineering works						185,633	98,028
Informatics software						200,533	201,357
Equipment						4,785,377	4,702,463
						5,999,294	5,845,815
Total	43,507,872	(466,941)	2,545,517	(663,015)	44,923,433	32,640,145	32,559,154



For the year ended March 31

15. Tangible capital assets (continued)

As at March 31, 2017 the Department had \$24.5 million in net book value of capital asset holdings (\$3,768 million acquisition value) that had been declared surplus for operational requirements. These assets have not yet been disposed. Further evaluation of these capital asset holdings will be conducted in future fiscal years and once the review is completed, the applicable write-off accounting entries will be recorded.

16. Contingent liabilities

Contingent liabilities arise in the normal course of the operations of the Department and their ultimate disposition is unknown. The Department is involved in contingent liabilities on claims and litigations.

Claims and litigations

Claims have been made against the Department in the normal course of operations. These claims include items with pleading amounts and others for which no amount is specified. While the total amount claimed in these actions is significant, their outcomes are not determinable. The Department has recorded an allowance for claims and litigations where it is likely that there will be a future payment and a reasonable estimate of the loss can be made. Claims and litigations for which the outcome is not determinable and a reasonable estimate can be made by management amount to approximately \$50.6 million (\$3.5 million in 2015-16) at March 31, 2017.

17. Contractual obligations

The nature of the Department's activities can result in some large multi-year contracts and obligations whereby the Department will be obligated to make future payments when the services/goods are received. Contractual obligations over \$10 million that can be reasonably estimated are summarized as follows:

(in thousands of dollars)	2017-18	2018-19	2019-20	2020-21	2021-22 and thereafter	Total
Fixed assets	2,192,277	1,778,572	1,206,513	860,969	1,554,545	7,592,876
Purchases	3,476,933	1,421,161	1,252,684	860,461	6,129,407	13,140,646
Total	5,669,210	3,199,733	2,459,197	1,721,430	7,683,952	20,733,522

18. Related party transactions

The Department is related as a result of common ownership to all government departments, agencies and crown corporations. The Department enters into transactions with these entities in the normal course of business and on normal trade terms. During the year, the Department received common services which were obtained without charge from other government departments as disclosed below.



For the year ended March 31

(a) Common services provided without charge by other government departments

During the year, the Department received services without charge from certain common service organizations, related to accommodation, legal services, the employer's contribution to the health and dental insurance plans and workers' compensation coverage. These services provided without charge have been recorded in the Department's Statement of Operations and Departmental Net Financial Position as follows:

(in thousands of dollars)	2017	2016
Employer's contributions to the health and dental plans paid by Treasury Board of Canada Secretariat	696,250	648,821
Accommodation provided by Public Services and Procurement Canada (PSPC)	66,033	75,430
Worker's compensation coverage provided by Employment and Social Development Canada	7,260	7,418
Legal services provided by Department of Justice Canada	4,013	3,695
Total	773,556	735,364

(b) Other transactions with related parties

(in thousands of dollars)	2017	2016
Expenses – other government departments and agencies	1,226,786	1,229,420
Revenues – other government departments and agencies	18,392	20,871
Total	1,245,178	1,250,291

Expenses and revenues disclosed in (b) exclude common services provided without charge, which are already disclosed in (a).

19. Transfers to other government departments

Transfer of the transition payments for implementing salary payments in arrears

The Government of Canada implemented salary payments in arrears in 2014-15. As a result, a one-time payment was issued to employees and will be recovered from them in the future. The transition to salary payments in arrears forms part of the transformation initiative that replaces the pay system and also streamlines and modernizes the pay processes. This change to the pay system had no impact on the expenses of the Department. However, it did result in the use of additional spending authorities by the Department. Prior to year end, the transition payments for implementing salary payments in arrears were transferred to a central account administered by PSPC, who is responsible for the administration of the Government pay system.

In 2016-17, payments in the amount of \$14 thousand (\$307 thousand in 2015-16) continued to be transferred to PSPC for the implementation of salary payments in arrears.



For the year ended March 31

20. Segmented information

The presentation by segment is based on the Department's program alignment architecture as stated in note 1 and is based on the accounting policies as described in the Summary of significant accounting policies in note 2. The following table presents the expenses incurred and revenues generated for the main program, by major object of expense and by major type of revenue. The segment results for the period are as follows:

(in thousands of dollars)	DCSO ¹	DSCG ²	DRFEP ³	DCEP ⁴
Operating expenses				
Salary and employee benefits	838,940	299,201	2,895,043	4,803,594
Amortization	85	17	295	2,545,120
Professional and special services	167,198	25,180	64,844	1,642,938
Repair and maintenance	17,603	909	6,786	1,281,864
Expenses related to tangible assets	22,611	4,472	65,697	943,327
Materials and supplies	72,503	33,284	315,777	469,038
Transportation and communication	61,882	28,775	138,085	531,867
Other services	24,351	8,201	44,901	292,210
Accommodation	12,798	10,065	31,641	130,151
Equipment and other rentals	16,386	16,274	94,709	46,938
Utilities	2,238	369	1,310	168,130
Loss on disposals and write-offs and write-downs of assets	167,918	0	0	0
Bad debts	1,202	471	1,833	30,152
Interest on capital lease payments	70,551	0	0	(54,403)
Advertising, printing and related services	3,724	377	1,032	7,992
Other expenses	(83,105)	3,533	190,607	75,929
Total operating expenses	1,396,885	431,128	3,852,560	12,914,847
Transfer payments				
Transfers to other countries and international organizations	130,839	0	9,500	(8)
Transfers to other levels of government	0	0	0	5,177
Transfers to non-profit organizations	0	4,782	0	0
Transfers to individuals	0	0	0	2,161
Total transfer payments	130,839	4,782	9,500	7,330
Total expenses	1,527,724	435,910	3,862,060	12,922,177
Revenues				
Sale of goods and services	113,428	(24,745)	10,892	267,310
Gains on disposals of assets	72	5	6,229	9,098
Interest and gains on foreign exchange	513	49	1,408	9,463
Revenues earned on behalf of Government	0	0	(2,070)	0
Other	5	271	90	3,008
Total revenues	114,018	(24,420)	16,549	288,879
Net cost from continuing operations	1,413,706	460,330	3,845,511	12,633,298



For the year ended March 31

20. Segmented information (continued)

(in thousands of dollars)	DCDR ⁵	IS ⁶	2017	2016 (Restated note 21)
Operating expense				
Salary and employee benefits	256,082	328,402	9,421,262	9,354,210
Amortization	0	0	2,545,517	2,490,333
Professional and special services	70,970	26,824	1,997,954	1,868,355
Repair and maintenance	6,538	4,468	1,318,168	1,323,505
Expenses related to tangible assets	14,741	3,970	1,054,818	858,283
Materials and supplies	7,197	3,658	901,457	836,383
Transportation and communication	15,147	6,741	782,497	696,910
Other services	38,346	86,867	494,876	493,271
Accommodation	2,158	3,338	190,151	197,900
Equipment and other rentals	879	969	176,155	163,367
Utilities	5	0	172,052	159,659
Loss on disposals and write-offs and write-downs of assets	0	0	167,918	420,222
Bad debts	2,623	3,957	40,238	155,135
Interest on capital lease payments	0	0	16,148	19,271
Advertising, printing and related services	994	844	14,963	15,800
Other expenses	38,099	(47,945)	177,118	804,008
Total operating expenses	453,779	422,093	19,471,292	19,856,612
Transfer payments				
Transfers to other countries and international organizations	0	0	140,331	140,080
Transfers to other levels of government	0	(29)	5,148	3,918
Transfers to non-profit organizations	129	0	4,911	5,689
Transfers to individuals	0	0	2,161	2,577
Total transfer payments	129	(29)	152,551	152,264
Total expenses	453,908	422,064	19,623,843	20,008,876
Revenues				
Sale of goods and services	1,395	41,498	409,778	449,750
Gains on disposals of assets	174	2,713	18,291	17,771
Interest and gains on foreign exchange	274	3,463	15,170	20,758
Revenues earned on behalf of Government	(1,282)	(6,840)	(10,192)	(18,251)
Other	0	11,405	14,779	108,865
Total revenues	561	52,239	447,826	578,893
Net cost from continuing operations	453,347	369,825	19,176,017	19,429,983

- (1) DCSO Defence Combat and Support Operations
(2) DSCG Defence Services and Contributions to Government
(3) DRFEP Defence Ready Force Element Production

- (4) DCEP Defence Capability Element Production
(5) DCDR Defence Capability Development and Research
(6) IS Internal Services



For the year ended March 31

21. Accounting changes

Restatement of previous year's results

The Department is undergoing a multi-year review of its business processes related to the recording and valuation of tangible capital assets and inventory. In 2016-17 this review identified capital assets and inventory that should have been reported in previous fiscal years, and also the Department reclassified \$169.9 million of inventory to API.

In 2016-17 the remediation liability has been restated to conform to the current year's presentation, which includes both the liability recorded in the accounts of the Department and by the central agency.

The effect of the resulting retroactive adjustments are presented below:

(in thousands of dollars)	2016 As previously stated	Effect of changes	2016 Restated
Consolidated Statement of Financial Position			
Remediation liabilities (note 5)	499,938	19,433	519,371
Total liabilities	5,474,333	19,433	5,493,766
Departmental net debt	2,246,313	19,433	2,265,746
Inventory (note 14)	6,234,105	(169,988)	6,064,117
Tangible capital assets (note 15)	32,392,302	166,852	32,559,154
Total non-financial assets	39,270,565	(3,136)	39,267,429
Departmental net financial position	37,024,252	(22,569)	37,001,683
Consolidated Statement of Operations and Departmental Net Financial Position			
Total expenses	20,002,339	6,537	20,008,876
Net cost from continuing operations	19,423,446	6,537	19,429,983
Net cost of operations before government funding and transfers	19,424,784	6,537	19,431,321
Net cost of operations after government funding and transfers	113,933	6,537	120,470
Departmental net financial position - beginning of year	37,138,185	(16,032)	37,122,153
Departmental net financial position - end of year	37,024,252	(22,569)	37,001,683
Consolidated Statement of Change in Departmental Net Debt			
Net cost of operations after government funding and transfers	113,933	6,537	120,470
Adjustments of tangible capital assets	349,520	28,349	377,869
Total change due to tangible capital assets	189,471	28,349	217,820
Change due to inventories	(92,917)	(15,453)	(108,370)
Departmental net debt - end of year	2,246,313	19,433	2,265,746
Consolidated Statement of Cash Flows			
Net cost of operations before government funding and transfers	19,424,784	6,537	19,431,321
Adjustments of tangible capital assets	349,520	28,349	377,869
Decrease in inventories	(92,917)	(15,453)	(108,370)

22. Comparative information

Comparative figures have been reclassified to conform to the current year's presentation.



1. Introduction

This document provides summary information on the measures taken by the Department to maintain an effective system of internal control over financial reporting, including information on internal control management, assessment of results and related action plans. Over the past year the Department has made tremendous progress to successfully complete its testing of Design and Operating effectiveness. This work was completed ahead of schedule.

Detailed information on the Department's authority, mandate and program activities can be found in the 2016-17 Report on Plans and Priorities and the 2017-18 Departmental Plan.

2. Departmental system of ICFR

2.1 Internal control management

The Department has a well-established governance and accountability structure to support departmental assessment efforts and oversight of its system of internal control. A departmental internal control management framework, approved by the Deputy Minister (DM), is in place and includes:

- Organizational accountability structures as they relate to internal control management to support sound financial management, including roles and responsibilities of senior managers in their areas of responsibility for control management;
- A focused internal control management group under the Chief Financial Officer (CFO) to monitor the effectiveness of ICFR across the Department, including reporting on deficiencies and providing assistance to business process owners in the implementation of ICFR;
- An internal financial attestation process in support of certification by the DM and CFO, whereby senior departmental executives who report to the DM attest that they have maintained an effective system of

internal control over financial reporting in their area of responsibility;

- A Defence Ethics Program which is a comprehensive values-based program put in place to meet the needs of the Department and the Canadian Armed Forces (CAF), at both the individual and the organizational levels;
- A comprehensive Fraud Management Strategy that protects the Department's resources from fraud, waste and abuse through a prevention and detection framework;
- Ongoing communication and training on statutory requirements, and policies and procedures for sound financial management and control;
- Regular monitoring of internal control management by Internal Audit as well as the provision of related assessments of results and action plans to the Deputy Minister and departmental senior management; and
- The Departmental Audit Committee (DAC) has oversight on the adequacy and functioning of the Department's risk, management and control and governance framework and processes.

2.2 Service arrangements relevant to financial statements

The Department relies on other organizations for the processing of certain transactions that are recorded in its Departmental Financial Statements as follows:

(i) Common Arrangements:

- Public Services and Procurement Canada (PSPC) centrally administers the payments of salaries and the procurement of goods and services as per the delegation of authority of other government organizations. PSPC also administers the Receiver General Central Systems used to make payments on behalf of the Department;
- The Treasury Board of Canada Secretariat provides the Department with information used to calculate various accruals and allowances, such as the accrued severance liability;
- Shared Services Canada provides information technology infrastructure services and support to the Department, such as but not limited to, email, data centres and network services;



- The Department of Justice provides legal services to the Department, as well as information for establishing the contingent liability note to the financial statements and for inclusion in the *Public Accounts of Canada*; and
- PSPC provides Pension services to Canadian Armed Forces members.

(i) Specific Arrangements:

- Defence Construction Canada provides contracting, construction contract management and payment processing services as well as infrastructure support to the Department in accordance with the Memorandum of Understanding between the two organizations and as per the Department's Delegation of Authorities instrument; and
- The Office of the Superintendent of Financial Institutions provides the Department with the accrued severance liability amount for the CAF.

3. Departmental assessment results during fiscal year 2016-17

The Department is one of the largest and most complex organizations in the Government of Canada with annual expenditures of almost \$20 billion, revenues of \$500 million and assets in excess of \$40 billion (net book value) managed in a highly decentralized financial environment. There are three separate payroll systems, all currently undergoing major transformations, which annually expend more than \$9 billion in salaries and benefits to more than 100,000 Regular and Reserve Force military members as well as civilian employees. Furthermore, there are two major Enterprise Resource Planning systems, Defence Resource Management Information System and Human Resource Management System, which support the business and extend to every operational area of the Department.

The Department continued with its implementation of the Policy on Internal Control and with its plan to carry out documentation, design and operating effectiveness testing for the assessment of ICFR in key control areas consisting of Entity-Level Controls, Information Technology General Controls and various Business Process Controls.

3.1 Design effectiveness testing of key controls

In 2016-17, in accordance with the multi-year departmental plan, the Department completed the design effectiveness testing of key controls earlier than the initial plan. All this work was accomplished ahead of the schedule by leveraging internal resources and contractors. Transformation initiatives will continue to improve processes and compensating controls have been put in place where risks are high and will remain in place until process changes are fully implemented.

3.2 Operating effectiveness testing of key controls

In accordance with the multi-year departmental action plan, operating effectiveness testing of key controls for the business processes was completed for 2016-17. The Department did not identify any significant deficiency that could lead to material misstatement of its financial statements.

3.3 Ongoing monitoring and continuous improvement of key controls

The Department continued its on-going monitoring activities for business processes initiated in previous years for Entity Level Control, IT General Control and Revenues and Receivables. Moreover, in 2016-17, the Department conducted a risk-based approach for monitoring of prepaid expenses. The Department's ongoing monitoring plan is refreshed based on risk, finding, key changes to business processes and transformation initiatives. This is all in accordance with Government of Canada management accountability framework requirements.



4. Departmental action plan

4.1 Progress during fiscal year 2016-17

During fiscal year 2016-17 through collaboration with various organizations, the Department has made significant strides to re-design and implement business processes to address and mitigate control deficiencies previously identified. Included in some of these new business processes is a complete re-design of the payment card program; a new direct asset buy process; introduction of a quality assurance process for salaries and benefits; improved classification of materiel; and a new process for losses of inventory and capital assets. These changes have provided the Department with improved timeliness, accuracy, and completeness and increased visibility of reporting. All this work has allowed the Department to progress towards ongoing monitoring at the end of fiscal year 2016-17.

The Department has successfully implemented the internal control policy; business processes and controls have been documented, tested and remediated. Compensating controls have been implemented where risk was too high and will remain in place until transformation initiatives have been completed.

As stated in section 3.3, the Department has developed ongoing monitoring activities for some of its processes and will complete the implementation of ongoing monitoring for the remaining business processes in 2017-18. The plan will be reassessed on an annual basis.

4.2 Status and action plan for the next fiscal year and subsequent years

The Department has met the requirements of the Office of the Comptroller General on internal controls and is moving to full monitoring activities. Senior management remains committed to ensuring continuous improvement of financial controls through the Assistant Deputy Minister (ADM) Financial Control Steering Committee, the Deputy Minister Council and the DAC.

In 2017-18, the Chief Financial Officer's team will continue to monitor and test financial controls and will participate as a key stakeholder in transformation initiatives and projects undertaken by the Department to ensure adequate controls are in place and properly maintained. The internal control team under the CFO will continue to support business process owners to maintain proper documentation and improve the development of business frameworks, procedure, tools and monitoring activities. Internal controls' compliance remains a key component of ADM's and equivalent's accountability.

The Department will finalize a five step rotational ongoing monitoring plan as recommended by the Office of the Comptroller General in 2017-18. The Department will execute the detailed multi-year ongoing monitoring plan over a three to five year cycle depending on the risks of each process. The five steps include a detailed risk assessment, development of an ongoing monitoring plan, complete assessment for the items in the ongoing monitoring plan, detailed analysis of results including action plans, and documented internal and external reports. The focus will be on high risk areas by retesting controls on a rotational basis and by focusing on changes in business processes or organizations.

The ongoing monitoring plan includes self-assessments, internal assessments and independent third party assessments. Self-assessments will be used to conduct detailed internal control assessments of processes and controls. Under internal assessment activities, the Department will perform data analytics on the transactional data and review post payment verification results looking for potential weaknesses and/or gaps in controls. The Department will also be supported by an independent third party to conduct rigorous testing of controls, processes and documentation to ensure operating effectiveness.

The Department will continue to report these findings on an annual basis, as well as the plan for the upcoming year to the DAC.

**ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING — INTERNAL CONTROL OVER FINANCIAL REPORTING (ICFR)
ASSESSMENT OF ICFR AND THE ACTION PLAN FOR THE FISCAL YEAR ENDING MARCH 31, 2017**



Status and Action Plan for the Completion of Identified Control Areas

Key Control Area	ASSESSMENT ELEMENTS		
	Design effectiveness testing	Operating effectiveness testing	On-going monitoring
Entity Level Controls	Completed	Completed	Yes
IT General Controls	Completed	Completed	Yes
Financial Reporting and Financial Close	Completed	Completed	2017-18
Process Level Controls:			
Revenue and Receivables	Completed	Completed	Yes
Prepaid Expenses	Completed	Completed	Yes
Procurement to Payment	Completed	Completed	2017-18
Civilian Payroll	Completed	Completed	2017-18
Military Regular & Reserve Forces Payroll	Completed	Completed	2017-18
Inventories	Completed	Completed	2017-18
Capital Equipment Assets	Completed	Completed	2017-18
Real Property Assets	Completed	Completed	2017-18
Remediation Liabilities	Completed	Completed	2017-18



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