

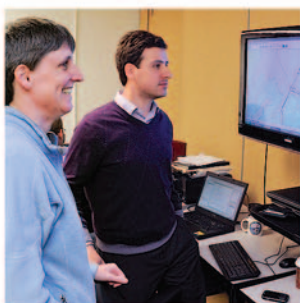


National
Defence

Défense
nationale

DEPARTMENTAL FINANCIAL STATEMENTS

2 0 1 1 – 2 0 1 2
(UNAUDITED)



Canada 



STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING

Responsibility for the integrity and objectivity of the accompanying financial statements for the year ended March 31, 2012, and all information contained in these statements rests with the management of National Defence. These financial statements have been prepared by management using Government's accounting policies, which are based on Canadian public sector accounting standards.

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 Performance 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.

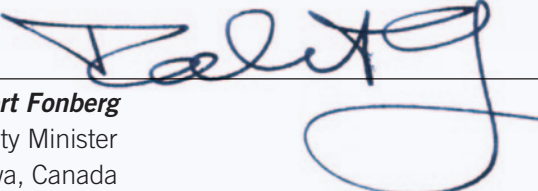
Management seeks to ensure the objectivity and integrity of data in its financial statements through careful selection, training, and development of qualified staff; through organizational arrangements that provide appropriate divisions of responsibility; through communication programs aimed at ensuring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

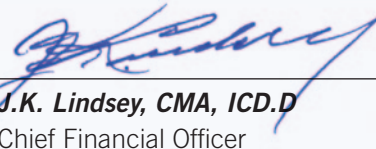
The system of ICFR is designed to mitigate risks to a reasonable level based on an on-going process to identify, assess effectiveness and adjust as required key risks and associated key controls.

A risk-based assessment of the system of ICFR for the year ended March 31, 2012 was completed in accordance with Treasury Board Policy on Internal Control 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 National Defence have not been audited.


Robert Fonberg
Deputy Minister
Ottawa, Canada


J.K. Lindsey, CMA, ICD.D
Chief Financial Officer

Date: August 29, 2012

STATEMENT OF FINANCIAL POSITION (UNAUDITED)

As at March 31

(in thousands of dollars)	2012	2011
Liabilities		Restated (Note 20)
Accounts Payable and Accrued Liabilities (Note 4)	3,216,886	2,926,742
Vacation Pay and Compensatory Leave	204,475	215,659
Deposits and Trust Accounts (Note 5)	3,866	2,952
Deferred Revenue (Note 6)	22,958	22,941
Canadian Forces Pension and Insurance Accounts (Note 7)	47,057,243	46,516,700
Lease Obligations for Tangible Capital Assets (Note 8)	532,505	593,975
Employee Future Benefits (Note 9)	1,729,159	1,669,423
Remediation Liabilities (Note 15)	425,054	325,456
Future Asset Restoration Liabilities (Note 15)	3,757	15,843
Total liabilities	53,195,903	52,289,691
Financial Assets		
Due from Consolidated Revenue Fund	49,308,050	48,804,509
Receivables (Note 10)	158,233	190,018
Loans and Advances (Note 11)	34,216	41,186
Total gross financial assets	49,500,499	49,035,713
Financial assets held on behalf of Government		
Receivables (Note 10)	(2,076)	(2,208)
Total financial assets held on behalf of Government	(2,076)	(2,208)
Total net financial assets	49,498,423	49,033,505
Departmental net debt	3,697,480	3,256,186
Non-Financial Assets		
Prepaid Expenses (Note 12)	789,095	871,913
Inventories (Note 13)	6,068,173	6,045,000
Tangible Capital Assets (Note 14)	31,864,329	31,902,811
Total non-financial assets	38,721,597	38,819,724
Departmental net financial position	35,024,117	35,563,538

Contingent Liabilities (Note 15)

Contractual Obligations (Note 16)

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

Robert Fonberg
Deputy Minister
Ottawa, Canada

J.K. Lindsey, CMA, ICD.D
Chief Financial Officer

Date: August 29, 2012

STATEMENT OF OPERATIONS AND DEPARTMENTAL NET FINANCIAL POSITION (UNAUDITED)

For the year ended March 31

(in thousands of dollars)	Planned Results	2012	2011*
Expenses			Restated (Note 20)
Defence Science and Technology	310,014	417,749	379,070
Recruiting of Personnel and Initial Training	1,489,468	1,138,688	1,186,784
Equipment Acquisition and Disposal	4,261,635	2,262,641	1,348,788
Real Property and Informatics Infrastructure Acquisition and Disposal	799,157	459,053	281,185
Maritime Readiness	2,093,734	2,235,127	2,124,379
Land Readiness	3,328,126	3,966,534	3,605,700
Aerospace Readiness	1,865,545	1,800,940	1,825,542
Joint and Common Readiness	2,130,737	2,625,983	2,300,015
Situational Awareness	340,835	392,572	392,099
Canadian Peace, Stability and Security	282,019	318,607	303,284
Continental Peace, Stability and Security	215,687	198,588	191,151
International Peace, Stability and Security	2,046,515	2,173,525	2,469,213
Defence Team Personnel Support	888,100	1,117,952	1,026,306
Canadian Identity	365,965	373,565	364,907
Environment Protection and Stewardship	72,877	198,287	118,096
Non-Security Support	8,470	19,725	7,361
Internal Services	883,843	1,488,856	1,174,321
	21,382,727	21,188,392	19,098,201
Revenues			
Sale of Goods and Services	423,528	397,044	404,754
Gains on Disposals of Assets	4,462	4,168	33,790
Other	22,024	20,571	20,460
Interest and Gains on Foreign Exchange	10,632	9,931	7,721
Revenues earned on behalf of Government	(32,274)	(28,177)	(52,815)
	428,372	403,537	413,910
Net cost from continuing operations	20,954,355	20,784,855	18,684,291
Transferred operations (Note 18)			
Expenses	471,690	372,081	550,296
Revenue	1,560	1,362	1,006
	470,130	370,719	549,290
Net cost of operations before government funding and transfers	21,424,485	21,155,574	19,233,581
Government funding and transfers			
Net cash provided by Government	20,049,663	19,985,175	19,040,014
Change in due from Consolidated Revenue Fund	705,812	503,541	1,085,363
Services provided without charge by other government departments (Note 17)	764,725	769,154	770,303
Prior year adjustment	0	0	263,089
Transfer of assets and liabilities from (to) other government departments (Note 18)	0	(641,717)	0
Net cost of operations after government funding and transfers	(95,715)	539,421	(1,925,188)
Departmental net financial position — Beginning of year	34,469,400	35,563,538	33,638,350
Departmental net financial position — End of year	34,565,115	35,024,117	35,563,538

Comparative Information (Note 21)

Segmented information (Note 19)

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

STATEMENT OF CHANGE IN DEPARTMENTAL NET DEBT (UNAUDITED)

For the year ended March 31

(in thousands of dollars)	2012	2011
Net cost of operations after government funding and transfers	539,421	(1,925,189)
Change due to tangible capital assets		
Acquisition of tangible capital assets	3,539,679	3,938,303
Amortization of tangible capital assets	(2,419,453)	(2,374,895)
Proceeds from disposal of tangible capital assets	(26,316)	(11,741)
Loss on Disposals of Tangible Capital Assets	(323,533)	(183,823)
Adjustments of Tangible Capital Assets	(111,866)	(124,260)
Prior year adjustment	0	263,089
Transfer to other government departments	(696,993)	0
Total change due to tangible capital assets	(38,482)	1,506,673
Change due to inventories	23,173	691,292
Change due to prepaid expenses	(82,818)	(36,782)
Net increase (decrease) in departmental net debt	441,294	235,994
Departmental net debt — Beginning of year	3,256,186	3,020,192
Departmental net debt — End of year	3,697,480	3,256,186

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

STATEMENT OF CASH FLOW (UNAUDITED)

For the year ended March 31

(in thousands of dollars)	2012	2011
Operating Activities		Restated (Note 20)
Net Cost of Operations Before Government Funding and Transfers	21,155,574	19,233,581
<i>Non-Cash Items Included in Net Cost of Operations</i>		
Amortization of Tangible Capital Assets	(2,419,453)	(2,374,895)
Loss on Disposals of Tangible Capital Assets	(323,533)	(183,823)
Adjustments of Tangible Capital Assets	(111,846)	(124,260)
Services Provided Without Charge by Other Government Departments	(769,154)	(770,303)
<i>Variations in Statement of Financial Position</i>		
Increase (decrease) in Receivables and Advances	(38,623)	77,197
Decrease in Prepaid Expenses	(82,818)	(36,782)
Increase in Inventories	23,173	691,292
Increase in Liabilities, net of Capital Lease Obligations	(967,682)	(1,465,604)
Transfer of liabilities to other government departments (Note 18)	(55,297)	0
Cash Used by Operating Activities	16,410,341	15,046,403
Capital Investment Activities		
Acquisitions of Tangible Capital Assets (Note 14)	3,539,679	3,938,303
Proceeds on Disposal of Surplus Assets	(26,316)	(11,741)
Cash Used by Capital Investment Activities	3,513,363	3,926,562
Financing Activities		
Payments against / Adjustments to Capital Lease Obligations	61,471	67,049
Cash Used by Financing Activities	61,471	67,049
Net Cash Provided by Government of Canada	19,985,175	19,040,014

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



NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the Year Ended March 31

1. Authorities 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 (CF) and of all matters relating to National Defence.

OBJECTIVES

The Defence mission is to defend Canada and Canadian interests and values, while contributing to international peace and security. On behalf of the people of Canada, the CF and the Department of National Defence stand ready to perform three key roles:

- Defend Canada — by delivering excellence at home;
- Defend North America — by being a strong and reliable partner with the United States in the defence of the continent; and
- Contribute to International Peace and Security — by projecting leadership abroad.

The Defence mission is delivered through seventeen program activities, which are as follows:

(a) Defence Science and Technology (S&T):

This program provides the Government of Canada with critical scientific knowledge and innovation to address defence and security challenges and needs. The S&T Program includes direction setting, program planning, program management, and capability management, execution and assessment. The program comprises multi-year projects with activities in research, technology development, analysis and

experimentation applied to inform, enable and respond to Canada's defence and security priorities over multiple time horizons extending up to a 20-year outlook. The scientific knowledge and innovation generated from these activities informs decisions on Defence capability acquisitions, readiness preparation and the conduct of operations in response to Government priorities. Activities under this program draw on internal capability and make extensive use of partnerships with Canadian industry and academia as well as international organizations.

(b) Recruiting of Personnel and Initial Training:

This program promotes National Defence as a preferred workplace with the general public and to recruit new hires for a broad range of trades and other general, professional and scientific occupations. This involves deepening Defence's connections to the various educational and ethnic communities to attract the right number and mix of people who have the skills needed to contribute in meeting the Defence Mission. Engaging in effective leadership, strategic planning, and targeted outreach activities will ensure proactive measures are taken to address the challenges arising from current labour market pressures for specific skill sets within certain geographic locations. The program attracts, selects and enrolls personnel and conducts initial training (basic recruit and occupational training) to military members to the Operational Functional Point. This ensures that sufficient personnel are recruited and trained with the needed skills in the appropriate occupation, now and into the future, to meet Defence requirements. This is accomplished through the provision of recruitment centres, recruitment campaigns, advertising and other outreach activities as well as the necessary training staff, facilities and associated supports.



NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

(c) Equipment Acquisition and Disposal:

This program acquires equipment required for CF operations. This includes the acquisition of new and replacement capabilities or capital improvements to in-service equipment and disposes of them at the end of their service life. Equipment Acquisition occurs primarily through collaboration with Public Works and Government Services (PWGSC), Industry Canada and the vendors. Equipment Acquisition activities include defining requirements, engineering design, sourcing, validation of requirements, developing procurement strategy, contracting, contract negotiation and award, contract administration and management and project management of equipment acquisitions.

(d) Real Property and Informatics Infrastructure Acquisition and Disposal:

An extensive portfolio of land, works, and buildings and informatics required to support the delivery of defence operations. The Real Property Acquisition and Informatics Infrastructure Acquisition Disposal program ensures that the right real property and informatics is acquired and disposed of, and is available where and when needed, while providing value for money, advancing objectives for the greening of government land and buildings, and adhering to best practices for asset life-cycle management. Program activities include working with stakeholders to define requirements; updating the real property and informatics development and management plans; managing projects for new and replacement construction; and identifying and eliminating excess facilities. Real property and informatics are acquired through construction and recapitalization, purchase or capital leases, and disposed of through deconstruction, sale or transfer. The activity includes the Capital Assistance Program (CAP) which is a

capital contribution program under which National Defence makes financial contributions to support the transfer of infrastructure facilities to provinces, territories, municipalities and/or their agencies. CAP projects support real property goals and objectives by encouraging cost-effective solutions for the provision of infrastructure on bases and wings across Canada.

(e) Maritime Readiness:

This program provides Canada with a combat-capable, multi-purpose Navy. The program generates and sustains relevant, responsive, combat capable maritime forces that are able to respond to a spectrum of tasks, as may be directed by the Government, within the required response time. This is accomplished by bringing maritime forces to a state of readiness for operations, by assembling, and organizing maritime personnel, supplies, and materiel. This includes the training and equipping of forces and the provision of their means of deployment, sustainment and recovery to defend Canadian interests domestically, continentally and internationally.

(f) Land Readiness:

This program provides Canada with a combat-capable, multi-purpose Army. The program generates and sustains relevant, responsive, combat capable land forces that are effective across the spectrum of conflict, from peacekeeping and nation building to war fighting. This is accomplished by bringing land forces to a state of readiness for operations, assembling and organizing Land personnel, supplies, and materiel as well as the provision of individual and collective training to prepare land forces to defend Canadian interests domestically, continentally and internationally.



NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the Year Ended March 31

(g) Aerospace Readiness:

This program provides Canada with a combat-capable, multi-purpose Air Force. The program generates and sustains relevant, responsive, combat capable aerospace forces that are able to respond to the spectrum of tasks, as may be directed by the Government, within the required response time. This is accomplished by bringing aerospace forces to a state of readiness for operations, by assembling, and organizing aerospace personnel, supplies, and materiel. This includes the training and equipping of aerospace forces and the provision of their means of deployment, sustainment and recovery to defend Canadian interests domestically, continentally and internationally.

(h) Joint and Common Readiness:

This program ensures Defence is ready to operate in a joint capacity, as directed by Government, to respond to domestic, continental and international requirements within the required response time. The program generates and sustains forces for activities, operations and organizations in which elements of at least two services (e.g Navy, Army, Air Force) participate. This is accomplished through the provision of training of a joint and common nature, the equipping of forces and the provision of their means to deploy in a joint capacity.

(i) Situational Awareness:

The Government of Canada and Defence require an accurate and timely security picture and comprehensive situational awareness and threat knowledge for Canada and abroad. This program provides credible, reliable and sustained intelligence services to Defence in support of decision making and military operations, as well as, support to other government departments in the defence and security of Canada. Work activities include geospatial intelligence, imagery intelligence, signals intelligence, and counter intelligence. The program also ensures

the acquisition and use of information from the global information infrastructure to provide foreign intelligence to support Government of Canada intelligence priorities. This is accomplished through the collection, dissemination and analysis of electronic information. The program ensures the provision of advice, guidance and services to help protect electronic information and information infrastructures of importance to the Government of Canada as well as technical and operational assistance to federal law enforcement and security agencies in the performance of their lawful duties.

(j) Canadian Peace, Stability and Security:

This program employs the CF in the conduct of operations to ensure the safety and security of Canadians and the defence of Canada. These operations include protecting Canada's sovereignty, responding to domestic disasters or humanitarian crisis, supporting domestic security requirements, and conducting search and rescue activities. This is accomplished through the mobilization and deployment of forces within Canada. Canada Command is responsible for the conduct of all CF domestic operations — routine and contingency — and is the national operational authority for the defence of Canada.

(k) Continental Peace, Stability and Security:

This program employs the CF in the conduct of operations, both independently and in conjunction with allies, for the defence of North America and its approaches. Activities under this program include continental operations, as required in accordance with Government of Canada policy. This is accomplished through the mobilization and deployment of forces for the defence of North America and its approaches. Canada Command is responsible for the conduct of all continental operations — routine and contingency — and



NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

is the national operational authority for the defence of North America and its approaches.

(l) International Peace, Stability and Security:

This program contributes to global peace and security by conducting global CF operations, across the spectrum from humanitarian assistance to combat, in concert with national and international partners, to achieve timely and decisive results in support of Canada's national interests. This is accomplished through the mobilization and deployment of forces internationally. Canadian Expeditionary Force Command is the operational command responsible for all CF international operations, with the exception of operations conducted solely by Special Operations Forces elements.

(m) Defence Team Personnel Support:

The Defence Team Personnel Support program provides a broad spectrum of support services such as financial support for education and housing and facilities services, as well as, benefits to military personnel and their families. This program also provides learning support to Defence civilians. This program is necessary as the provision of fair and equitable support is a key element of the Social Contract between the nation and its military personnel that is essential to enhance personnel readiness and deployability, and establish the CF as an employer of choice and learning institution.

(n) Canadian Identity:

This program preserves and promotes Canadian identity by providing youth programs, ceremonial activities and the preservation of military history. The program is necessary to demonstrate the military heritage and proficiency of the CF to Canadians and inform them of the military profession and practice in Canada. This is realized through initiatives such as ceremonial and band performances, CF museums,

CF history and heritage books, web content and the Cadets.

(o) Environment Protection and Stewardship:

This program promotes public health and safety and supports sustainable development on Defence lands and wherever Defence operates. It delivers multi-faceted real property/infrastructure environmental protection and stewardship compliant with applicable legislation and federal policy that extends through every level of departmental decision-making.

(p) Non-Security Support:

Defence is strongly committed to contribution to Canadian society in non-operational roles. The program provides support to develop national competency in defence issues and to the whole of government approach by sharing information with other government departments and non-governmental organizations. This may include the provision of grants to researchers to generate knowledge related to defence issues or provide meteorological or mapping information to other government departments in the interest of information sharing on horizontal initiatives.

(q) 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. These groups 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; Acquisition Services; and Travel and Other Administrative Services. Internal Services include only those activities and resources that apply across an organization and not to those provided specifically to a program.



NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

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. The presentation and results using the stated accounting policies do not result in any significant differences from Canadian public sector accounting standards.

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 Statement of Operations, Departmental Net Financial Position and the 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 Statement of Operations and Departmental Net Financial Position are the amounts reported in the future-oriented financial statements included in the *2011–12 Report on Plans and Priorities*.

(b) Consolidation

These consolidated financial statements include the accounts of the sub-entities that the deputy head (DH) is accountable for. 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 DND, the CF and several related organizations and agencies in the Defence Portfolio,

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 Department of National Defence and Canadian Forces Ombudsman;
- Office of the Judge Advocate General; and
- National Search and Rescue Secretariat.

The Canadian Forces Grievance Board, the Military Police Complaints Commission 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.

(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



NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

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 from external parties for specified purposes are recorded upon receipt as deferred revenue. These revenues are recognized in the period in which the related expenses are incurred.
- Funds that have been received are recorded as deferred revenue, provided the Department has an obligation to other parties for the provision of goods, services or the use of assets in the future.
- 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 DH is expected to maintain accounting control, he or she 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 criteria or the entitlements established for the transfer payment program. In situations where payments do not form part of an existing program, transfer

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. Transfer payments that become repayable as a result of conditions specified in the contribution agreement that have come into being are recorded as the reduction to transfer payment expense and as a receivable.

- 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 Superannuation Plan, a multi-employer plan administered by the Government. 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. Actuarial surpluses or deficiencies are recognized in the financial statements of the Government of Canada, as the Plan's sponsor.

The Government sponsors a variety of employee future benefits such as pension plans and disability benefits, which cover civilian employees and members of the CF National



NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the Year Ended March 31

Defence administers the pension benefits for members of the CF. The actuarial liability and related disclosures for these future benefits are presented in the financial statements of the Government of Canada and reported annually to Parliament as required by the *Canadian Forces Superannuation Act*. This differs from the accounting and disclosures of future benefits for military members presented in these financial statements whereby pension expense corresponds to the Department's annual contributions toward the cost of current and prior service, which is based on actual contributions made by members of the Plans during the period. In addition to its regular contributions, current legislation also requires the Department to make contributions for actuarial deficiencies in the Canadian Forces Pension Plan and in the Reserve Force Pension Plan, which came into force on March 1, 2007. These contributions are expensed in the year they are credited to the Plans. This accounting treatment corresponds to the funding provided to departments through Parliamentary authorities.

(ii) Severance Benefits

Employees and military 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 relating to the benefits earned

by civilian employees and CF members is calculated using information derived from the results of the actuarially determined liability for employee severance benefits for the Government as a whole. Nevertheless, civilian collective agreements are the reference, and define when such entitlements will cease for paying severance pay. The process of severance pay for civilian employees will then be processed instructively by their respective collective agreements.

(h) Accounts and Loans Receivables

Accounts and loans receivables 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 fail 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 or an amount cannot be reasonably estimated, the contingency is disclosed in the notes to the financial statements (refer to Note 15(a) of these financial statements).



NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

(j) Remediation Liabilities

Remediation liabilities reflect the estimated costs related to the management and remediation of environmentally contaminated sites. Based on management's best estimate, a liability is accrued and an expense recorded when a site becomes contaminated or the Department becomes aware that a site has become contaminated and is obligated, or likely to be obligated to incur costs related to implementing a site-specific management plan. If the likelihood of the Department's obligation to incur these costs is not determinable, or cannot be reasonably estimated, the costs are disclosed as a contingent liability in the notes to the financial statements (refer to Note 15 (b) of these financial statements).

(k) Future Asset Restoration Liabilities

Future asset restoration liabilities represent the estimated costs related to the risk management of unexploded explosive ordnance (UXO) affected legacy sites. A liability, based on a management's best estimate, is accrued when the Department becomes aware that a site is affected by UXO and is obligated, or is likely to be obligated, to incur costs related to a site-specific management plan. If the likelihood of the Department's obligation to incur these costs is not determinable, or if an amount cannot be reasonably estimated, the costs are disclosed as a contingent liability in the notes to the financial statements (refer to Note 15 (c) of these financial statements).

(l) Inventories

Inventory consists of consumables (such as non-repairables, uniforms and clothing, medical and other equipment and machine tools) and ammunition (including bombs and missiles). Consumable inventories are valued using a moving weighted average price methodology. Some items classified as repairable ammunition (e.g. missiles and torpedoes) are valued using a standard price. Inventory managed by contractors and not held in the CF Supply System or Defence Resource Management Information System (DRMIS) is valued based on contractor-supplied records. DND is currently conducting a multi-year conversion of legacy systems into DRMIS. During the conversion process both periodic and perpetual inventory methods are being utilized. Items identified for disposal are excluded from the value of inventory as no value is expected to be recovered.

(m) 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 and losses resulting from foreign currency transactions are included as revenues in Interest and Gains on Foreign Exchange in Note 19 and losses from foreign currency transactions are included in Other Expenses in Note 19.

NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the Year Ended March 31

(n) 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. Capitalization threshold values lower than \$30,000 may apply to certain assets such as vehicles and asset pooled items (API), formerly known as repairables.

Amortization of tangible capital assets is done 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 in accordance with the sum of the accumulated amortization of the equipment platform that they support.

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.

(o) 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 gains and liabilities, remediation liabilities, future asset restoration liabilities, the liability for employee future benefits, allowance for doubtful accounts 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.

NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

3. Parliamentary Authorities

National Defence receives most of its funding through annual parliamentary authorities. Items recognized in the Statement of Operations and Departmental Net Financial Position and the 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)	2012	2011
Net cost of operations before government funding and transfers	21,155,574	19,233,581
Adjustments for items affecting Net Cost of Operations but not affecting Authorities:		
Amortization of Tangible Capital Assets	(2,419,453)	(2,374,895)
Services Provided Without Charge by Other Government Departments	(769,154)	(770,303)
Employee Future Benefits	(105,580)	(63,170)
Refund of Previous Year's Expenses	145,472	74,271
Vacation Pay and Compensatory Leave	1,731	15,243
Gain (Loss) on Disposals of Capital Assets	(323,533)	(183,823)
Adjustments of Capital Assets	(111,846)	(124,260)
Accrued Liabilities	(604,116)	(299)
Bad Debts Expense	(5,019)	2,449
Miscellaneous	(49,193)	(10,258)
	(4,240,691)	(3,435,045)
Adjustments for items not affecting Net Cost of Operations but affecting Authorities:		
Tangible Capital Assets Acquisitions	3,539,679	3,938,303
Tangible Capital Assets Acquisitions with no monetary impact	(223,265)	(174,974)
Payments Against Capital Lease Obligations	61,470	83,189
Inventory Purchases net of Usage and Adjustments	23,173	691,292
Proceeds not respendable by the department	(26,316)	0
Net Variation Prepaid Expenses (excluding transferred operations)	(82,818)	(36,782)
Revenues Collected from Prior Year Receivables	13,513	(36)
Material Management Integrations Adjustments	0	(1,270)
Miscellaneous	(1,561)	0
	3,303,875	4,499,722
Current Year Authorities Used	20,218,758	20,298,258

Comparative Information (Note 20)

NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the Year Ended March 31

3. Parliamentary Authorities (continued)

(b) Authorities Provided and Used

(in thousands of dollars)	2012	2011
		Restated (Note 22)
Operating Expenditures — Vote 1	15,417,928	15,689,461
Capital Expenditures — Vote 5	4,322,835	5,311,275
Grants & Contributions — Vote 10	241,678	272,491
Statutory Amounts	1,735,684	1,481,392
Less:		
Authorities Available for Future Years	(1,348,324)	(1,441,120)
Frozen Allotments and Other Planned Lapses	(114,753)	(64,822)
Residual Lapse	(36,290)	(950,419)
Current Year Authorities Used	20,218,758	20,298,258

4. Accounts Payable and Accrued Liabilities

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

(in thousands of dollars)	2012	2011
Accounts payable — Other government departments and agencies	73,970	79,950
Accounts payable — External parties	1,585,585	1,638,271
	1,659,555	1,718,221
Accrued Liabilities	1,557,331	1,208,521
	3,216,886	2,926,742

NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

5. Deposits and Trust Accounts

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

(in thousands of dollars)	2012	2011
Contractor Security Deposits		
Deposits, beginning of year	2,607	1,437
Deposits Received	7,257	5,931
Refunds	(6,282)	(4,760)
Contractor Security Deposits, end of year	3,582	2,608
Trust Account, Estates — Armed Services*		
Trust Account, beginning of year	345	549
Funds Received	1,111	1,457
Payments	(1,172)	(1,662)
Trust Account, Estates — Armed Services, end of year	284	344
	3,866	2,952

* 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.

6. 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)	2012	2011
Foreign Governments		Restated (Note 20)
Beginning of Year	14,608	28,764
Funds Received	12,497	(3,440)
Revenue Recognized	(10,519)	(10,716)
Foreign Governments, end of year	16,586	14,608
Other Specified Purposes		
Beginning of Year	8,333	7,965
Funds Received	(1,969)	6,931
Revenue Recognized	8	(6,563)
Other Specified Purposes, end of year	6,372	8,333
	22,958	22,941



NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the Year Ended March 31

7. 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 Canadian Forces. 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 Canadian Forces Pension Fund Account, the Retirement Compensation Arrangement Account, and the Reserve Force Pension Fund Account. 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 for the CF pension plans reflect only the balances which are posted in the departmental financial system. These balances do 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 of National Defence Website. For further information on PSPIB, please visit their website www.pspib.ca.

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

NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

7. Canadian Forces Pension and Insurance Accounts (continued)

The following table provides details of the Canadian Forces Pension and Insurance Accounts:

(in thousands of dollars)	2012	2011
Canadian Forces Superannuation Account		
Beginning of Year	45,995,263	45,490,149
Funds Received and Other Credits	2,685,609	2,894,824
Payments and Other Charges	(2,411,726)	(2,389,710)
Canadian Forces Superannuation Account, end of year	46,269,146	45,995,263
Canadian Forces Pension Fund Account		
Beginning of Year	37,744	38,045
Funds Received and Other Credits	1,378,111	1,089,264
Payments and Other Charges	(320,494)	(261,466)
Transfers to the Public Sector Pension Investment Board	(814,864)	(828,099)
Canadian Forces Pension Fund Account, end of year	280,497	37,744
Reserve Force Pension Fund Account		
Beginning of Year	5,027	4,316
Funds Received and Other Credits	56,504	65,837
Payments and Other Charges	(20,751)	(11,081)
Transfers to the Public Sector Pension Investment Board	(31,055)	(54,045)
Reserve Force Pension Fund Account, end of year	9,725	5,027
Retirement Compensation Arrangements Account*		
Beginning of Year	286,772	255,794
Funds Received and Other Credits	47,137	71,214
Payments and Other Charges	(26,337)	(40,236)
Retirement Compensation Arrangements Account, end of year	307,572	286,772
Regular Force Death Benefit Account		
Beginning of Year	191,894	192,113
Funds Received and Other Credits	30,240	31,088
Payments and Other Charges	(31,831)	(31,307)
Regular Force Death Benefit Account, end of year	190,303	191,894
	47,057,243	46,516,700

* The Retirement Compensation Arrangements (RCA) account 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, 2012, the total refundable tax transferred amounts to \$297 million (\$275 million in 2011).

NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the Year Ended March 31

8. Lease Obligations for Tangible Capital Assets

The Department has entered into agreements to lease certain equipment under capital leases with a cost of \$870 million and accumulated amortization of \$476 million as at March 31, 2012 (\$988 million and \$540 million respectively as at March 31, 2011). 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 2012	Balance of Obligations 2011
Buildings	155,916	(49,591)	106,325	111,948
Aircraft	532,989	(106,809)	426,180	480,057
Informatics Hardware	0	0	0	1,970
	688,905	(156,400)	532,505	593,975

Future Minimum Lease Payments

(in thousands of dollars)	2012–2013	2013–2014	2014–2015	2015–2016	2016–2017	2017– 2018 and Thereafter
Buildings	12,225	12,198	12,135	12,077	12,013	95,270
Aircraft	70,105	70,105	70,105	70,105	70,105	182,462
	82,330	82,303	82,240	82,182	82,118	277,732

* The Department has entered into agreements for buildings, aircraft and informatics hardware under capital leases (refer to Note 14 of these financial statements).



NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

9. Employee Future Benefits

(a) Pension Benefits:

i) The Department's Public Service employees participate in the Public Service Pension 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. The 2011–12 expense amounts to \$239.2 million (\$236.0 million in 2010–11), which represents approximately 1.8 times (1.9 times in 2010–11) the contributions by employees.

The Department's responsibility with regard to the pension 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.

ii) The members of the Canadian 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.

iii) The members of the Canadian 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 2011–12 expense amounts to \$1,107 million (\$868.0 million in 2010–11), which represents approximately 2.5 times (2.5 times in 2010–11) 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 Plans' sponsor. 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 \$249 million (nil in 2010–11) to fund the deficit in the Canadian Forces Pension Fund Account, until the deficit is funded as per the triennial funding valuation; and

NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the Year Ended March 31

9. Employee Future Benefits (continued)

- A government contribution holiday to the Reserve Force Pension Fund Account starting in November 2011, to reduce the non-permitted surplus in the account (no adjustment was required in 2010–11). Government contributions will resume when the non-permitted surplus is reduced 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>)

(b) Severance Benefits:

The Department provides severance benefits to its public service employees and CF 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.

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 commencing in 2012. 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)	2012	2011
Public Service Employees		
Accrued Benefit Obligation, beginning of year	398,823	392,553
Transferred to other government department (Note 18)	(45,844)	0
	352,979	392,553
Expenses for the year	26,127	37,548
Benefits Paid During the Year	(156,647)	(31,278)
Accrued Benefit Obligation, end of year	222,459	398,823
Canadian Forces Members		
Accrued Benefit Obligation, beginning of year	1,270,600	1,213,700
Expenses for the Year	335,119	153,633
Benefits Paid During the Year	(99,019)	(96,733)
Accrued Benefit Obligation, end of year	1,506,700	1,270,600
	1,729,159	1,669,423

NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

10. Receivables

The following table presents details of accounts receivable:

(in thousands of dollars)	2012	2011
		Restated (Note 20)
External Clients	56,486	42,678
Other Government Departments	110,579	152,237
	167,065	194,915
Less: Allowance for Doubtful Accounts on External Receivables	8,832	4,897
Gross accounts receivable	158,233	190,018
Accounts receivable held on behalf of Government	(2,076)	(2,208)
Net Receivables	156,157	187,810

11. Loans and Advances

The following table presents details of loans and advances:

(in thousands of dollars)	2012	2011
Imprest Accounts, Standing Advances and Authorized Loans to CF Members	34,180	41,151
Accountable Advances (Temporary Advances)	36	35
	34,216	41,186

12. Prepaid Expenses

The following is a breakdown of prepaid expenses.

(in thousands of dollars)	2012	2011
Foreign Military Purchases	448,616	566,517
Sea Sparrow Missiles	124,535	77,069
NATO Flying Training Canada (NFTC)	46,414	46,055
Joint Strike Fighter Development	18,055	30,091
Building Rentals	15,835	10,025
Military Salaries	9,885	10,121
Other Purchases	125,755	132,035
	789,095	871,913

NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the Year Ended March 31

13. Inventories

The following table presents the details of inventory, measured at cost using the weighted moving average method.

(in thousands of dollars)	2012	2011
Ammunition, Bombs and Missiles	3,430,190	3,336,575
Uniforms and Clothing	488,566	461,841
Contractor Held Inventory**	355,861	401,656
Metal	295,732	297,001
Communication, Electrical Parts/Accessories and Informatics Equipment	255,998	271,298
Engineering, Test and Technical Equipment and Machine Tools	241,007	235,714
Ship Spares	219,308	168,106
Land Equipment Spares	198,735	197,420
Medical Equipment	125,963	111,742
Aircraft Spares	118,707	134,576
Sonobuoys, Parts and Accessories	107,896	110,139
Fuel, Petroleum and Oil	55,996	140,640
Miscellaneous	174,214	178,292
	6,068,173	6,045,000

** Contractor Held Inventory is valued at historical cost.

The cost of consumed inventory recognized as an expense in the Statement of Operations is \$725.8 million in 2011–12 (\$196.1 million in 2010–11).

NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

14. Tangible Capital Assets and Accumulated Amortization

TANGIBLE CAPITAL ASSETS

(in thousands of dollars)	Balance Beginning of Year Restated (Note 22)	Current Year Adjustments ¹	Acquisitions ²	Disposals	Balance End of Year
Land, Buildings & Works					
Land	84,176	0	(862)	(145)	83,169
Buildings	7,182,585	327,863	(48,309)	(65,615)	7,396,524
Works	2,110,546	144,325	(16,090)	(111,283)	2,127,498
	9,377,307	472,188	(65,261)	(177,043)	9,607,191
Machinery & Equipment					
Machinery and Equipment	6,290,752	123,180	181,475	(74,762)	6,520,645
Informatics Hardware	7,005,677	(386,866)	176,830	(68,471)	6,727,170
Informatics Software	604,397	(80,331)	4,535	(44,758)	483,843
Arms and Weapons	6,565,030	82,429	104,518	(338,671)	6,413,306
Other Equipment	80,606	1,133	3,668	(2,025)	83,382
	20,546,462	(260,455)	471,026	(528,687)	20,228,346
Ships, Aircraft & Vehicles					
Ships and Boats	11,681,639	44,194	77,047	(9,941)	11,792,939
Aircraft	13,473,144	1,125,936	214,798	(217,644)	14,596,234
Non-military Motor Vehicles	736,051	15,408	31,850	(22,752)	760,557
Military Vehicles	1,824,180	29,784	13,550	(72,644)	1,794,870
Other Vehicles	396,627	1,929	22,106	(2,014)	418,648
	28,111,641	1,217,251	359,351	(324,995)	29,363,248
Leasehold Improvements					
Leasehold Improvements	31,605	11,990	0	0	43,595
	31,605	11,990	0	0	43,595
Leased Tangible Capital Assets					
Buildings	138,858	0	0	0	138,858
Informatics Hardware	7,253	(8,134)	8,134	(7,253)	0
Other Equipment	48	0	0	0	48
Aircraft	841,380	0	0	(110,250)	731,130
	987,539	(8,134)	8,134	(117,503)	870,036
Assets Under Construction					
Buildings	1,010,361	(765,559)	843,850	0	1,088,652
Engineering Works	188,064	(132,768)	129,785	0	185,081
Informatics Software	533,915	(1,788)	73,895	0	606,022
Equipment	5,797,177	(1,291,126)	1,718,899	0	6,224,950
	7,529,517	(2,191,241)	2,766,429	0	8,104,705
Gross Tangible Capital Assets	66,584,071	(758,401)	3,539,679	(1,148,228)	68,217,121

(1) Current Year Adjustments represent adjustments to API, assets under construction (AUC) put into use, reclassifications and adjustments of tangible capital assets.

(2)	Total Acquisitions	3,539,679
	Less: Leased Tangible Capital Assets	8,134
		3,531,545
	Less: Acquisitions related to public-private partnership (P3):	215,131
	Acquisitions excluding capital leases and P3	3,316,414

NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the Year Ended March 31

14. Tangible Capital Assets and Accumulated Amortization (continued)

ACCUMULATED AMORTIZATION

(in thousands of dollars)	Balance Beginning of Year	Current Year Ad- justments	Current Year Amortization	Disposals	Balance End of Year	Net Book Value 2012	Net Book Value 2011 Restated (Note 22)
Land, Buildings & Works							
Land						83,169	84,176
Buildings	3,169,303	1,238	194,510	(15,398)	3,349,653	4,046,871	4,013,282
Works	1,213,514	(698)	65,260	(73,459)	1,204,617	922,881	897,032
	4,382,817	540	259,770	(88,857)	4,554,270	5,052,921	4,994,490
Machinery & Equipment							
Machinery and Equipment	4,580,236	88,644	280,545	(26,247)	4,923,178	1,597,467	1,710,516
Informatics Hardware	5,037,538	(239,462)	462,757	(48,431)	5,212,402	1,514,768	1,968,139
Informatics Software	304,891	(54,976)	60,522	(35,427)	275,010	208,833	299,506
Arms and Weapons	3,722,849	(25,744)	239,411	(227,245)	3,709,271	2,704,035	2,842,181
Other Equipment	48,867	1,184	6,142	(1,659)	54,534	28,848	31,739
	13,694,381	(230,354)	1,049,377	(339,009)	14,174,395	6,053,951	6,852,081
Ships, Aircraft & Vehicles							
Ships and Boats	6,501,890	40,204	417,369	(3,316)	6,956,147	4,836,792	5,179,749
Aircraft	7,675,806	212,294	488,866	(192,617)	8,184,349	6,411,885	5,797,338
Non-military Motor Vehicles	472,058	11,597	44,654	(19,942)	508,367	252,190	263,993
Military Vehicles	1,149,757	15,058	71,284	(35,733)	1,200,366	594,504	674,423
Other Vehicles	248,027	1,473	26,881	(1,793)	274,588	144,060	148,600
	16,047,538	280,626	1,049,054	(253,401)	17,123,817	12,239,431	12,064,103
Leasehold Improvements							
Leasehold Improvements	16,906	0	7,132	0	24,038	19,557	14,699
	16,906	0	7,132	0	24,038	19,557	14,699
Leased Tangible Capital Assets							
Buildings	48,148	0	6,283	0	54,431	84,427	90,710
Informatics Hardware	5,488	(354)	1,728	(6,862)	0	0	1,765
Other Equipment	31	0	5	0	36	12	17
Aircraft	485,951	0	46,104	(110,250)	421,805	309,325	355,429
	539,618	(354)	54,120	(117,112)	476,272	393,764	447,921
Assets Under Construction							
Buildings						1,088,652	1,010,361
Engineering Works						185,081	188,064
Informatics Software						606,022	533,915
Equipment						6,224,950	5,797,177
						8,104,705	7,529,517
Total	34,681,260	50,458	2,419,453	(798,379)	36,352,792	31,864,329	31,902,811



NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

14. Tangible Capital Assets and Accumulated Amortization (continued)

The Department is presently reviewing its process for recording and valuation of tangible capital assets. This work will be conducted over a number of years. In 2011–12, DND identified and recorded \$134.5 million (\$102.6 million in 2010–11) in post-capitalization of tangible capital assets as current year transactions.

In 2011–12, the Department had capital asset holdings that were damaged but that have yet to be approved for write-down or write-off. The net book value of these holdings has been estimated as follows:

	2012	2011 (Restated)
Assets Likely for Disposal	\$179.7 million	\$80 million
Assets Pending Evaluation	\$6.4 million	\$9.3 million
Assets Under Repair	\$14.9 million	\$26.8 million

Further evaluation of these capital asset holdings will be conducted in fiscal year 2012–13 and, once the review is completed and the net book value of these holdings is confirmed, the applicable write-down or write-off accounting entries will be recorded.

Included in current year adjustments in the preceding tables are amounts transferred to Shared Services Canada and Communications Security Establishment with a net book value of \$697 million. (Note 18)

15. 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 three categories of contingent liabilities: claims and litigations, remediation liabilities, and future asset restoration liabilities.

(a) 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 \$6.7 million (\$2.0 million in 2010–11) at March 31, 2012.

(b) Remediation Liabilities — Contaminated Sites

Liabilities are accrued to record the estimated costs related to the management and remediation of environmentally contaminated sites where the Department is obligated or likely to be obligated to incur such costs.



NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the Year Ended March 31

15. Contingent Liabilities (continued)

Liability estimates are based on information known at a given point in time. These estimates are subject to variability due to: professional judgment involved in developing estimates, the possibility that additional volumes of contaminated media may be discovered upon implementation of the remedial action plan, and/or new technologies becoming available during the course of implementing the remedial action plan.

The Department has confirmed approximately 246 sites where such action is possible and for which a liability of \$425.1 million has been recorded. The Department has also estimated contingent liabilities relating to contaminated sites of \$ 244 million for mitigation costs that are not accrued.

The DEW Line Clean Up project has completed remediation work on 20 out of a total of 21 sites. The costs for the remaining close out and remediation activities have been reflected in changes to the liability estimates.

The Department has initiated planning of a remediation strategy in Esquimalt Harbour. In addition to regulatory risk associated with a fish consumption advisory (by Fisheries and Oceans Canada), both Public Works and Government Services Canada and Transport Canada have initiated remediation of the sediments on their sites in Esquimalt Harbour.

In fiscal year 2011–12, development of remediation strategies continued with two projects at Valcartier to address the risks associated with the trichloroethylene (TCE) contamination. These projects have produced

cost estimates that are considered reasonable at this time and for which an accrual has been made; however, the potential for these estimates to change is likely given the long duration of these projects (15+ years). The cost estimates will continue to be reviewed at least annually and adjusted as necessary.

A potential obligation exists for environmental mitigation at Camp Ipperwash. The uncertainty related to this potential liability will be resolved once environmental investigations have been completed and clean-up options have been developed. These investigations are expected to continue until fiscal year 2014–15.

During fiscal year 2011–12, assessment activities were undertaken at 238 suspected or confirmed contaminated sites. There were 121 new contaminated sites identified. Of these new sites, 110 are under assessment. As a result of assessment activities, additional liabilities may be reported in the future.

(c) Future Asset Restoration Liabilities

Liabilities are accrued to record the estimated costs related to the risk management and clearance of unexploded explosive ordnance (UXO) affected legacy sites, where the Department is obligated or likely to be obligated to incur such costs. The liability estimates are based on information known at a given point in time and are subject to variability due to the use of professional judgment in developing the estimate, changes to the size of the site or type of UXO on the site, and/or new technologies becoming available during the implementation of the risk management strategy.



NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

15. Contingent Liabilities (continued)

The Department has confirmed 43 sites where clearance or risk management activities will be necessary and for which a liability of \$3.8 million has been recorded.

A potential obligation exists for UXO risk mitigation at Camp Ipperwash. The uncertainty will be resolved once UXO investigations have been completed and clearance options have been developed. These investigations are expected to continue until fiscal year 2014–15.

The amount of the contingent liability for Lac St. Pierre has been reviewed and remains unchanged from last year. The estimated contingent liability (a rough order magnitude estimate ranging from \$180 million to \$524 million) relates to potential clearance costs to mitigate UXO risk at Lac St. Pierre.

UXO liabilities for 3 new legacy sites were identified and subsequently recorded in the departmental submission: SS Claire Lilley, HMCS Theipval and Churchill.

The Department will be transferring administration of approximately 50 hectares of land at Beecher's Bay, BC to Aboriginal Affairs and Northern Development Canada. Although the Department retains liability, the research showed that the risk of UXO existence is low.

In addition to the liabilities related to UXO affected legacy sites, there are potential obligations related to real property. These obligations may arise from property disposal transactions, termination of lease agreements, oil and gas activities on DND/CF property, and other transactions.

The Niagara-on-the-Lake range was closed in 2000 as it was no longer required by the Department for operations. The property is owned by Parks Canada and, according to the lease agreement, the property must be free of contamination before the lease agreement can be terminated. Previous investigations confirmed that parts of the property are affected by UXO, but further assessment is necessary. Once the assessment is completed, and a final land use is determined, the Department will be better able to determine and estimate its liability.

A potential obligation exists for abandoned wells associated with oil and gas activities at CFB Suffield, however the extent of this obligation is not known at this time. The uncertainty will be resolved once the departmental research into provincial, federal and industry standards and obligations is completed. This research will continue through fiscal year 2012–13.

NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the Year Ended March 31

16. 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)	2012–2013	2013–2014	2014–2015	2015–2016	2016– 2017 and Thereafter	Total
Fixed Assets	1,485,781	1,384,023	757,515	461,518	485,549	4,574,386
Purchases	2,170,249	1,439,180	1,029,874	807,079	4,429,787	9,876,169
	3,656,030	2,823,203	1,787,389	1,268,597	4,915,336	14,450,555

17. 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.

(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)	2012	2011
Employer's Contributions to the Health and Dental Plans Paid by Treasury Board of Canada Secretariat	685,508	675,221
Accommodation Provided by Public Works and Government Services Canada	70,789	80,826
Worker's Compensation Coverage Provided by Human Resources and Skills Development Canada	8,721	9,585
Legal Services Provided by Department of Justice Canada	4,136	4,671
	769,154	770,303



NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

17. Related Party Transactions (continued)

The Government has centralized some of its administrative activities for efficiency, cost-effectiveness purposes and economic delivery of programs to the public. As a result, the Government uses central agencies and common service organizations so that one department performs services for all other departments and agencies without charge. The costs of these services, such as the payroll and cheque issuance services provided by Public Works and Government Services of Canada and audit services provided by the Office of the Auditor General are not included in the Department's Statement of Operations and Departmental Net Financial Position.

(b) Other transactions with related parties

(in thousands of dollars)	2012	2011
		Restated (Note 22)
Accounts Payable to Other Government Departments and Agencies	73,970	79,950
Accounts Receivable from Other Government Departments and Agencies	110,579	152,237
Expenses — Other Government departments and agencies	1,197,329	1,156,512
Revenues — Other Government departments and agencies	14,709	49,922
	1,396,587	1,438,621

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



NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the Year Ended March 31

18. Transfers to Other Government Departments

Effective November 15, 2011, in accordance with Order-in-Council 2011-1297, the Department of National Defence transferred responsibility for the Email, Data Centre and Network Services Units to Shared Services Canada including the stewardship responsibility for the assets and liabilities related to the program. In addition, effective November 16, 2011, in accordance with Order-in-Council 2011-1305, the Department transferred responsibility for Communications Security Establishment to Communications Security Establishment including the stewardship responsibility for the assets and liabilities related to the program. Accordingly, the Department transferred the following assets and liabilities related to the transferred operations:

(in thousands of dollars)	
Assets	
Tangible capital assets (Note 14)	696,993
Liabilities	
Vacation pay and compensatory leave	9,453
Employee future benefits (Note 9)	45,844
Adjustment to the Departmental Net Financial Position	641,696

In addition, the 2011 comparative figures have been reclassified on the Statement of Operations and Departmental Net Financial Position to present the revenues and expenses of the transferred operations.

During the transition period, the Department continued to administer the transferred activities on behalf of the transferred operations. The administered revenues and expenses amounted to \$.9 million and to \$306.2 million respectively, for the year. These revenues and expenses are not recorded in these financial statements.

19. Segmented Information

Presentation by segment is based on the Department's program activity architecture. The presentation by segment is based on the same 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 activities, by major object of expenses and by major type of revenues. The segment results for the period are as follows:

NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

19. Segmented Information (continued)

(in thousands of dollars)	DST	RPIT	EAD	RPIAD
Operating expense				
Salary and Employee Benefits	195,568	924,297	181,022	15,412
Amortization	60	0	2,119,707	268,333
Professional and Special Services	91,312	56,380	462,901	76,477
Repair and Maintenance	6,874	234	63,947	93,651
Transportation and Communication	14,145	23,339	21,022	1,134
Materials and Supplies	11,828	35,226	36,283	3,349
Expenses Related to Tangible Assets	9,297	3,733	494,374	6,735
Other Services	25,412	9,409	39,618	3,944
Equipment and Other Rentals	1,760	3,519	562	302
Loss on Disposals and Write-offs and Write-downs of Tangible Capital Assets	0	0	236,308	87,685
Accommodation	2,662	7,091	5,453	2,187
Utilities	2,537	209	1	70
Other Expenses	56,012	22,333	(1,343,686)	(96,990)
Interest on Capital Lease Payments	41	44,867	(55,908)	(5,622)
Advertising, Printing and Related Services	27	7,496	912	1
Bad Debts	93	555	125	10
Total operating expenses	417,628	1,138,688	2,262,641	456,678
Transfer payments				
Transfers to Other Countries and International Organizations	0	0	0	0
Transfers to Other Levels of Government	121	0	0	0
Transfers to Individuals	0	0	0	2,375
Transfers to Non-Profit Organizations	0	0	0	0
Total transfer payments	121	0	0	2,375
Total expenses	417,749	1,138,688	2,262,641	459,053
Revenues				
Sale of Goods and Services	4,000	1,539	123	215
Gains on Disposals of Assets	111	17	(20,504)	0
Other	132	1	0	20
Interest and Gains on Foreign Exchange	22	6	2,976	25
Revenues earned on behalf of Government	(2,638)	(23)	17,335	(21)
Total revenues	1,627	1,540	(70)	239
Total	416,122	1,137,148	2,262,711	458,814

DST Defence Science and Technology
RPIT Recruiting of Personnel and Initial Training
EAD Equipment Acquisition and Disposal
RPIAD Real Property and Informatics Infrastructure Acquisition and Disposal

NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the Year Ended March 31

19. Segmented Information (continued)

(in thousands of dollars)	MR	LR	AR	JCR
Operating expense				
Salary and Employee Benefits	1,358,458	2,406,350	1,043,529	1,556,417
Amortization	0	0	0	2,335
Professional and Special Services	266,046	226,480	157,588	245,451
Repair and Maintenance	166,942	218,054	253,862	69,377
Transportation and Communication	36,359	102,911	55,738	94,625
Materials and Supplies	95,182	131,177	117,483	197,572
Expenses Related to Tangible Assets	107,099	133,470	60,162	77,316
Other Services	17,117	67,706	31,065	74,801
Equipment and Other Rentals	20,443	73,523	41,221	33,186
Loss on Disposals and Write-offs and Write-downs of Tangible Capital Assets	6	486	(994)	33
Accommodation	11,459	23,917	10,230	29,566
Utilities	19,298	36,381	21,665	18,127
Other Expenses	135,742	541,522	7,828	215,164
Interest on Capital Lease Payments	82	2,919	41	8,375
Advertising, Printing and Related Services	244	547	994	1,978
Bad Debts	650	1,091	528	560
Total operating expenses	2,235,127	3,966,534	1,800,940	2,624,883
Transfer payments				
Transfers to Other Countries and International Organizations	0	0	0	0
Transfers to Other Levels of Government	0	0	0	1,100
Transfers to Individuals	0	0	0	0
Transfers to Non-Profit Organizations	0	0	0	0
Total transfer payments	0	0	0	1,100
Total expenses	2,235,127	3,966,534	1,800,940	2,625,983
Revenues				
Sale of Goods and Services	20,953	22,904	26,363	12,885
Gains on Disposals of Assets	1,557	1,812	1,159	2,657
Other	594	599	675	707
Interest and Gains on Foreign Exchange	114	(155)	190	152
Revenues earned on behalf of Government	(1,560)	(1,234)	(2,423)	(2,815)
Total revenues	21,658	23,926	25,964	13,586
Total	2,213,469	3,942,608	1,774,976	2,612,397

MR Maritime Readiness

LR Land Readiness

AR Aerospace Readiness

JCR Joint and Common Readiness

NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

19. Segmented Information (continued)

(in thousands of dollars)	SA	CaPSS	CoPSS	IPSS
Operating expense				
Salary and Employee Benefits	255,967	116,942	54,174	925,379
Amortization	0	0	0	0
Professional and Special Services	18,695	8,602	62,964	162,300
Repair and Maintenance	40,084	114,152	22,064	84,824
Transportation and Communication	8,920	11,182	4,169	95,840
Materials and Supplies	9,412	42,700	27,503	190,021
Expenses Related to Tangible Assets	3,592	4,188	1,314	42,211
Other Services	39,285	3,339	2,201	83,193
Equipment and Other Rentals	878	7,293	3,826	242,240
Loss on Disposals and Write-offs and Write-downs of Tangible Capital Assets	0	0	0	0
Accommodation	2,829	1,177	1,212	19,130
Utilities	876	263	2,729	1,876
Other Expenses	11,650	108	16,372	108,111
Interest on Capital Lease Payments	0	0	0	35,821
Advertising, Printing and Related Services	175	270	22	209
Bad Debts	209	105	38	365
Total operating expenses	392,572	310,321	198,588	1,991,520
Transfer payments				
Transfers to Other Countries and International Organizations	0	190	0	182,005
Transfers to Other Levels of Government	0	2,395	0	0
Transfers to Individuals	0	5,701	0	0
Transfers to Non-Profit Organizations	0	0	0	0
Total transfer payments	0	8,286	0	182,005
Total expenses	392,572	318,607	198,588	2,173,525
Revenues				
Sale of Goods and Services	142	1,364	535	160,373
Gains on Disposals of Assets	29	27	468	11,218
Other	105	65	41	197
Interest and Gains on Foreign Exchange	56	12	9	621
Revenues earned on behalf of Government	(142)	(40)	(5)	(11,846)
Total revenues	190	1,428	1,048	160,563
Total	392,382	317,179	197,540	2,012,962

SA Situational Awareness

CaPSS Canadian Peace, Stability and Security

CoPSS Continental Peace, Stability and Security

IPSS International Peace, Stability and Security

NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the Year Ended March 31

19. Segmented Information (continued)

(in thousands of dollars)	DTPS	CI	EPS	NSS
Operating expense				
Salary and Employee Benefits	512,067	221,702	22,527	16,801
Amortization	4,791	0	0	0
Professional and Special Services	42,497	21,083	61,068	53
Repair and Maintenance	87,388	17,404	456	0
Transportation and Communication	287,373	27,919	1,717	83
Materials and Supplies	8,182	23,718	1,495	9
Expenses Related to Tangible Assets	3,364	4,071	534	19
Other Services	118,873	4,863	12,397	226
Equipment and Other Rentals	1,259	17,907	507	1
Loss on Disposals and Write-offs and Write-downs of Tangible Capital Assets	9	0	0	0
Accommodation	8,485	6,222	218	135
Utilities	9,728	1,475	1,859	0
Other Expenses	28,269	25,039	87,882	54
Interest on Capital Lease Payments	328	82	71	0
Advertising, Printing and Related Services	328	716	45	0
Bad Debts	248	110	11	3
Total operating expenses	1,113,189	372,311	190,787	17,384
Transfer payments				
Transfers to Other Countries and International Organizations	0	0	0	0
Transfers to Other Levels of Government	25	1,254	1,500	2,341
Transfers to Individuals	0	0	6,000	0
Transfers to Non-Profit Organizations	4,738	0	0	0
Total transfer payments	4,763	1,254	7,500	2,341
Total expenses	1,117,952	373,565	198,287	19,725
Revenues				
Sale of Goods and Services	106,678	161	121	791
Gains on Disposals of Assets	5	103	7	0
Other	1,148	3	0	194
Interest and Gains on Foreign Exchange	12	2	0	0
Revenues earned on behalf of Government	(44)	(37)	0	0
Total revenues	107,799	232	128	985
Total	1,010,153	373,333	198,159	18,740

DTPS Defence Team Personnel Support

CI Canadian Identity

EPS Environment Protection and Stewardship

NSS Non-Security Support

NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

19. Segmented Information (continued)

(in thousands of dollars)	ISS	2012	Restated (Note 20) 2011
Operating expense			
Salary and Employee Benefits	499,516	10,306,128	9,783,818
Amortization	0	2,395,226	2,342,565
Professional and Special Services	52,338	2,012,235	1,786,527
Repair and Maintenance	75,683	1,314,996	1,192,418
Transportation and Communication	6,000	792,476	777,829
Materials and Supplies	5,552	936,692	662,445
Expenses Related to Tangible Assets	(10,759)	940,720	402,545
Other Services	81,244	614,693	559,123
Equipment and Other Rentals	2,208	450,635	369,270
Loss on Disposals and Write-offs and Write-downs of Tangible Capital Assets	0	323,533	318,358
Accommodation	30,525	162,498	182,259
Utilities	254	117,348	160,864
Other Expenses	743,126	558,536	233,318
Interest on Capital Lease Payments	1,410	32,507	35,713
Advertising, Printing and Related Services	1,761	15,725	27,387
Bad Debts	318	5,019	(2,449)
Total operating expenses	1,489,176	20,978,967	18,831,990
Transfer payments			
Transfers to Other Countries and International Organizations	(148)	182,047	244,208
Transfers to Other Levels of Government	0	8,736	8,855
Transfers to Individuals	(172)	13,904	7,673
Transfers to Non-Profit Organizations	0	4,738	5,475
Total transfer payments	(320)	209,425	266,211
Total expenses	1,488,856	21,188,392	19,098,201
Revenues			
Sale of Goods and Services	37,897	397,044	404,754
Gains on Disposals of Assets	5,502	4,168	33,790
Other	16,090	20,571	20,460
Interest and Gains on Foreign Exchange	5,889	9,931	7,721
Revenues earned on behalf of Government	(22,684)	(28,177)	(52,815)
Total revenues	42,694	403,537	413,910
Total	1,446,162	20,784,855	18,684,291

ISS Internal Services

NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the Year Ended March 31

20. Accounting Changes

During 2011, amendments were made to Treasury Board Accounting Standard 1.2 — Departmental and Agency Financial Statements to improve financial reporting by government departments and agencies. The amendments are effective for financial reporting of fiscal years ending March 31, 2012, and later. The significant changes to the Department's financial statements are described below. These changes have been applied retroactively, and comparative information for 2010–11 has been restated.

Net debt (calculated as liabilities less financial assets) is now presented in the Statement of Financial Position. Accompanying this change, the Department now presents a Statement of Change in Net Debt and no longer presents a Statement of Equity.

Revenue and related accounts receivable are now presented net of non-respendable amounts in the Statement of Operations and Departmental Net Financial Position and Statement of Financial Position. The effect of this change was to increase the net cost of operations before government funding and transfers by \$28.2 million for 2012 (\$52.8 million for 2011) and decrease total financial assets by \$2.1 million for 2012 (\$2.2 million for 2011).

Government funding and transfers, as well as the credit related to services provided without charge by other government departments, are now recognized in the Statement of Operations and Departmental Net Financial Position below "Net cost of operations before government funding and transfers." In previous years, the Department recognized these transactions directly in the Statement of Equity of Canada. The effect of this change was to decrease the net cost of operations after government funding and transfers by \$20.8 billion for 2012 (\$21.2 billion for 2011).

(in thousands of dollars)	2011 As previously stated	Effect of changes	2011 Restated
Statement of Financial Position			
Assets held on behalf of Government	0	(2,208)	(2,208)
Departmental financial position	35,302,657	260,881	35,563,538
Statement of Operations and Departmental Net Financial Position			
Revenues	467,731	(52,815)	414,916
Government funding			
Net cash provided by Government	0	19,040,014	19,040,014
Change in due from Consolidated Revenue Fund	0	1,085,363	1,085,363
Services provided without charge by other government departments (Note 17)	0	770,303	770,303

NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

21. Comparative Information

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

22. Restatement of Previous Year's Balance

During the fiscal year, the Department of National Defence recorded adjustments which resulted in changes to Note 3b, Note 14, Note 17b and the Statement of Financial Position and accordingly required restatement of the comparative figures for 2010–11, as noted below.

(in thousands of dollars)	2011 As previously stated	Effect of changes	2011 Restated
Statement of Financial Position			
Tangible capital assets (note 14)	31,639,722	263,089	31,902,811
Departmental financial position	35,300,449	263,089	35,563,538
Note 3b			
Statutory Amounts	1,470,487	10,905	1,481,392
Authorities Available for Future Years	(1,430,215)	(10,905)	(1,441,120)
Note 14			
Tangible Capital Assets			
Machinery & Equipment:			
Machinery and Equipment	6,204,710	86,042	6,290,752
Informatics Hardware	6,881,287	124,390	7,005,677
Informatics Software	484,946	119,451	604,397
Arms and Weapons	6,465,398	99,632	6,565,030
Other Equipment	67,679	12,927	80,606
	20,104,020	442,442	20,546,462
Ships, Aircraft & Vehicles:			
Ships and Boats	11,472,749	208,890	11,681,639
Aircraft	13,165,360	307,784	13,473,144
Non-military Motor Vehicles	728,746	7,305	736,051
Military Vehicles	1,791,631	32,549	1,824,180
Other Vehicles	396,331	296	396,627
	27,554,817	556,824	28,111,641

(continued)

NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the Year Ended March 31

22. Restatement of previous year's balance (continued)

(in thousands of dollars)	2011 As previously stated	Effect of changes	2011 Restated
Assets Under Construction:			
Buildings	1,060,775	(50,414)	1,010,361
Engineering Works	201,491	(13,427)	188,064
Informatics Software	697,085	(163,170)	533,915
Equipment	6,142,686	(345,509)	5,797,177
	8,102,037	(572,520)	7,529,517
Accumulated Amortization			
Machinery & Equipment:			
Machinery and Equipment	4,553,843	26,393	4,580,236
Informatics Hardware	4,985,955	51,583	5,037,538
Informatics Software	282,127	22,764	304,891
Arms and Weapons	3,712,007	10,842	3,722,849
Other Equipment	44,105	4,762	48,867
	13,578,037	116,344	13,694,381
Ships, Aircraft & Vehicles:			
Ships and Boats	6,463,811	38,079	6,501,890
Aircraft	7,670,011	5,795	7,675,806
Non-military Motor Vehicles	469,941	2,117	472,058
Military Vehicles	1,148,489	1,268	1,149,757
Other Vehicles	247,973	54	248,027
	16,000,225	47,313	16,047,538
Total	26,182,612	263,089	26,445,701
Note 17b			
Accounts Payable to Other Government Departments and Agencies	76,649	3,301	79,950



ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2011–2012 (UNAUDITED)

Note to the reader

Under Treasury Board's *Policy on Internal Control* (PIC), which became effective April 1, 2009, departments demonstrate the measures they are taking to maintain an effective system of internal control over financial reporting (ICFR).

As part of this policy, departments conduct annual assessments of their system of ICFR, establish an action plan to address any necessary adjustments, and attach to their *Statement of Management Responsibility* a summary of their assessment results and action plans. For most departments, completion of the assessment of all their key controls is expected to be a multi-year undertaking, and departments communicate action plans and show progress each year.

Annually, DND engages a third party to objectively assess the Department's progress against prior year action plans for ICFR implementation. The assessment is reflected and summarized in this Annex.

Effective systems of ICFR aim to achieve reliable financial statements and to provide assurances that:

- Transactions are appropriately authorized;
- Financial records are properly maintained;
- Assets are safeguarded from risks such as waste, abuse, loss, fraud and mismanagement; and
- Applicable laws, regulations and policies are complied with.

It should be noted that the system of ICFR is not designed to eliminate all risks, but rather to mitigate risk to a reasonable level with controls that are balanced with and proportionate to the risks they aim to mitigate.

The system of ICFR is designed to mitigate risks to a reasonable level based on an on-going process to identify key risks, to assess the effectiveness of associated key controls and adjust as required, as well as to monitor the system in support of continuous improvement. As a result, the scope, pace and status of departmental assessments of the effectiveness of their system of ICFR will vary from one organization to another based on risks and taking into account their unique circumstances.

1. INTRODUCTION

This document is an annex to the Department of National Defence's (DND) *Statement of Management Responsibility Including Internal Control Over Financial Reporting* for the fiscal year 2011–12. This document provides summary information on the measures taken by DND to maintain an effective system ICFR. In particular, it provides summary information on the internal control assessments conducted by DND as at March 31, 2012, including progress, results and related action plans along with some financial highlights pertinent to understanding the control environment unique to DND.

1.1 Authority, mandate and program activities

Detailed information on DND's authority, mandate and program activities can be found in Note 1 to these financial statements, as well as in the *Departmental Performance Report* and the *Report on Plans and Priorities*.



ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2011–2012 (UNAUDITED)

1.2 Financial highlights

Total liabilities were \$53.2 billion at the end of 2011–12, an increase of \$0.9 billion (1.7%) over the previous year's total liabilities of \$52.3 billion. Canadian Forces Pension and Insurance Accounts comprised 88% of total liabilities.

Total net financial assets were \$49.5 billion at the end of 2011–12, an increase of \$0.5 billion (1.0%) over the previous year's total of 49.0 billion (restated). Due from the Consolidated Revenue Fund comprised 99.6% of total net financial assets.

Total non-financial assets were \$38.7 billion at the end of 2011–12, a decrease of \$0.1 billion (0.3%) over the previous year's total of \$38.8 billion (restated). Tangible capital assets comprised 82.3% of non-financial assets.

Since the increase in liabilities exceeded the increase in financial assets, the Departmental net debt increased \$0.4 billion (13.5%) over the previous year's total of \$3.3 billion (restated) to \$3.7 billion at the end of 2011–12. As a result of all the preceding factors, the Departmental net financial position ended the year at \$35.0 billion, a decrease of \$0.5 billion (1.5%) over the prior year total of \$35.5 billion (restated).

Total expenses for the Department of National Defence were \$21.2 billion in 2011–12 an increase of \$2.1 billion (11.0 %) from the previous year's total of \$19.1 billion (restated). Salary and employee benefits comprised 49.1% of total expenses.

The Department's total revenues amounted to \$403.5 million for 2011–12, a decrease of \$10.4 million (-2.5%) over the previous year's total of \$413.9 million (restated).

1.3 Service arrangements relevant to financial statements

DND relies on other organizations for the processing of certain transactions that are recorded in its financial statements, and relies on these service providers to ensure an adequate system of ICFR is maintained over services provided to the Department. These include:

- Government-wide pay and Receiver General central systems administered by Public Works and Government Services Canada (PWGSC). The central systems consist of six individual systems: Standard Payment System (SPS), Government Banking System (GBS), Regional Pay System (RPS), Payroll System-General Ledger (PS-GL), Receiver General-General Ledger (RG-GL), and the Central Financial Management Reporting System (CFMRS);
- Accommodations provided without charge from PWGSC totalling \$80.8 million throughout the year;
- Various other services without charge from Treasury Board Secretariat (TBS), Human Resources and Skills Development Canada (HRSDC) and the Department of Justice (DOJ) totalling \$698.4 million in fiscal year 2011–12;
- Information from TBS used to calculate various accruals and allowances, such as the accrued severance liability; and
- Information from the DOJ for establishing the contingent liability note to the financial statements and for inclusion in the public accounts.



ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2011–2012 (UNAUDITED)

1.4 Material changes in fiscal-year 2011–12

Effective November 2011, DND transferred responsibility for the Email, Data Centre and Network Services Units, including associated resources to Shared Services Canada (SSC) (Order-in-Council 2011-1297), which was created in August 2011 to consolidate, streamline and improve the government's information technology (IT) infrastructure services. The administration and delivery of these services were shared during the 2011–12 transition period while SSC was being established.

Also effective November 2011, DND transferred responsibility for Communications Security Establishment to Communications Security Establishment (Order-in-Council 2011-1305), including the stewardship responsibility for the assets and liabilities related to this program.

During the year, the Department continued the process of aligning Chief Financial Officer (CFO) roles and authorities to better reflect the role of the departmental CFO, and to more effectively align accountabilities to functional authorities.

2. DND'S CONTROL ENVIRONMENT RELEVANT TO ICFR

DND recognizes the importance of senior management leadership in ensuring that staff at all levels understand their role in maintaining effective systems of ICFR and are well equipped to exercise these responsibilities effectively. DND's focus is to ensure risks are managed through a responsive and risk-based control environment that enables continuous improvement and innovation.

2.1 Key positions, roles and responsibilities

Below are DND's key positions and committees with responsibilities for maintaining and reviewing the effectiveness of its system of ICFR.

Deputy Minister — As DND's Accounting Officer, the Deputy Minister assumes overall responsibility and leadership for the measures taken to maintain an effective system of internal control and signs the *Statement of Management Responsibility Including Internal Control Over Financial Reporting*, which includes this annex.

Chief of the Defence Staff (CDS) — The CDS has primary responsibility for command, control and administration of the Canadian Forces and military strategy, plans and requirements.

Vice Chief of the Defence Staff (VCDS) — The VCDS coordinates and directs the activities necessary to ensure Defence policy and departmental strategic objectives are achieved.

Chief Financial Officer (CFO) — The CFO supports and reports directly to the Deputy Minister and provides leadership for the coordination, coherence and focus on the design and maintenance of an effective and integrated system of ICFR, including its annual assessment. The CFO also signs the *Statement of Management Responsibility Including Internal Control Over Financial Reporting*, which includes this annex.

Senior Departmental Managers — The senior departmental managers in charge of program delivery are responsible for maintaining and reviewing effectiveness of the ICFR falling within their mandate.



ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2011–2012 (UNAUDITED)

Chief Review Services (CRS) — As DND's Chief Audit Executive, CRS reports directly to the Deputy Minister and provides assurance through periodic internal audits which are instrumental to the maintenance of an effective system of ICFR.

Defence Management Committee (DMC) — The DMC provides the Deputy Minister and the CDS with decision support and advice with respect to issues of strategic importance and the overall effective management of the Department.

Defence Finance Committee (DFC) — The DFC acts as an advisory body to the Deputy Minister in support of his accountabilities under the *Financial Administration Act* (FAA). It provides high level strategic financial guidance and a more formal consolidated structure for dealing with resource issues.

Departmental Audit Committee (DAC) — The DND/Canadian Forces (CF) DAC is an advisory committee which provides objective views on the Department's risk management, control and governance frameworks. It reviews DND's Corporate Risk Profile and its system of internal control.

2.2 Key measures taken by DND

DND's control environment includes a series of measures and tools to enable its staff to effectively manage risks through raising awareness, providing appropriate knowledge, as well as developing skill sets. This control environment sets the tone for the Department, and is the foundation for its ICFR. Key measures include:

- DND's culture, which is based on a strong tone at the top, and its governance structure consisting of senior committees and reporting roles which provide both the DM and the CDS with the decisions, support, and advice required to achieve the objectives of the Defence Priorities;
- A Defence Ethics Program which is a comprehensive values-based ethics program put in place to meet the needs of DND and the CF, at both the individual and the organizational levels;
- A comprehensive Fraud Risk Management Strategy that protects DND's resources from fraud, waste and abuse through a prevention and detection framework;
- An annually updated Corporate Risk Profile;
- An approved updated *Delegation of Authorities for Financial Administration* matrix;
- Implementation of a department-wide integrated financial and materiel management Enterprise Resource Planning (ERP) system and expansion of the ERP to other business lines;
- Training programs and regular communication to employees on core areas of financial management;
- Ongoing revalidation of documentation of main business processes and related key risk and control points to support and sustain the management and oversight of its system of ICFR and the preparation of a consolidated departmental financial control framework (FCF);
- A risk-based internal audit plan;
- Ongoing review of financial policies;
- Procurement of a PIC software tool to facilitate PIC implementation; and
- A unit within Financial Operations solely dedicated to strengthening ICFR.



ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2011–2012 (UNAUDITED)

3. ASSESSMENT OF DND'S SYSTEM OF ICFR

3.1 Assessment approach

We are committed to maintaining an effective system of ICFR with the objective of providing reasonable assurances that: a) transactions are appropriately authorized; b) financial records are properly maintained; c) assets are safeguarded; and d) applicable laws, regulations and policies are complied with. In doing so, we are assessing, on an annual basis, both **design** and **operating** effectiveness of key controls over financial reporting in support of continuous improvement.

Design effectiveness means ensuring that key control points are identified, documented, in place and that they are aligned with the risks (i.e. controls are balanced with and proportionate to the risks they aim to mitigate) and that any required remediation is addressed.

Operating effectiveness means that key controls have been tested over a defined period and that any required remediation is addressed. The testing of controls covers all departmental control levels which include corporate or entity, general computer and business process controls.

To achieve DND's ICFR objective and to meet its operational requirements with fiscal discipline and integrity, the Department needs to be in a position to monitor the functioning of its key controls on an ongoing basis. To do this, DND has followed a structured assessment process which comprises the following seven steps:

- 1) Risk Assessment and Scoping;
- 2) Documentation of Control Activities;
- 3) Evaluation of Design Effectiveness;
- 4) Remediation of Design Effectiveness of Controls;

- 5) Evaluation of Operating Effectiveness of Controls;
- 6) Remediation of Operating Effectiveness of Controls; and
- 7) On-going Monitoring of Controls.

As described in this annex, the Department is presently at steps 3 and 4 in most areas with a few areas commencing step 5. Each business process has been assigned a risk rating ranging from low to high depending on the materiality and complexity of the transactions. To date, efforts have been focused on documenting, assessing and remediating the design of controls of high and moderate risk processes. Once well designed controls are in place, assessments will be based on a rotational strategy to ensure that all ICFR systems remain up to date and effective.

3.2 Departmental assessment scope for 2011–12

DND continued with the assessment of its system of ICFR, and made significant progress during fiscal year 2011–12 by developing FCFs and performing process walkthroughs for higher-risk processes, including procurement, stocktaking, remediation liabilities, and financial reporting. In addition, DND continued to assess the design effectiveness of the FCFs that had been previously developed for payables and payments, civilian payroll, revenue and receivables, and remediation liabilities. For Entity Level Controls (ELCs) DND completed its assessment of design effectiveness and commenced assessing operating effectiveness. Some operating effectiveness testing was also performed on Information Technology General Controls (ITGCs).

Table 1 to this Annex summarizes DND's assessment scope during fiscal year 2011–12 and highlights its areas of focus for the fiscal year along with the status as of March 31, 2012.



ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2011–2012 (UNAUDITED)

Table 1 — Scope of DND's assessment during fiscal year 2011–12

Control Level	Significant Account	Design Effectiveness Assessment	Operating Effectiveness Assessment	Location
Entity Level Controls (ELCs)	Control Environment	Completed	Commenced	HQ
	Risk Management	Completed	Commenced	HQ
	Information & Communication	Completed	Commenced	HQ
	Monitoring	Completed	Commenced	HQ
Information Technology General Controls (ITGCs)	Access Management	Completed	Commenced	HQ, Borden and bases
	Quality Assurance and Testing	Completed	Commenced	HQ and Borden
	Change Management	Completed	Commenced	HQ and Borden
	Computer Operations	Completed	Commenced	HQ and Borden
Financial Statement Preparation	Financial Statements and Notes	Completed		HQ
Financial Transactions	Revenue and Receivables	Completed		HQ
	Prepays	Partially Completed		HQ
	Inventory	Partially Completed		HQ and bases
	Stocktaking	Partially Completed		HQ and bases
	Capital Equipment Assets	Partially Completed		HQ and bases
	Real Property Assets	Partially Completed		HQ and bases
	Remediation Liabilities	Partially Completed		HQ and bases
	Procurement	Partially Completed		HQ and bases
	Payables & Payments	Partially Completed		HQ and bases
	Civilian Payroll	Completed		HQ and bases



ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2011–2012 (UNAUDITED)

4. DND'S ASSESSMENT RESULTS DURING FISCAL YEAR 2011–12

4.1 Design effectiveness of key controls

In assessing the design effectiveness of controls, DND made significant progress during fiscal year 2011–12 by developing FCFs (consisting of documentation of key processes, risk and control points) for all high-risk business areas followed by walkthroughs of key processes. In addition, DND continued to assess the effectiveness of the FCFs that had been previously developed for Entity Level Controls, Payables and Payments, Civilian Payroll, Revenue and Receivables, and Remediation Liabilities. Assessment results for the year are summarized as follows:

ELCs — During 2011–12 DND advanced the work on ELCs by completing the assessment of design effectiveness, advanced the work for remediation, and commenced operating effectiveness testing of selected key controls based on risk to achievement of ICFR objectives. Although remediation is not complete in all areas, significant progress has been made on key initiatives which will support the design effectiveness of ELCs.

ITGCs — Significant progress was made in the area of general controls around the two ERP environments (SAP and PeopleSoft) in 2011–12. A design effectiveness review (SAP) and remediation reviews (SAP and PeopleSoft) were conducted and remediation activity was carried out in both

environments. A follow-up remediation assessment of the technical data conversion of legacy supply system data to the SAP environment determined that all conversion control weaknesses previously identified by the Office of the Auditor General (OAG) and PricewaterhouseCoopers were remediated by the Department.

Financial Reporting and Financial Statement

Preparation — DND completed the evaluation of design effectiveness of its Financial Reporting and Financial Statement Preparation process during the year, including the controls surrounding Quarterly Financial Reports (QFR).

Inventory — During 2011–12 DND developed a Stocktaking FCF and performed a detailed scoping of all Materiel Acquisition and Support (MA&S) processes. In addition, DND commenced the assessment of design effectiveness of the Stocktaking FCF by conducting one walkthrough with the Army at 3 Area Support Group in Gagetown.

Capital Equipment and Real Property Assets

and Leases — DND made significant progress by completing the development of draft FCFs for assets and leases.

Procurement, Purchases, Payables and Payments

— During 2011–12 DND completed the assessment of design effectiveness for the material processes within the Procurement to Payments (P2P) cycle.



ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2011–2012 (UNAUDITED)

All other transaction flows and processes —

Significant advancement was made in the control documentation of key processes. The design effectiveness of several processes has been assessed, FCFs have been completed, and remediation activities have been initiated.

Additional details of assessments and results of transaction flows and processes are provided in Table 2 of this Annex.

4.2 Operating effectiveness of key controls

DND has commenced operating effectiveness testing for some key ELCs and ITGCs as described below. For most other processes, this assessment has not yet started. The Department will first complete and test the design effectiveness of control activities and complete remediating any control gaps, as this forms the basis for assessing the operating effectiveness of key controls.

ELCs — The Department developed an operating effectiveness testing strategy for ELCs during 2011–12. As part of this strategy, interviews and document reviews were conducted which served to provide evidence regarding the operating effectiveness of key ELCs. Further to this, a targeted effectiveness testing program was developed whereby higher-risk ELCs were selected for additional testing. The results indicate that DND has now positioned itself to implement a program of ongoing monitoring and continuous improvement of ELC, and that, while there are some areas for improvement before

the Department can achieve its ELC maturity target, progress on ELCs to date and the continued support of senior management will serve to validate confidence in the Department's entire system of ICFR.

ITGCs — In 2011–12, DND developed an operating effectiveness testing strategy and methodology for ITGCs including data conversion, after which an operating effectiveness assessment was performed for the legacy Canadian Forces Supply System (CFSS) to SAP technical data conversion. The assessment concluded that all IT conversion controls were in place.

5. DND'S ACTION PLAN

5.1 Progress as of March 31, 2012

As planned, DND made significant progress towards PIC implementation during 2011–12, and met or exceeded almost all the expectations that were communicated in its action plan for the year. The Department focused its efforts on developing FCFs for higher-risk processes and continued to assess the effectiveness of frameworks that had been previously developed. This work, combined with its convergence towards a common ERP platform supported by ITGC frameworks, serves to strengthen the internal control environment within the Department.

Table 2 below summarizes an independent third party assessment of DND's progress, as at March 31 2012, against its action plan for FY 2011–12.



ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2011–2012 (UNAUDITED)

Table 2 — DND's Progress against its 2011–12 Action Plan

Financial Statement Area	DND's stated 2011–12 Action Plan as per Annex	2011–12 Progress under the Action Plan
Entity Level Controls (ELCs)	Complete the assessment of design effectiveness and remediate control deficiencies identified.	<p>During 2011–12 DND completed the assessment of design effectiveness and made significant progress on remediation.</p> <p>Although remediation is not complete in all areas, significant progress was made on key initiatives which will support the design effectiveness of ELCs. These include initiatives related to implementation of the CFO Model.</p> <p>In support of operational effectiveness testing and the ongoing monitoring of ELCs, DND updated the ELC framework to enhance sustainability and more clearly link with ICFR objectives and risks. DND has also commenced operational effectiveness testing of selected ELCs based on risk to ICFR objectives.</p>

(continued)



ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2011–2012 (UNAUDITED)

Table 2 — DND's Progress against its 2011–12 Action Plan (continued)

Financial Statement Area	DND's stated 2011–12 Action Plan as per Annex	2011–12 Progress under the Action Plan
Information Technology General Controls (ITGCs)	Make significant progress in the work that has commenced for ITGCs.	<p>DND made significant progress on work that had commenced for ITGCs.</p> <p>To support the implementation of the single SAP instance, DND performed an ITGC design effectiveness review of the Defence Resource Management Information System (DRMIS) early in the 2011–12 fiscal year. This review was followed up by a remediation assessment later in the year to determine the status of ITGC weaknesses previously identified. Included in this remediation assessment was a review of CFSS to DRMIS technical data conversion controls, which determined that all previously identified control weaknesses were remediated.</p> <p>An ITGC design effectiveness remediation assessment was also performed for PeopleSoft (GC HRMS 8.9) and the Regional Pay System (RPS), which concluded that while some progress had been made since the original review in 2009, a large number of ITGC weaknesses were not fully remediated.</p> <p>Note: The review of the RPS system was limited to controls performed at DND and did not include controls for which PWGSC is responsible.</p>

(continued)



ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2011–2012 (UNAUDITED)

Table 2 — DND's Progress against its 2011–12 Action Plan (continued)

Financial Statement Area	DND's stated 2011–12 Action Plan as per Annex	2011–12 Progress under the Action Plan
Accounts Receivable/Revenues	Complete the assessment of design effectiveness and remediate control deficiencies identified.	<p>During 2011–12 DND completed the assessment of design effectiveness for Revenue and Receivables by reviewing the DRMIS application controls.</p> <p>The manual controls reflected in the FCF had undergone walkthroughs and an evaluation of control weaknesses in a previous year. The results of the DRMIS application control review resulted in additional remediation that will be incorporated into existing remediation efforts that are currently ongoing by the Department. DND is currently updating the FCF to reflect the results of the application control review.</p>
Prepaid Expenses	No planned activities in 2011–12.	Although no activities were planned in support of the remediation for design effectiveness for the Prepaid Expenses process, DND formed a working group in order to review the Co-operative Logistics (COLOG) prepaid process and update the FCF, as necessary.
Inventory	Make significant progress in the work that has commenced for Inventory.	<p>During 2011–12 DND developed a Stocktaking FCF (as part of Warehouse Management) and performed one process walkthrough. A formal evaluation of the design effectiveness, and the identification of control weaknesses, is awaiting the completion of two additional walkthroughs in 2012–13.</p> <p>In addition to the Stocktaking FCF, a detailed scoping of all Materiel Acquisition and Support (MA&S) processes was performed in order to determine which processes beyond Warehouse Management and Procurement are material for PIC purposes. This scoping exercise resulted in a total of seven sub-processes within MA&S that should be included for PIC purposes.</p>

(continued)



ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2011–2012 (UNAUDITED)

Table 2 — DND's Progress against its 2011–12 Action Plan (continued)

Financial Statement Area	DND's stated 2011–12 Action Plan as per Annex	2011–12 Progress under the Action Plan
Capital Equipment Assets and Capital Equipment Leases	Make significant progress in the work that has commenced for Capital Assets.	During 2011–12 DND developed a draft FCF for Capital Equipment Assets and Leased Capital Equipment Assets. The FCF is scheduled to undergo process walkthroughs and an evaluation of design effectiveness in 2012–13.
Real Property Assets and Real Property Leases	No planned activities in 2011–12.	Although no activities were planned during 2011–12 DND did develop a draft 'to-be' FCF for Real Property Assets and Real Property Leases. The FCF is reflective of a SAP/DRMIS environment. As DND moves from various legacy systems (RAIS, R3A) to DRMIS as part of its Business Transformation Initiative, it is anticipated that the 'to be' FCF will be fully implemented as designed.
Procurement/ Purchases/ Payables/ Payments and Accrued Liabilities (P2P)	Continue to substantially advance the assessment of design effectiveness and identification of major control deficiencies, as well as the completion of walkthrough testing for P2P.	During 2011–12 DND completed the assessment of design effectiveness for the most material processes within Procurement to Payments through: 1) the development of a Procurement FCF; 2) updating of the FCF for Payables and Payments to incorporate proposed TBS Common Financial Management Business Processes (FM-BP); and 3) the subsequent process walkthroughs of all of the Procurement to Payments FCFs. In addition, the application controls for the Procurement to Payment cycle were reviewed. The results of the DRMIS application control review and the manual design effectiveness walkthroughs will result in an overall results report for which design weaknesses identified will be incorporated into existing remediation efforts that are currently ongoing by the Department. DND is currently updating the FCF to reflect the results of the application control review and manual design effectiveness testing.

(continued)



ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2011–2012 (UNAUDITED)

Table 2 — DND's Progress against its 2011–12 Action Plan (continued)

Financial Statement Area	DND's stated 2011–12 Action Plan as per Annex	2011–12 Progress under the Action Plan
Civilian Payroll & Payroll Liabilities	Complete the assessment of design effectiveness and remediate control deficiencies identified.	During 2011–12 DND completed the assessment of design effectiveness primarily through process walkthroughs of the Civilian Payroll FCF and of the Payroll Liabilities FCF that had been previously developed. Based on the walkthroughs and a comparison against proposed TBS Common Financial Management Business Processes (FM-BP), Civilian Payroll control documentation was updated to reflect the current process and align with FM-BP. Additionally, proposed recommendations were developed to respond to gaps/issues identified from the assessment of design effectiveness. Remediation on control weaknesses identified was not fully complete at year-end.
Military Payroll	No planned activities in 2011–12.	Although no activities were planned during 2011–12 DND did analyze the progress made by the MPMCT Project Team to determine if the project timelines would align with the Department's PIC objectives. Based on this analysis, it was determined DND should document existing processes. The Military Payroll processes were further defined through a detailed risk assessment and scoping exercise. Based on the outcome of the scoping, DND initiated the development of a FCF for current Military Payroll processes.

(continued)



ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2011–2012 (UNAUDITED)

Table 2 — DND's Progress against its 2011–12 Action Plan (continued)

Financial Statement Area	DND's stated 2011–12 Action Plan as per Annex	2011–12 Progress under the Action Plan
Financial Reporting and Financial Statement Preparation	Financial reporting processes are scheduled for walkthroughs and an evaluation of design effectiveness during Spring-Summer 2011 in connection with preparation of the fiscal 2010–11 DND departmental financial statements.	<p>During 2011–12 DND performed process walkthroughs of the financial statement process while developing the 2010/11 financial statements. Based on these process walkthroughs, control documentation that had previously been developed was updated and a review for design effectiveness was performed. Several of the control weakness identified as part of the design effectiveness review will be addressed during the development of the 2011–12 financial statements.</p> <p>In addition, requirements associated with the new Quarterly Financial Reports (QFR) were reviewed and incorporated into the existing Financial Reporting FCF. QFR also underwent a process walkthrough and an evaluation of control weaknesses.</p>
Remediation Liabilities and Contaminated Unexploded Explosive Ordnance (UXO) Sites	Continue to substantially advance the assessment of design effectiveness and identification of major control deficiencies, as well as the completion of walkthrough testing.	<p>DND substantially advanced the evaluation of design effectiveness for Remediation Liabilities and UXO.</p> <p>During 2011–12 DND completed the development of two draft FCFs, one for Contaminated Sites and one for UXO Sites. Subsequent to the development of the FCFs, DND performed process walkthroughs on both the Contaminated Sites and UXO processes in order to assess design effectiveness. Based on these walkthroughs a number of high risk control deficiencies were noted and should be addressed in the upcoming fiscal year.</p>
Canadian Forces Pension and Insurance Accounts	No planned activities in 2011–12.	These pension liabilities are included in the financial statements of the Canadian Forces Pension Plans, and are audited annually by the OAG. They are therefore deemed low-risk to the Department and are presently not a high priority.



ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2011–2012 (UNAUDITED)

5.2 Action plan for the fiscal year 2012–13, 2013–14, and future years

Building on progress to date, DND is focusing on advancing the work that is under way in the assessment of its system of ICFR and is committed to completing internal controls implementation and commencing on-going monitoring of controls by fiscal year 2016-17. Most of DND's challenges, as it moves towards full PIC compliance, are due to the size of the Department and complexity of its processes and operations. IT, Inventory and Capital Assets together present the greatest challenge, and will have a significant impact on the successful and timely implementation of PIC. It is important to note that full PIC implementation will be achieved only when the IT and business transformation projects in the Department that are attempting to rationalize, consolidate or modernize business processes are completed.

DND's action plan is based on current resources as well as the interdependencies described above. As such, it may be impacted by changes to resource levels and project outcomes and may therefore require amendment accordingly. The action plan will be updated annually.

By end of 2012–13, DND plans to:

ELCs — Complete the operating effectiveness testing that commenced in 2011–12 for ELCs, update the ELC Framework to reflect new COSO guidance and other emerging best practices, and develop a detailed plan for the ongoing monitoring of PIC related ELC elements.

ITGCs — As a continuation of the remediation of ITGC design deficiencies identified in 2011–12, strengthen and implement policies and procedures around SAP access roles and authorizations in the DRMIS environment; begin development of a sustainment model and processes for ITGCs; develop a plan for remediation of any application control deficiencies which may be identified during the on-going and upcoming business process controls assessments; implement roles and access modifications to classification, compensation and technical user roles of GC HRMS 8.9; complete remediation of deficiencies identified in the 2011–12 GC HRMS 8.9 remediation review; publish revised guidance on Pay Interface Security; and increase the frequency of system access reviews.

Inventory — Develop the Inventory FCF for the remaining seven MA&S business processes and complete the evaluation of design effectiveness for these control frameworks. Continue with the evaluation of design effectiveness for Stocktaking, including two additional walkthroughs; one at an Air Force Wing, and one at a Navy Unit.

Capital Equipment Assets — Validate the Capital Equipment Assets FCF with process owners and subject matter experts (SMEs) and update the documentation; complete the assessment of design effectiveness by conducting walkthroughs; issue the final report indicating the gaps in the internal control framework; commence development of a plan for the annual validation of equipment assets; and conclude the review of the accounting for Asset Pooled Items (API).



ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2011–2012 (UNAUDITED)

Procurement, Payables & Payments — Establish a remediation working group and develop an action plan for Procurement for the remediation of control weaknesses identified during the evaluation of design effectiveness of controls in 2011–12; commence working towards the remediation of design effectiveness for the payables and payments processes tested in 2011–12 (Regular invoice processing, Maintaining vendor master data, Priority payments and Interdepartmental Settlements); complete the control documentation for Departmental Credit cards and Post-payment Verification (Payments sub-processes), Payables-at-year-end and Contractor holdbacks; and complete design effectiveness testing for Departmental Credit Cards, Payables-at-year-end and Contractor's holdbacks.

Real Property — Complete documentation of control activities for Real Property Assets (Stream 1).

Remediation Liabilities — Begin addressing control deficiencies noted in 2011–12 by introducing new IT capabilities in DRMIS, improving policies and procedures, providing training to personnel, and changing the governance structure for the management and accounting of liabilities to a more centralized one.

Financial Statement Preparation / Revenues & Receivables / Civilian Payroll & Payroll Liabilities — Continue to remediate control design deficiencies identified in the evaluation of design effectiveness completed in 2011–12 for Financial Statement Preparation, Revenues & Receivables and Civilian Payroll & Payroll Liabilities.

Military Payroll — Complete the documentation of control activities, evaluate design effectiveness of controls and submit the documentation to the Military Personnel Management Capability Transformation (MPMCT) project for the implementation of the new Military Payroll process.

GRC Application — Commence the implementation of a Governance, Risk and Compliance (GRC) application for use as an internal controls documentation tool in the Department.

By end of 2013–14, DND plans to:

ELCs — Complete the remediation of operating effectiveness testing and commence on-going monitoring of ELCs.

ITGCs — Complete DRMIS ITGC control design remediation; plan and work towards remediation of ERP application control deficiencies identified during the on-going business process controls assessments in order of priority; evaluate operating effectiveness of the IT general controls for GC HRMS 8.9 system and RPS interface; begin implementation of a sustainment model and processes for IT general controls; and begin planning for ITGC review of systems related to military pay.

Inventory/Capital Equipment Assets — Establish Remediation Working Groups (RWGs) for Inventory and Capital Equipment Assets; conduct analyses of gaps and options; develop remediation plans; and develop and design resource, system, training, and policy requirements.



ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2011–2012 (UNAUDITED)

Procurement, Payables & Payments — Continue with the Procurement remediation activities that were approved during the analysis with the Remediation Working Group in 2012–13; commence working towards the remediation of design effectiveness for the processes tested in 2012–13 (PAYEs, Contractor Holdbacks, Departmental Credit cards); complete control documentation for Payments to employees, Working Capital Fund, Integrated Relocation Program and Source systems (Payments and payables sub-processes); and complete design effectiveness testing for Post-payment Verification, Payments to employees, Working Capital Fund, Integrated Relocation Program and Source systems (Payments and payables sub-processes).

Real Property / Military Payroll — Evaluate design effectiveness and remediate design deficiencies of control activities documented in 2012–13 for Real Property Assets (Stream 1) and Military Payroll.

Revenues & Receivables / Civilian Payroll & Payroll Liabilities — Complete remediation of control design deficiencies and evaluate operational effectiveness of controls for Financial Statement Preparation, Revenues & Receivables and Civilian Payroll & Payroll Liabilities.

Future Years:

Beyond 2013–2014, DND plans to continue maturing the organizational structure that will be responsible for the on-going monitoring of operating effectiveness of the departmental system of ICFR, and complete the development of a consolidated Financial Control Framework, which will include all business process and systems that have a significant impact on the departmental financial statements.

The Department plans to complete the documentation, design effectiveness testing, remediation and operating effectiveness testing of key controls of all significant areas. As work is completed for all processes and on-going monitoring commences, the Department plans to continue addressing key gaps identified and implementing corrective measures to ensure that DND remains fully PIC compliant.



INDEX

Accounting Changes (Note 20)	38
Accounts Payable and Accrued Liabilities (Note 4).....	16
Annex	41
Authorities and Objectives (Note 1)	6
Canadian Forces Pension and Insurance Accounts (Note 7)	18
Comparative Information (Note 21).....	39
Contingent Liabilities (Note 15)	27
Contractual Obligations (Note 16).....	30
Deferred Revenue (Note 6)	17
Deposits and Trust Accounts (Note 5)	17
Employee Future Benefits (Note 9).....	21
Inventories (Note 13)	24
Lease Obligations for Tangible Capital Assets (Note 8)	20
Loans and Advances (Note 11)	23
Parliamentary Authorities (Note 3)	15
Prepaid Expenses (Note 12)	23
Receivables (Note 10)	23
Related Party Transactions (Note 17).....	30
Restatement of Previous Year's Balance (Note 22).....	39
Segmented Information (Note 19)	33
Statement of Cash Flow.....	5
Statement of Change in Departmental Net Debt.....	4
Statement of Financial Position	2
Statement of Management Responsibility	1
Statement of Operations and Departmental Net Financial Position.....	3
Summary of Significant Accounting Policies (Note 2).....	10
Tangible Capital Assets and Accumulated Amortization (Note 14)	25
Transfers to Other Government Departments (Note 18)	32