



National
Defence

Défense
nationale



CONSOLIDATED DEPARTMENTAL FINANCIAL STATEMENTS

2012–2013
(UNAUDITED)



Canada



STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING (UNAUDITED)

Responsibility for the integrity and objectivity of the accompanying financial statements for the year ended March 31, 2013, 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, 2013 was completed in accordance with the 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.

// Signed by //

Richard B. Fadden

Deputy Minister
Ottawa, Canada

Date: August 23, 2013

// Signed by //

Stephen O'Connor

Interim Chief Financial Officer

CONSOLIDATED STATEMENT OF FINANCIAL POSITION (UNAUDITED)

As at March 31

(in thousands of dollars)	2013	2012 (Restated note 20)
Liabilities		
Accounts payable and accrued liabilities (note 4)	2,910,981	3,216,886
Vacation pay and compensatory leave	208,959	204,475
Deposits and trust accounts (note 5)	4,167	3,866
Deferred revenue (note 6)	17,617	22,958
Canadian Forces pension and insurance accounts (note 7)	47,167,979	47,057,243
Lease obligations for tangible capital assets (note 8)	480,389	532,505
Employee future benefits (note 9)	1,773,358	1,729,159
Remediation liabilities (note 15)	407,149	425,054
Future asset restoration liabilities (note 15)	3,044	3,757
Total liabilities	52,973,643	53,195,903
Financial assets		
Due from Consolidated Revenue Fund	49,584,038	49,308,050
Receivables (note 10)	189,632	158,233
Loans and advances (note 11)	34,793	34,216
Total gross financial assets	49,808,463	49,500,499
Financial assets held on behalf of Government		
Receivables (note 10)	(2,080)	(2,076)
Total financial assets held on behalf of Government	(2,080)	(2,076)
Total net financial assets	49,806,383	49,498,423
Departmental net debt	3,167,260	3,697,480
Non-financial assets		
Prepaid expenses (note 12)	610,022	789,095
Inventories (note 13)	6,505,117	6,218,804
Tangible capital assets (note 14)	31,819,848	32,086,628
Total non-financial assets	38,934,987	39,094,527
Departmental net financial position	35,767,727	35,397,047

Contingent liabilities (note 15)
Contractual obligations (note 16)

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

// Signed by //

Richard B. Fadden

Deputy Minister
Ottawa, Canada

Date: August 23, 2013

// Signed by //

Stephen O'Connor

Interim Chief Financial Officer

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

For the year ended March 31

(in thousands of dollars)	Planned Results (Restated)	2013	2012 (Restated note 20)
Expenses			
Defence Science and Technology	378,786	375,270	417,749
Recruiting of Personnel and Initial Training	1,136,989	1,215,403	1,138,688
Equipment Acquisition and Disposal	1,151,609	2,695,522	1,889,711
Real Property Infrastructure Acquisition and Disposal	430,400	350,814	459,053
Maritime Readiness	2,137,925	2,410,612	2,235,127
Land Readiness	3,690,706	3,978,242	3,966,534
Aerospace Readiness	1,810,141	1,916,419	1,800,940
Joint and Common Readiness	2,327,587	1,892,144	2,625,983
Situational Awareness	653,710	415,195	392,572
Canadian Peace, Stability and Security	290,786	350,717	318,607
Continental Peace, Stability and Security	194,398	239,707	198,588
International Peace, Stability and Security	2,440,113	1,417,445	2,173,525
Defence Team Personnel Support	1,073,585	1,791,085	1,117,952
Canadian Identity	382,242	372,983	373,565
Environment Protection and Stewardship	114,409	96,105	198,287
Non-Security Support	14,616	3,519	19,725
Internal Services	1,374,980	1,310,593	1,488,856
Total expenses	19,602,982	20,831,775	20,815,462
Revenues			
Sale of goods and services	436,804	416,618	397,044
Gains on disposals of assets	37,678	36,070	4,168
Other	16,576	22,171	20,571
Interest and gains on foreign exchange	12,403	11,657	9,931
Revenues earned on behalf of Government	(24,627)	(15,842)	(28,177)
Total revenues	478,834	470,674	403,537
Net cost from continuing operations	19,124,148	20,361,101	20,411,925
Transferred operations (note 18)			
Expenses	0	0	372,081
Revenue	0	0	1,362
Net cost of transferred operations	0	0	370,719
Net cost of operations before government funding and transfers	19,124,148	20,361,101	20,782,644
Government funding and transfers			
Net cash provided by Government		19,594,643	19,985,175
Change in due from Consolidated Revenue Fund		275,988	503,541
Services provided without charge by other government departments (note 17)		861,165	769,154
Transfer of assets and liabilities from (to) other government departments		(15)	(641,717)
Net cost of operations after government funding and transfers		(370,680)	166,491
Departmental net financial position — beginning of year		35,397,047	35,563,538
Departmental net financial position — end of year		35,767,727	35,397,047

Segmented information (note 19)

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

CONSOLIDATED STATEMENT OF CHANGE IN DEPARTMENTAL NET DEBT

(UNAUDITED)

For the year ended March 31

(in thousands of dollars)	2013	2012 (Restated note 20)
Net cost of operations after government funding and transfers	(370,680)	166,491
Change due to tangible capital assets		
Acquisition of tangible capital assets	3,008,019	3,539,679
Amortization of tangible capital assets	(2,709,530)	(2,673,491)
Proceeds on disposal of surplus assets	(38,672)	(26,316)
Loss on disposals of tangible capital assets	(541,366)	(323,533)
Adjustments of tangible capital assets	14,784	364,472
Transfer to other government departments	(15)	(696,993)
Total change due to tangible capital assets	(266,780)	183,817
Change due to inventories	286,313	173,804
Change due to prepaid expenses	(179,073)	(82,818)
Net increase (decrease) in departmental net debt	(530,220)	441,294
Departmental net debt — beginning of year	3,697,480	3,256,186
Departmental net debt — end of year	3,167,260	3,697,480

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

CONSOLIDATED STATEMENT OF CASH FLOW (UNAUDITED)

For the year ended March 31

(in thousands of dollars)	2013	2012 [Restated note 20]
Operating activities		
Net cost of operations before Government funding and transfers	20,361,101	20,782,644
Non-cash items included in net cost of operations		
Amortization of tangible capital assets	(2,709,530)	(2,673,491)
Loss on disposals of tangible capital assets	(541,366)	(323,533)
Adjustments of tangible capital assets	14,784	364,472
Services provided without charge by other government departments	(861,165)	(769,154)
Variations in Statement of Financial Position		
Increase (decrease) in receivables and advances	31,972	(38,623)
Increase (decrease) in prepaid expenses	(179,073)	(82,818)
Increase (decrease) in inventories	286,313	173,804
Decrease (increase) accounts payable and accrued liabilities	305,905	(290,125)
Decrease (increase) vacation pay and compensatory leave	(4,484)	11,184
Decrease (increase) deposits and trust accounts	(301)	(914)
Decrease (increase) deferred revenue	5,341	(17)
Decrease (increase) Canadian Forces pension and insurance accounts	(110,736)	(540,543)
Decrease (increase) employee future benefits	(44,199)	(59,736)
Decrease (increase) remediation liabilities	17,905	(99,598)
Decrease (increase) future asset restoration liabilities	713	12,086
Transfer of liabilities to other government departments (note 18)	0	(55,297)
Cash Used by operating activities	16,573,180	16,410,341
Capital investment activities		
Acquisitions of tangible capital assets (note 14)	3,008,019	3,539,679
Proceeds on disposal of surplus assets	(38,672)	(26,316)
Cash used by capital investment activities	2,969,347	3,513,363
Financing activities		
Payments against / adjustments to capital lease obligations	52,116	61,471
Cash used by financing activities	52,116	61,471
Net cash provided by Government of Canada	19,594,643	19,985,175

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



CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

1. Authority and objectives

AUTHORITIES

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

OBJECTIVES

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 Canadian Armed Forces (CAF) and the Department of National Defence (DND) 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.



CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

(c) Equipment Acquisition and Disposal:

This program acquires equipment required for CAF 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 (IC) 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 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 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. Programs 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.



CONSOLIDATED 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. Royal Canadian Navy, Canadian Army, Royal Canadian 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.

(j) Canadian Peace, Stability and Security:

This program employs the CAF 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 CAF 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 CAF 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 is the national operational authority for the defence of North America and its approaches.

* Canada Command was dissolved and formally replaced by Canadian Joint Operations Command (CJOC) on 5 October 2012.



CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

(l) International Peace, Stability and Security:

This program contributes to global peace and security by conducting global CAF 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 CAF 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 CAF 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 CAF to Canadians and inform them of the military profession and practice in Canada. This is realized through initiatives such as ceremonial and band performances, CAF museums, CAF 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 contributing 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.

** Canadian Expeditionary Force Command was dissolved and formally replaced by CJOC on 5 October 2012.



CONSOLIDATED 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 *2012-13 Report on Plans and Priorities*. The planned results from the future oriented financial statements for 2012-13 have been restated to reflect the revenue net of non-respendable amounts. This restatement resulted in a \$24.6 million increase in the net cost of operations before government funding and transfers. In addition, the future-oriented statements have also been reclassified to conform to current year presentation.

(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 CAF 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, Communications Security Establishment Canada and the Office of the Communications Security Establishment Commissioner are excluded from the consolidation because these organizations are not part of the Defence Services Program, although they fall under the responsibility of the Minister of National Defence.



CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

(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 processed through the CRF. Amounts due from the CRF represent the net amount of cash that the Department is entitled to draw from the CRF without further authorities to discharge its liabilities.

(e) Revenues

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

Revenues that are non-respendable are not available to discharge the Department's liabilities.

While the 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.



CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

(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.

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

(h) Accounts and Loans 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.



CONSOLIDATED 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.

(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.

(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 Canadian Forces Supply System (CFSS) or Defence Resource Management Information System (DRMIS) is valued at historical cost 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 the Statement of Operations and Departmental Net Financial Position.

(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).

CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

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 at a rate consistent with the capital asset pool 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.

CONSOLIDATED 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)	2013	2012 (Restated note 20)
Net cost of operations before government funding and transfers	20,361,101	20,782,644
Adjustments for items affecting net cost of operations but not affecting authorities:		
Amortization of tangible capital assets	(2,709,530)	(2,673,491)
Services provided without charge by other government departments	(861,165)	(769,154)
Increase in employee future benefits	(44,199)	(105,580)
Refund of previous year's expenses	74,963	145,472
Increase (decrease) in vacation pay and compensatory leave	(4,484)	1,731
Loss on disposals of capital assets	(541,366)	(323,533)
Adjustments of tangible capital assets	14,784	364,472
Refund of program expenditures	9,970	0
Decrease (increase) in deferred revenue	5,341	(17)
Decrease (increase) in accrued liabilities not charged to authorities	503,235	(604,116)
Bad debt expense	2,517	(5,019)
Miscellaneous	(6,463)	(49,156)
Total items affecting net cost of operations but not affecting authorities	(3,556,397)	(4,018,391)
Adjustments for items not affecting net cost of operations but affecting authorities:		
Acquisition of tangible capital assets	3,008,019	3,539,679
Acquisition of tangible capital assets under Public-Private Partnership	0	(223,265)
Decrease in lease obligations for tangible capital assets	52,116	61,470
Increase in inventory purchases net of usage and adjustments	286,313	173,804
Decrease in prepaid expenses	(179,073)	(82,818)
Revenues collected from prior year receivables	6,111	13,513
Miscellaneous	0	(27,878)
Total items not affecting net cost of operations but affecting authorities	3,173,486	3,454,505
Current year authorities used	19,978,190	20,218,758

Comparative Information (note 21)

CONSOLIDATED 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)	2013	2012
Vote 1 — Operating expenditures	16,123,500	15,417,928
Vote 5 — Capital expenditures	3,322,188	4,322,835
Vote 10 — Grants & contributions	215,368	241,678
Statutory amounts	1,767,428	1,735,684
Less:		
Authorities available for future years	(1,135,950)	(1,348,324)
Frozen allotments and other planned lapses	(276,889)	(114,753)
Residual lapse	(37,455)	(36,290)
Current year authorities used	19,978,190	20,218,758

4. Accounts payable and accrued liabilities

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

(in thousands of dollars)	2013	2012
Accounts payable — other government departments and agencies	97,232	73,970
Accounts payable — external parties	1,390,577	1,585,585
	1,487,809	1,659,555
Accrued liabilities*	1,423,172	1,557,331
Total accounts payable and accrued liabilities	2,910,981	3,216,886

* In *Canada's Economic Action Plan 2012*, the Government announced savings measures to be implemented by departments over the next three fiscal years starting in 2012–2013. As a result, the Department has recorded at March 31, 2013, an obligation for termination benefits for an amount of \$ 41.8 million (2011–12 estimate was not available) as part of accrued liabilities to reflect the estimated workforce adjustment costs.

CONSOLIDATED 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)	2013	2012
Contractor security deposits		
Deposits, beginning of year	3,582	2,607
Deposits received	7,189	7,257
Refunds	(7,157)	(6,282)
Contractor security deposits, end of year	3,614	3,582
Trust account, estates — Armed Services*		
Trust account, beginning of year	284	345
Funds received	1,815	1,111
Payments	(1,546)	(1,172)
Trust account, estates — Armed Services, end of year	553	284
Closing balance	4,167	3,866

* 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)	2013	2012
Foreign governments		
Beginning of year	16,586	14,608
Funds received	5,418	12,497
Revenue recognized	(12,210)	(10,519)
Foreign governments, end of year	9,794	16,586
Other specified purposes		
Beginning of year	6,372	8,333
Funds received	1,444	(1,969)
Revenue recognized	7	8
Other specified purposes, end of year	7,823	6,372
Closing balance	17,617	22,958



CONSOLIDATED 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 Armed 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 Armed Forces. This account records contributions, premiums, interest, and benefit payments.

CONSOLIDATED 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)	2013	2012
Canadian Forces Superannuation Account		
Beginning of year	46,269,146	45,995,263
Funds received and other credits	2,558,251	2,685,957
Payments and other charges	(2,470,261)	(2,412,074)
Canadian Forces Superannuation Account, end of year	46,357,136	46,269,146
Canadian Forces Pension Fund Account		
Beginning of year	280,497	37,744
Funds received and other credits	1,479,324	1,378,150
Payments and other charges	(428,566)	(320,533)
Transfers to the Public Sector Pension Investment Board	(1,055,159)	(814,864)
Canadian Forces Pension Fund Account, end of year	276,096	280,497
Reserve Force Pension Fund Account		
Beginning of year	9,725	5,027
Funds received and other credits	41,256	56,504
Payments and other charges	(37,747)	(20,751)
Transfers to the Public Sector Pension Investment Board	0	(31,055)
Reserve Force Pension Fund Account, end of year	13,234	9,725
Retirement Compensation Arrangements Account*		
Beginning of year	307,572	286,772
Funds received and other credits	49,339	47,137
Payments and other charges	(26,960)	(26,337)
Retirement Compensation Arrangements Account, end of year	329,951	307,572
Regular Force Death Benefit Account		
Beginning of year	190,303	191,894
Funds received and other credits	29,903	30,240
Payments and other charges	(28,644)	(31,831)
Regular Force Death Benefit Account, end of year	191,562	190,303
Closing balance	47,167,979	47,057,243

* 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, 2013, the total refundable tax transferred amounts to \$319 million (\$297 million in 2012).

CONSOLIDATED 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 \$518 million as at March 31, 2013 (\$870 million and \$477 million respectively as at March 31, 2012). 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 2013	Balance of obligations 2012
Buildings	143,795	(43,486)	100,309	106,325
Aircraft	462,884	(82,804)	380,080	426,180
Total	606,679	(126,290)	480,389	532,505

Future minimum lease payments

(in thousands of dollars)	2013–2014	2014–2015	2015–2016	2016–2017	2017–2018	2018–2019 and thereafter
Buildings	12,205	12,142	12,084	12,020	11,949	83,395
Aircraft	70,105	70,105	70,105	70,105	70,105	112,359
Total	82,310	82,247	82,189	82,125	82,054	195,754

The Department has entered into agreements for buildings and aircraft under capital leases (refer to note 14 of these financial statements).



CONSOLIDATED 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 2012-13 expense amounts to \$215.7 million (\$239.2 million in 2011-12), which represents approximately 1.7 times (1.8 times in 2011-12) 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 Armed Forces Regular Force and eligible members of the Reserve Force participate in the Canadian Forces pension plan, which is sponsored by the

Government of Canada and administered by the Department. Pension benefits accrue up to a maximum of 35 years at a rate of 2 percent per year of pensionable service, times the average of the best five consecutive years of earnings. The benefits are integrated with Canada/Québec Pension Plan benefits and are indexed to inflation.

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

Both the members and the Department contribute to the cost of the CF pension plans for both current and prior service. The 2012-13 expense amounts to \$1,140.7 million (\$1,107 million in 2011-12), which represents approximately 2.3 times (2.5 times in 2011-12) the contributions by employees.



CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

9. Employee future benefits (continued)

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 (\$249 million in 2011–12) to fund the deficit in the Canadian Forces Pension Fund Account, until the deficit is funded as per the triennial funding valuation; and
- A government contribution holiday to the Reserve Force Pension Fund Account starting in November 2011, to reduce the non-permitted surplus in the account. 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 CAF members based on eligibility, years of service, final salary and authorized period of service. These severance benefits are not pre-funded. Benefits will be paid from future authorities.

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.

CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

9. Employee future benefits (continued)

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

(in thousands of dollars)	2013	2012
Public Service Employees		
Accrued benefit obligation, beginning of year	222,459	398,823
Transferred to other government department (note 18)	0	(45,844)
	222,459	352,979
Expenses for the year	46,393	26,127
Benefits paid during the year	(103,594)	(156,647)
Accrued benefit obligation, end of year	165,258	222,459
Canadian Armed Forces Members		
Accrued benefit obligation, beginning of year	1,506,700	1,270,600
Expenses for the year	722,083	335,119
Benefits paid during the year	(620,683)	(99,019)
Accrued benefit obligation, end of year	1,608,100	1,506,700
Total accrued benefit obligation, end of year	1,773,358	1,729,159

10. Receivables

The following table presents details of accounts receivable:

(in thousands of dollars)	2013	2012
External parties	63,854	56,486
Other government departments and agencies	131,670	110,579
	195,524	167,065
Less: allowance for doubtful accounts on external receivables	5,892	8,832
Gross accounts receivable	189,632	158,233
Accounts receivable held on behalf of Government	(2,080)	(2,076)
Net Receivables	187,552	156,157



CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

11. Loans and advances

The following table presents details of loans and advances:

(in thousands of dollars)	2013	2012
Imprest accounts, standing advances and authorized loans to CAF members	34,781	34,180
Accountable advances (temporary advances)	12	36
Total loans and advances	34,793	34,216

12. Prepaid expenses

The following is a breakdown of prepaid expenses:

(in thousands of dollars)	2013	2012
Foreign military purchases	420,456	442,620
Sea sparrow missiles	48,923	124,449
Building rentals	18,985	19,580
NATO flying training Canada (NFTC)	11,308	46,389
Joint strike fighter development	6,018	18,055
Military salaries	0	9,885
Other purchases	104,332	128,117
Total prepaid expenses	610,022	789,095

CONSOLIDATED 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)	2013	2012 [Restated note 20]
Ammunition, bombs and missiles	3,705,972	3,468,933
Uniforms and clothing	520,894	531,223
Contractor held inventory	377,526	355,861
Metal	321,187	295,732
Communication, electrical parts/accessories and informatics equipment	297,293	296,579
Engineering, test and technical equipment and machine tools	263,649	256,246
Land equipment spares	249,689	207,780
Ship spares	229,528	219,745
Medical equipment	117,804	127,239
Sonobuoys, parts and accessories	113,498	107,896
Aircraft spares	78,403	121,360
Fuel, petroleum and oil	64,065	55,996
Miscellaneous	165,609	174,214
Total inventories	6,505,117	6,218,804

The cost of consumed inventory recognized as an expense in the Statement of Operations and Departmental Net Financial Position is \$393.0 million in 2012–13 (\$725.8 million in 2011–12).

CONSOLIDATED 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 20)	Adjustments ⁽¹⁾	Acquisitions	Disposals and write-offs	Balance end of Year
Land, buildings and works					
Land	83,169	0	1,050	(15)	84,204
Buildings	7,470,584	494,834	1,157	(9,402)	7,957,173
Works	2,192,407	58,554	1,828	(580)	2,252,209
	9,746,160	553,388	4,035	(9,997)	10,293,586
Machinery and equipment					
Machinery and equipment	6,683,502	108,931	100,473	(31,224)	6,861,682
Informatics hardware	6,798,798	(21,802)	94,641	(42,222)	6,829,415
Informatics software	504,278	105,403	194	(518)	609,357
Arms and weapons	6,563,887	(87,554)	72,090	(273,895)	6,274,528
Other equipment	89,197	238	3,019	(4,066)	88,388
	20,639,662	105,216	270,417	(351,925)	20,663,370
Ships, aircraft and vehicles					
Ships and boats	11,922,318	5,267	31,788	(101,914)	11,857,459
Aircraft	15,032,411	159,320	112,438	(153,020)	15,151,149
Non-military motor vehicles	763,278	5,633	45,227	(26,791)	787,347
Military vehicles	1,815,852	29,700	14,186	(57,084)	1,802,654
Other vehicles	418,648	(8,476)	16,785	(6,365)	420,592
	29,952,507	191,444	220,424	(345,174)	30,019,201
Leasehold improvements					
Leasehold improvements	44,769	7,289	0	(10,697)	41,361
	44,769	7,289	0	(10,697)	41,361
Leased tangible capital assets					
Buildings	139,004	0	0	0	139,004
Other equipment	48	0	0	0	48
Aircraft	731,130	0	0	0	731,130
	870,182	0	0	0	870,182
Assets under construction					
Buildings	985,566	(487,675)	688,657	0	1,186,548
Engineering works	165,799	(69,803)	134,062	0	230,058
Informatics software	580,409	(132,180)	70,085	0	518,314
Equipment	5,708,401	(679,885)	1,620,339	(76)	6,648,779
	7,440,175	(1,369,543)	2,513,143	(76)	8,583,699
Gross tangible capital assets	68,693,455	(512,206)	3,008,019	(717,869)	70,471,399

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

During 2012–13, the Department transferred vehicles with a net book value of \$ 15,431 to Public Works and Government Services Canada and the Canadian International Development Agency. This transfer is included in the adjustment column.

CONSOLIDATED 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 (Restated note 20)	Adjust- ments	Amorti- zation	Disposals and write-offs	Balance end of year	Net book value 2013	Net book value 2012 (Restated note 20)
Land, buildings and works							
Land						84,204	83,169
Buildings	3,353,390	0	205,195	(6,252)	3,552,333	4,404,840	4,117,194
Works	1,212,841	891	68,380	(628)	1,281,484	970,725	979,566
	4,566,231	891	273,575	(6,880)	4,833,817	5,459,769	5,179,929
Machinery and equipment							
Machinery and equipment	4,948,671	(67,422)	304,646	(6,289)	5,179,606	1,682,076	1,734,831
Informatics hardware	5,239,601	(36,873)	452,924	26,885	5,682,537	1,146,878	1,559,197
Informatics software	278,518	1,687	61,233	(237)	341,201	268,156	225,760
Arms and weapons	3,729,461	(129,675)	281,867	(174,819)	3,706,834	2,567,694	2,834,426
Other equipment	55,883	242	6,746	(3,343)	59,528	28,860	33,314
	14,252,134	(232,041)	1,107,416	(157,803)	14,969,706	5,693,664	6,387,528
Ships, aircraft and vehicles							
Ships and boats	7,109,191	(116,367)	495,164	37,409	7,525,397	4,332,062	4,813,127
Aircraft	8,193,648	(153,186)	642,159	74,716	8,757,337	6,393,812	6,838,763
Non-military motor vehicles	508,420	(8,088)	44,892	(24,924)	520,300	267,047	254,858
Military vehicles	1,202,179	(9,842)	73,321	(44,175)	1,221,483	581,171	613,673
Other vehicles	274,588	(8,339)	25,147	(5,477)	285,919	134,673	144,060
	17,288,026	(295,822)	1,280,683	37,549	18,310,436	11,708,765	12,664,481
Leasehold improvements							
Leasehold improvements	24,164	0	6,097	(10,697)	19,564	21,797	20,605
	24,164	0	6,097	(10,697)	19,564	21,797	20,605
Leased tangible capital assets							
Buildings	54,431	0	6,318	0	60,749	78,255	84,573
Other equipment	36	0	5	0	41	7	12
Aircraft	421,805	(3)	35,436	0	457,238	273,892	309,325
	476,272	(3)	41,759	0	518,028	352,154	393,910
Assets under construction							
Buildings						1,186,548	985,566
Engineering works						230,058	165,799
Informatics software						518,314	580,409
Equipment						6,648,779	5,708,401
						8,583,699	7,440,175
Total	36,606,827	(526,975)	2,709,530	(137,831)	38,651,551	31,819,848	32,086,628

In 2012–13, the Department had capital asset holdings that were damaged but that have yet to be approved for write-down or write-off. The estimated net book value of these holdings is disclosed in the table on the right.

Further evaluation of these capital asset holdings will be conducted in fiscal year 2013–14 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.

	2013	2012
Assets likely for disposal	\$32.9 million	\$179.7 million
Assets pending evaluation	\$3.7 million	\$6.4 million
Assets under repair	\$3.7 million	\$14.9 million



CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

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 \$33.9 million (\$6.7 million in 2011–12) at March 31, 2013.

(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.

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 277 sites (246 sites in 2011–12) where such action is possible and for which a liability of \$407.1 million (\$425.1 million in 2011–12) has been recorded. The Department has also estimated contingent liabilities relating to contaminated sites of \$224.8 million (\$244 million in 2011–12) 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.



CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

15. Contingent liabilities (continued)

In fiscal year 2012–13, 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.

As knowledge increases about the impacts of contaminants on human health and the environment, new clean up criteria for emerging contaminants may be introduced and existing guidelines for known contaminants may be updated or revised. New or changed criteria have the potential to increase liability for the department. One group of emerging contaminants is perfluorinated compounds (PFCs) which has been found at several current and former federal sites.

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 2012–13, the assessment activities were undertaken at 135 suspected or confirmed contaminated sites. As a result of assessment activities, additional liabilities may be reported in the future.

(c) Future asset restoration liabilities

UXO affected legacy sites

Based on management's best estimates, a liability of \$3 million has been recorded for likely management and clearance action on 8 out of a total of 50 confirmed unexploded explosive ordnance (UXO) affected sites (\$3.8 million in 2012 related to 10 UXO sites out of a total of 43 confirmed UXO sites).

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.

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.



CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

15. Contingent liabilities (continued)

Real property liabilities

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/CAF 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.

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)	2013–2014	2014–2015	2015–2016	2016–2017	2017–2018 and thereafter	Total
Fixed assets	1,891,249	1,659,514	1,146,943	350,300	318,746	5,366,752
Purchases	2,136,118	1,004,181	861,410	577,705	3,882,137	8,461,551
Total	4,027,367	2,663,695	2,008,353	928,005	4,200,883	13,828,303

CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

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)	2013	2012
Employer's contributions to the health and dental plans Paid by Treasury Board of Canada Secretariat	776,994	685,508
Accommodation provided by Public Works and Government Services Canada	72,093	70,789
Worker's compensation coverage provided by Human Resources and Skills Development Canada	8,746	8,721
Legal services provided by Department of Justice Canada	3,332	4,136
Total	861,165	769,154

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)	2013	2012
Expenses — other government departments and agencies	2,458,418	1,197,329
Revenues — other government departments and agencies	14,709	14,709
Total	2,473,127	1,212,038

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



CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

18. Transfers to other government departments

Effective November 15, 2011, the Department of National Defence transferred responsibility for the Email, Data Centre and Network Services Units to Shared Services Canada in accordance with Order-in-Council 2011-1297, including the stewardship responsibility for the assets and liabilities related to the program. In addition, effective November 16, 2011, the Department transferred responsibility for Communications Security Establishment to Communications Security Establishment in accordance with Order-in-Council 2011-1305, 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)	2012
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

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 alignment 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, by major object of expenses and by major type of revenues. The segment results for the period are as follows:

CONSOLIDATED 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	208,998	964,787	206,649	19,058
Amortization	176	0	2,395,827	279,303
Professional and special services	78,806	70,184	393,496	88,878
Repair and maintenance	7,437	278	56,688	99,111
Expenses related to tangible assets	7,661	3,517	467,374	5,435
Transportation and communication	10,666	24,624	23,079	1,283
Materials and supplies	7,965	27,143	23,171	1,980
Loss on disposals and write-offs and write-downs of assets	0	0	521,854	3,468
Other services	18,952	6,129	38,544	1,937
Accommodation	2,361	10,567	8,580	3,578
Equipment and other rentals	917	3,160	467	667
Utilities	3,581	7	3	365
Interest on capital lease payments	41	44,867	(46,816)	(5,935)
Advertising, printing and related services	96	4,732	555	10
Other expenses	27,538	55,686	(1,393,886)	(148,369)
Bad debts	(47)	(278)	(63)	(5)
Total operating expenses	375,148	1,215,403	2,695,522	350,764
Transfer payments				
Transfers to other countries and international organizations	0	0	0	0
Transfers to individuals	0	0	0	50
Transfers to other levels of government	122	0	0	0
Transfers to non-profit organizations	0	0	0	0
Total transfer payments	122	0	0	50
Total expenses	375,270	1,215,403	2,695,522	350,814
Revenues				
Sale of goods and services	2,804	8,088	51	174
Gains on disposals of assets	238	9	(594)	0
Other	125	3	86	946
Interest and gains on foreign exchange	28	6	3,755	1
Revenues earned on behalf of Government	(1,892)	0	(355)	0
Total revenues	1,303	8,106	2,943	1,121
Net cost from continuing operations	373,967	1,207,297	2,692,579	349,693

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

CONSOLIDATED 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	1,342,000	2,481,545	1,137,356	953,603
Amortization	0	0	0	28,115
Professional and special services	281,562	228,016	139,355	243,818
Repair and maintenance	159,070	210,598	249,185	81,886
Expenses related to tangible assets	129,678	131,510	41,722	44,754
Transportation and communication	30,378	84,122	51,855	94,754
Materials and supplies	83,902	99,239	88,880	163,825
Loss on disposals and write-offs and write-downs of assets	1,612	3,406	2,121	91
Other services	14,589	59,242	32,288	57,135
Accommodation	10,445	26,940	10,401	40,464
Equipment and other rentals	19,866	50,555	34,452	14,934
Utilities	27,301	50,394	27,791	24,674
Interest on capital lease payments	82	2,935	41	8,314
Advertising, printing and related services	249	287	744	3,936
Other expenses	310,232	550,000	100,493	131,412
Bad debts	(326)	(547)	(265)	(281)
Total operating expenses	2,410,640	3,978,242	1,916,419	1,891,434
Transfer payments				
Transfers to other countries and international organizations	0	0	0	0
Transfers to individuals	(28)	0	0	0
Transfers to other levels of government	0	0	0	710
Transfers to non-profit organizations	0	0	0	0
Total transfer payments	(28)	0	0	710
Total expenses	2,410,612	3,978,242	1,916,419	1,892,144
Revenues				
Sale of goods and services	10,101	23,626	14,576	15,495
Gains on disposals of assets	1,845	1,730	1,494	1,237
Other	600	421	286	609
Interest and gains on foreign exchange	245	675	236	190
Revenues earned on behalf of Government	(9)	(299)	0	(1)
Total revenues	12,782	26,153	16,592	17,530
Net cost from continuing operations	2,397,830	3,952,089	1,899,827	1,874,614

MR Maritime Readiness
 LR Land Readiness
 AR Aerospace Readiness
 JCR Joint and Common Readiness

CONSOLIDATED 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	242,043	123,562	84,312	716,752
Amortization	0	0	0	0
Professional and special services	26,609	13,142	5,943	121,765
Repair and maintenance	41,852	111,881	81,990	48,081
Expenses related to tangible assets	23,737	4,712	5,148	22,327
Transportation and communication	9,316	11,242	5,897	43,728
Materials and supplies	8,714	31,835	23,350	109,982
Loss on disposals and write-offs and write-downs of assets	6	(7)	0	55
Other services	25,213	4,313	1,686	28,725
Accommodation	2,103	1,550	1,788	8,891
Equipment and other rentals	425	4,954	1,126	28,713
Utilities	1,153	385	3,727	3,433
Interest on capital lease payments	0	0	0	25,238
Advertising, printing and related services	250	406	3	119
Other expenses	33,879	34,414	24,756	98,697
Bad debts	(105)	(53)	(19)	(183)
Total operating expenses	415,195	342,336	239,707	1,256,323
Transfer payments				
Transfers to other countries and international organizations	0	190	0	161,122
Transfers to individuals	0	5,646	0	0
Transfers to other levels of government	0	2,545	0	0
Transfers to non-profit organizations	0	0	0	0
Total transfer payments	0	8,381	0	161,122
Total expenses	415,195	350,717	239,707	1,417,445
Revenues				
Sale of goods and services	49	(1,041)	373	181,207
Gains on disposals of assets	6	27	943	19,514
Other	27	64	41	25
Interest and gains on foreign exchange	108	17	42	342
Revenues earned on behalf of Government	0	0	0	0
Total revenues	190	(933)	1,399	201,088
Net cost from continuing operations	415,005	351,650	238,308	1,216,357

SA Situational Awareness
CaPSS Canadian Peace, Stability and Security
CoPSS Continental Peace, Stability and Security
IPSS International Peace, Stability and Security

CONSOLIDATED 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	1,172,671	226,089	23,615	2,977
Amortization	6,109	0	0	0
Professional and special services	38,677	22,353	49,088	48
Repair and maintenance	78,772	15,427	564	0
Expenses related to tangible assets	1,914	4,092	268	15
Transportation and communication	309,425	26,052	1,407	40
Materials and supplies	6,272	17,493	980	5
Loss on disposals and write-offs and write-downs of assets	121	0	0	0
Other services	118,715	4,901	11,266	63
Accommodation	13,135	7,916	309	21
Equipment and other rentals	1,722	16,070	395	0
Utilities	13,726	2,217	1,923	0
Interest on capital lease payments	329	82	71	0
Advertising, printing and related services	464	471	21	0
Other expenses	24,928	28,597	703	41
Bad debts	(124)	(55)	(5)	(2)
Total operating expenses	1,786,856	371,705	90,605	3,208
Transfer payments				
Transfers to other countries and international organizations	0	0	0	0
Transfers to individuals	0	0	4,000	(1)
Transfers to other levels of government	26	1,278	1,500	312
Transfers to non-profit organizations	4,203	0	0	0
Total transfer payments	4,229	1,278	5,500	311
Total expenses	1,791,085	372,983	96,105	3,519
Revenues				
Sale of goods and services	109,066	226	85	958
Gains on disposals of assets	0	21	50	0
Other	1,436	3	0	57
Interest and gains on foreign exchange	35	9	0	0
Revenues earned on behalf of Government	0	0	0	0
Total revenues	110,537	259	135	1,015
Net cost from continuing operations	1,680,548	372,724	95,970	2,504

DTPS Defence Team Personnel Support
 CI Canadian Identity
 EPS Environment Protection and Stewardship
 NSS Non-Security Support

CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

19. Segmented information (continued)

(in thousands of dollars)	ISS	2013	2012 (Restated note 20)
Operating expense			
Salary and employee benefits	806,625	10,712,642	10,306,128
Amortization	0	2,709,530	2,649,264
Professional and special services	107,367	1,909,107	2,012,235
Repair and maintenance	71,116	1,313,936	1,314,996
Expenses related to tangible assets	26,531	920,395	464,382
Transportation and communication	21,997	749,865	792,476
Materials and supplies	9,133	703,869	936,692
Loss on disposals and write-offs and write-downs of assets	8,639	541,366	323,533
Other services	86,443	510,141	614,693
Accommodation	45,567	194,616	162,498
Equipment and other rentals	1,910	180,333	450,635
Utilities	209	160,889	117,348
Interest on capital lease payments	0	29,249	32,507
Advertising, printing and related services	1,282	13,625	15,725
Other expenses	124,215	3,336	407,905
Bad debts	(159)	(2,517)	5,019
Total operating expenses	1,310,875	20,650,382	20,606,036
Transfer payments			
Transfers to other countries and international organizations	0	161,312	182,047
Transfers to individuals	(282)	9,385	13,904
Transfers to other levels of government	0	6,493	8,736
Transfers to non-profit organizations	0	4,203	4,738
Total transfer payments	(282)	181,393	209,425
Total expenses	1,310,593	20,831,775	20,815,462
Revenues			
Sale of goods and services	50,780	416,618	397,044
Gains on disposals of assets	9,550	36,070	4,168
Other	17,442	22,171	20,571
Interest and gains on foreign exchange	5,968	11,657	9,931
Revenues earned on behalf of Government	(13,286)	(15,842)	(28,177)
Total revenues	70,454	470,674	403,537
Net cost from continuing operations	1,240,139	20,361,101	20,411,925

ISS Internal Services

CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

20. Restatement of previous year's results

The Department is currently reviewing its processes for the recording and valuation of tangible capital assets and inventory. This work will be conducted over a number of years. In 2012–13 this review identified assets which had been recorded twice, post-capitalizations recorded as in-year transactions and previously unrecorded assets. The effect of the resulting retroactive adjustments are presented below.

(in thousands of dollars)	2012 As previously stated	Effect of changes	2012 Restated
Consolidated Statement of Financial Position			
Inventories (note 13)	6,068,173	150,631	6,218,804
Tangible capital assets (note 14)	31,864,329	222,299	32,086,628
Total non-financial assets	38,721,597	372,930	39,094,527
Departmental net financial position	35,024,117	372,930	35,397,047
Consolidated Statement of Operations and Departmental Net Financial Position			
Total expenses	21,188,392	(372,930)	20,815,462
Net cost from continuing operations	20,784,855	(372,930)	20,411,925
Net cost of operations after government funding and transfers	539,421	(372,930)	166,491
Departmental net financial position — end of year	35,024,117	372,930	35,397,047
Consolidated Statement of Change in Departmental Net Debt			
Net cost of operations after government funding and transfers	539,421	(372,930)	166,491
Amortization of tangible capital assets	(2,419,453)	(254,038)	(2,673,491)
Adjustments of tangible capital assets	(111,866)	476,338	364,472
Change due to inventories	23,173	150,631	173,804
Consolidated Statement of Cash Flows			
Net cost of operations before government funding and transfers	21,155,574	(372,930)	20,782,644
Amortization of tangible capital assets	(2,419,453)	(254,038)	(2,673,491)
Adjustments of tangible capital assets	(111,866)	476,338	364,472
Increase in inventories	23,173	150,631	173,804

21. Comparative information

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



ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2012–2013 (UNAUDITED)

1. Introduction

This document provides summary information on the measures taken by the Department of National Defence (DND) to maintain an effective system of internal control over financial reporting (ICFR), including information on internal control management and assessment results and related action plans.

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*.

2. DND's System of Internal Control over Financial Reporting

2.1 Internal Control Management

DND has a well established governance and accountability structure to support departmental assessment efforts and oversight of its system of internal control. Its 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. A departmental internal control management framework is in place which includes:

- Organizational accountability structures as they relate to internal control management to support sound financial management including roles and responsibilities for senior managers in their areas of responsibility for control management;

- A Defence Ethics Program which is a comprehensive values-based ethics program put in place to meet the needs of DND and the Canadian Armed Forces (CAF), 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;
- On-going communication and training on statutory requirements, policies, and procedures for sound financial management and control; and
- Regular updates, at least semi-annually, on internal control assessments and action plans provided to departmental senior management, the departmental Director General Policy on Internal Control (PIC) Governance Committee, the Departmental Audit Committee (DAC) and to the Deputy Minister (DM). The DAC provides advice to the DM on the adequacy and functioning of the department's risk management, control and governance frameworks and processes.

2.2 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 the following:



ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2012–2013 (UNAUDITED)

Common Arrangements:

- Public Works and Government Services Canada (PWGSC) centrally administers the payments of salaries and the procurement of goods and services, as per DND's Delegation of Authorities, and provides accommodation services;
- Treasury Board Secretariat (TBS) provides the Department certain services without charge, and also with information used to calculate various accruals and allowances, such as the accrued severance liability;
- The Department of Justice (DOJ) provides legal services to DND, as well as information for establishing the contingent liability note to the financial statements and for inclusion in the public accounts; and
- Shared Services Canada manages Information Technology General Controls (ITGCs) in the areas of email, data centre and network services.

Specific Arrangements:

- Defence Construction Canada (DCC) provides contracting, construction contract management and related infrastructure services to DND in accordance with the Memorandum of Understanding between the two organizations and as per DND's Delegation of Authorities; and
- Brookfield Global Relocation Services administers DND moves under the CAF Integrated Relocation Program, which represents TBS' approved policy on relocation.

3. DND's assessment results during fiscal year 2012–13

In 2012–13, DND made significant progress by developing financial control frameworks (FCFs) and performing an evaluation of design effectiveness for most remaining high risk processes. Additionally, DND completed operating effectiveness testing of Entity Level Controls (ELCs) and continued to remediate operating effectiveness gaps for ITGCs and design effectiveness gaps for other process level controls. This work resulted in DND meeting virtually all of its commitments for 2012–13.

3.1 Design effectiveness of key controls

In assessing the design effectiveness of controls, DND continued to assess the effectiveness of the FCFs that had been previously developed for its various processes, and to remediate control gaps identified. Assessment results for the year are summarized as follows:

Inventory — Of the eight Materiel Acquisition and Support (MA&S) processes that were considered in scope for the purposes of PIC, the documentation, validation and design effectiveness testing was completed for six processes. (Note — Procurement was previously completed under Procure to Pay, and Mission Support was delayed due to the Supply Chain Integration project which will include the implementation of the Departmental Resource Management Information System (DRMIS) Mission Support solution.) Testing of the design effectiveness of the controls associated with each MA&S process confirmed that some key controls were in place and designed effectively, however in specific cases, control gaps were identified.



ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2012–2013 (UNAUDITED)

Capital Equipment Assets and Leases — Design effectiveness testing was completed for all identified controls. Though the results confirmed that controls were generally designed effectively, design gaps with respect to the financial statement assertions of completeness and valuation exist. The control gaps are largely due to the lack of sufficient automation associated with the accounting processes.

Procurement, Purchases, Payables and Payments — DND established a working group to facilitate the remediation of control gaps identified during design effectiveness testing, and has developed a remediation plan for the majority of high risk deficiencies. In addition, progress was further made on documenting and testing the design effectiveness of specific sub-processes that were not previously documented or tested — including acquisition cards, payables-at-year-end (PAYEs) and contract holdbacks. Though no high risk findings were noted in most of the processes, some gaps have been identified and need to be remediated.

All other transaction flows and processes — As part of the implementation of PIC targets, progress has been made on developing FCFs and testing the design effectiveness of various process controls, establishing working groups to facilitate the remediation of control gaps identified during design effectiveness testing, and developing remediation plans for high and medium risk deficiencies. For a number of these processes, remediation efforts are underway.

Additional details of assessments and results for 2012–13 are provided in Table 1 of this annex.

3.2 Operating effectiveness of key controls

DND continued with the operating effectiveness testing of ELCs and ITGCs as described below. For all 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 and on-going monitoring of key controls.

ELCs — The Department completed the operating effectiveness testing commenced in 2011–12, and updated its ELC Framework based on recommendations resulting from the testing. The assessment results indicate that substantially all design and operating effectiveness has been completed across key ELC elements.

ITGCs — DND continued to make progress on remediation actions resulting from its operating effectiveness testing from previous years, though several identified weaknesses are yet to be fully remediated. The Department commenced the development of an ITGC sustainment model and processes.

ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2012–2013 (UNAUDITED)

4. DND's action plan

4.1 Progress during fiscal year 2012–13

In 2012–13, DND made significant progress towards PIC implementation. Table 1 below summarizes a third party assessment of DND's progress as at 31 March 2013 against its action plan for FY 2012–13.


Table 1: DND's Progress against its 2012–13 Action Plan

Element in 2012–13 Action Plan	Status
Entity Level Controls (ELCs) — Operational effectiveness testing and remediation	<p>Additional evidence was obtained in order to complete the operating effectiveness testing commenced in 2011–12, and updates to DND's ELC Framework were made based on recommendations resulting from the testing.</p> <p>During the year, DND developed an ongoing monitoring approach of PIC related ELC elements which defines DND's ELC Framework and describes the six (6) steps of the approach. The monitoring approach describes ELCs to be updated and tested in any given fiscal year and also identifies opportunities for DND to leverage from evidence being gathered for the Management Accountability Framework (MAF) departmental assessments.</p>
Information Technology General Controls (ITGCs) — Design effectiveness testing and remediation	<p>DND continued to make progress on remediation actions that had commenced for ITGCs which included implementation of select elements related to the roles and authorizations work plan. Further, DND commenced development of a sustainment model and processes for ITGCs and a plan for remediation of application control deficiencies identified during the business process controls assessments. To support the conversion of its legacy realty asset applications to DRMIS, DND also performed a data conversion assessment which was based on the previously developed conversion framework. DND continued to track the remediation of previously identified Human Resource Management System (HRMS) and the Regional Pay System (RPS) gaps, and continued to make progress in terms of remediation of those weaknesses. Revised guidance on Pay Interface Security was published, and the frequency of system access reviews has been increased. However, since the remediation review that was performed in 2011–12, several ITGC weaknesses have not been fully remediated</p>
Financial Reporting and Financial Statement Preparation — Design effectiveness testing and remediation	<p>During 2012–13, meetings were held with subject matter experts to discuss the way forward in remediating the control weaknesses and gaps identified during the evaluation of design effectiveness of controls in 2011–12.</p>

**ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING
INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT
OF NATIONAL DEFENCE FOR FISCAL YEAR 2012–2013 (UNAUDITED)**

Table 1: DND's Progress against its 2012–13 Action Plan (continued)

Element in 2012–13 Action Plan	Status
Revenues and Receivables — Design effectiveness testing and remediation	During 2012–13 DND formed a Revenue/Receivables Remediation Working Group to facilitate the completion of remediation for known control deficiencies. Of the 18 control deficiencies, nine (9) relate to segregation of duties and will be remediated via the DRMIS Roles and Authorization Strategy. The remaining nine (9) relate to manual control deficiencies. Of these nine (9), two (2) control deficiencies were remediated in 2012–13 and Standard Operating Procedures (SOPs) are currently being developed to address five (5) control deficiencies. It is expected that these SOPs will be completed by September 2013. The remaining 2 manual control deficiencies were deemed low risk and will not be remediated.
Inventory — Design effectiveness testing and remediation	During 2012–13, of the remaining MA&S processes considered in scope for purposes of PIC, the FCF was developed and tested for design effectiveness for all processes except Mission Support. The MA&S processes that were completed include: Materiel Identification, Customer Service Support, Order Fulfilment, Warehouse Management, Repair and Overhaul and Disposal. Procurement had been previously documented and tested in 2011–12. A FCF was initiated for Mission Support, however, due to delays in decisions regarding the DRMIS solution relative to Mission Support, the FCF could not be finalized or tested for design effectiveness. Included in Warehouse Management, the test of design effectiveness for the sub-process of Stocktaking was completed and the final report was issued on September 30, 2012.
Capital Equipment Assets and Capital Equipment Leases — Design effectiveness testing and remediation	During 2012–13, DND finalized the documentation and completed the test of design effectiveness of the FCF for Capital Equipment Assets and Leased Capital Equipment Assets. This included the development of a to-be FCF for Asset Validation and the review of the accounting for Asset Pooled Items (API).
Real Property Assets and Real Property Leases — Documentation of control activities	DND performed updates to the "to-be" control framework in 2012–13 to address outstanding feedback. DND also completed Phase 1 of the DRMIS implementation for Realty Assets.



ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2012–2013 (UNAUDITED)

Table 1: DND's Progress against its 2012–13 Action Plan (continued)

Element in 2012–13 Action Plan	Status
Procurement / Purchases / Payables / Payments and Accrued Liabilities (P2P) — Design effectiveness testing and remediation	<p>Based on the design effectiveness testing results issued in 2011–12 for the Procure to Pay financial business process, a Procure to Pay Remediation Working Group was established with representatives from key stakeholder organizations. During the course of the biweekly meetings, all control deficiencies were presented and discussed. A remediation action plan was used to document the commitments made and agreed to by the working group members for follow-up and tracking, to ensure all control deficiencies are remediated.</p> <p>During 2012–13, DND developed financial control documentation and performed an evaluation of design effectiveness for Acquisition Cards, Payables-at-year-end and Contract Holdbacks.</p> <p>Additionally, a post-payment verification (PPV) financial control framework was designed to standardize PPV practices and controls across the Department and align them with the Office of the Controller General (OCG) common financial management business processes related to PPV. Implementation of the PPV framework continues.</p>
Civilian Payroll & Payroll Liabilities — Design effectiveness testing and remediation	<p>A Civilian Payroll Remediation Working Group was established in 2012–13 to continue remediation of control deficiencies identified in the evaluation of design effectiveness completed in 2011–12 and to consider the impact of the PWGSC Consolidation of Pay Services Project on DND's Civilian Payroll control framework.</p>
Military Regular Force Payroll — Design effectiveness testing and remediation	<p>During 2012–13 DND completed and submitted the documentation of the control framework around Military Regular Force Payroll to the Military Personnel Management Capability Transformation (MPMCT) project for the implementation into the new Military Payroll process. DND also completed the assessment of control design effectiveness through process walkthroughs of the Regular Force Payroll processes. Based on the walkthroughs and a comparison against the Pay Administration Control Framework Tool (PA-CF) developed by the OCG, the Military Regular Force Payroll control documentation was updated to reflect the current process and to align with the PA-CF to the extent that it was applicable as it is based on a Civilian Payroll environment. Additionally, proposed recommendations were developed to respond to gaps/issues identified from the assessment of design effectiveness.</p>

ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2012–2013 (UNAUDITED)

Table 1: DND's Progress against its 2012–13 Action Plan (continued)

Element in 2012–13 Action Plan	Status
Military Reserve Force Payroll — No planned activities	During 2012–13 DND completed the documentation of the control framework around Military Reserve Force Payroll and began the assessment of control design effectiveness through process walkthroughs. Based on the walkthroughs and a comparison against the Pay Administration Control Framework Tool (PA-CF) developed by the OCG, the Military Reserve Force Payroll control documentation was updated to reflect the current process and to align with the PA-CF to the extent applicable as it is based on a Civilian Payroll environment.
Remediation Liabilities and Future Asset Restoration Liabilities — Design effectiveness testing and remediation	During 2012–13, DND completed Phase 1 of the DRMIS implementation for Environmental Liabilities. DND developed a user manual around the control framework and provided training to select bases/wings. Additionally, the Department drafted a revised policy on Environmental Liabilities which is currently being reviewed. There were no changes implemented in 2012–13 to the governance structure for the management and accounting of liabilities.
Canadian Forces Pension and Insurance Accounts — No planned activity	The Canadian Forces Pension and Insurance Accounts are included in the financial statements of the Canadian Forces Pension Plans and are audited annually by the Office of the Auditor General (OAG). As a result, these liability account balances are deemed low-risk to the department. Due to the inherent low risk and the ongoing Government of Canada's Transformation of Pension Administration Initiative, these pension accounts are presently not a priority for PIC control documentation and testing.

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

Building on progress to date, DND is positioned to complete the assessment of the majority of its system of ICFR by 2016–17. At that time, the Department will be applying its rotational on-going monitoring plan to reassess control performance on a risk basis across those control areas that have been fully assessed.

It is important to note that due to the size and complexities of DND's operations, full PIC implementation will only be achieved when the departmental IT and business transformation projects are completed. Highlights of these interdependencies are as follows:

Military Regular and Reserve Force Payroll:

The Military Personnel Management Capability Transformation (MPMCT) project for Regular Force and Reserve Force payroll is planned for full implementation by 2017. At this point all identified control deficiencies will be remediated and operating effectiveness testing and remediation will begin.

Civilian Payroll: The Government of Canada Pay Consolidation Project led by PWGSC has a phased implementation approach beginning October 2013 with a planned completion date of December 2015. Once completed, DND will be in a position to complete operating effectiveness testing and remediation for Civilian Payroll.



ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2012–2013 (UNAUDITED)

Capital Assets & Inventory: In accordance with the draft MA&S Transformation Campaign Plan, an Integrated Defence Environment (IDE) will be created that brings together all the MA&S activities required to support asset visibility, accountability, and trained practitioners to support operations and capability development. The draft Campaign Plan is currently comprised of the following three programs:

- Inventory Management — Total Asset Visibility (TAV) Program;
- Policy, Process, Training and Professionalization Program; and
- Enterprise Resource Planning (ERP) Program.

The ERP Program consists of the Supply Chain Integration (SCI) project which is currently underway as part of the Defence Resource Management Information System (DRMIS) Stream I activities. The SCI project will bring the Canadian Forces Supply System data into DRMIS, the DND SAP based ERP application, by 31 December 2013. Over the next five years additional MA&S capabilities, such as further supply chain integration, ammunition management, transportation management, extended warehouse management, etc. are currently planned to be established as part of DRMIS Phase II. ICFR documentation and implementation of financial controls will progress with these transformation initiatives.

Real Property Assets: Implementation of the Infrastructure Environment Business Modernization (IEBM) Stream 2 is planned for April 2015. Design effectiveness testing for the remainder of the sub-processes around Real Property Assets will commence shortly after the IEBM Stream 2 implementation.

Source System Related Payments: Due to the Government of Canada's Shared Travel Services Initiative and DND's ERP strategy, legacy systems will be undergoing business rationalization and transformation activities for several years. ICFR documentation and implementation of financial controls will progress with these transformation initiatives.

DND's action plan summarized below in Table 2 is based on current resources as well as the interdependencies described above. As such, it is impacted by changes to resource levels and project outcomes and will be reviewed annually.

ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING
INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT
OF NATIONAL DEFENCE FOR FISCAL YEAR 2012–2013 (UNAUDITED)

Table 2: Status and Action Plan for the Completion of Identified Control Areas

Key Control Area	ASSESSMENT ELEMENTS		
	Design effectiveness testing and remediation	Operational effectiveness testing and remediation	On-going monitoring rotation
Entity Level Controls (ELCs)	Completed	2013–14	2013–14
IT General Controls	Completed	Completed	2014–15
Financial Reporting	2013–14	2015–16	2015–16
Process Level Controls:			
Revenues and Receivables	2013–14	2014–15	2015–16
Prepaid Expenses	Completed	2014–15	2015–16
Procurement to Payment	2015–16	2016–17	2016–17
Source System-Related Payments	2016–17	2017–18	2017–18
Civilian Pay & Payroll Liabilities	2013–14	2015–16	2016–17
Military Regular & Reserve Force Pay	2014–15	2017–18	2018–19
Inventories	2014–15	2015–16	Future years*
Capital Equipment Assets	2014–15	2015–16	Future years*
Real Property Assets	2015–16	2016–17	Future years*
Remediation Liabilities & UXO	2014–15	2015–16	2016–17

*These control areas (Inventories, Capital Equipment Assets and Real Property Assets) are the most impacted by ongoing complex business transformation projects. A detailed review will occur in 2013–14 to determine appropriate timelines.



INDEX

Accounts payable and accrued liabilities (note 4).....	16
Annex to the <i>Statement of Management Responsibility Including Internal Control Over Financial Reporting</i> of the Department of National Defence for Fiscal Year 2012–2013.....	39
Authority and objectives (note 1)	6
Canadian Forces pension and insurance accounts (note 7)	18
Comparative information (note 21).....	38
Consolidated Statement of Cash Flow.....	5
Consolidated Statement of Change in Departmental Net Debt.....	4
Consolidated Statement of Financial Position	2
Consolidated Statement of Operations and Departmental Net Financial Position	3
Contingent liabilities (note 15)	28
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)	25
Lease obligations for tangible capital assets (note 8)	20
Loans and advances (note 11).....	24
Parliamentary authorities (note 3).....	15
Prepaid expenses (note 12).....	24
Receivables (note 10).....	23
Related party transactions (note 17)	31
Restatement of previous year's results (note 20).....	38
Segmented information (note 19).....	32
Statement of Management Responsibility Including Internal Control Over Financial Reporting	1
Summary of significant accounting policies (note 2)	10
Tangible capital assets and accumulated amortization (note 14).....	26
Transfers to other government departments (note 18)	32