



# CONSOLIDATED DEPARTMENTAL FINANCIAL STATEMENTS 2015-2016 (UNAUDITED)

 National  
Defence

Défense  
nationale

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, 2016 and all information contained in these statements rests with the management of the Department of National Defence (DND). These financial statements have been prepared by management using the Government's accounting policies, which are based on Canadian public sector accounting standards (PSAS), with the exception of the accounting for pension benefits, the presentation and results using the stated accounting policies do not result in any significant differences from PSAS.

Management is responsible for the integrity and objectivity of the information in these financial statements. Some of the information in the financial statements is based on management's best estimates and judgment, and gives due consideration to materiality. To fulfill its accounting and reporting responsibilities, management maintains a set of accounts that provides a centralized record of the DND's financial transactions. Financial information submitted in the preparation of the *Public Accounts of Canada*, and included in the DND'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 the Department; and through conducting an annual assessment of the effectiveness of ICFR.

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

A risk-based assessment of the system of ICFR for the year ended March 31, 2016 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 DND's system of internal control is reviewed by the work of internal audit staff, who conduct periodic audits of the different areas of the DND's operations, and by the DND's Audit Committee, which oversees management's responsibilities for maintaining adequate control systems and the quality of financial reporting.

The financial statements of the Department have not been audited.

// Signed by //

**John Forster**

Deputy Minister  
Ottawa, Canada

Date: August 29, 2016

// Signed by //

**Claude Rochette CPA, CMA**

Chief Financial Officer



## CONSOLIDATED STATEMENT OF FINANCIAL POSITION (UNAUDITED)

As at March 31

(in thousands of dollars)	2016	2015 (Restated note 21)
<b>Liabilities</b>		
Accounts payable and accrued liabilities (note 4)	<b>2,604,294</b>	2,340,067
Vacation pay and compensatory leave	<b>176,928</b>	183,056
Deposits and trust accounts (note 5)	<b>4,272</b>	5,793
Deferred revenue (note 6)	<b>12,817</b>	10,329
Canadian Forces pension and insurance accounts (note 7)	<b>695,218</b>	741,955
Lease obligations for tangible capital assets (note 8)	<b>307,992</b>	371,676
Employee future benefits (note 9)	<b>900,801</b>	975,506
Remediation liabilities (note 15)	<b>499,938</b>	425,388
Future asset restoration liabilities (note 15)	<b>272,073</b>	1,313
<b>Total liabilities</b>	<b>5,474,333</b>	<b>5,055,083</b>
<b>Financial assets</b>		
Due from Consolidated Revenue Fund	<b>2,797,865</b>	2,617,311
Accounts receivables (note 10)	<b>403,001</b>	239,479
Loans and advances (note 11)	<b>39,052</b>	36,240
<b>Total gross financial assets</b>	<b>3,239,918</b>	<b>2,893,030</b>
<b>Financial assets held on behalf of Government</b>		
Accounts receivables (note 10)	<b>(11,898)</b>	(7,434)
<b>Total financial assets held on behalf of Government</b>	<b>(11,898)</b>	<b>(7,434)</b>
<b>Total net financial assets</b>	<b>3,228,020</b>	<b>2,885,596</b>
<b>Departmental net debt</b>	<b>2,246,313</b>	<b>2,169,487</b>
<b>Non-financial assets</b>		
Prepaid expenses (note 12)	<b>644,158</b>	<b>777,819</b>
Inventories (note 13)	<b>6,234,105</b>	<b>6,327,022</b>
Tangible capital assets (note 14)	<b>32,392,302</b>	<b>32,202,831</b>
<b>Total non-financial assets</b>	<b>39,270,565</b>	<b>39,307,672</b>
<b>Departmental net financial position</b>	<b>37,024,252</b>	<b>37,138,185</b>

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

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

// Signed by //

**John Forster**  
Deputy Minister  
Ottawa, Canada

Date: August 29, 2016

// Signed by //

**Claude Rochette CPA, CMA**  
Chief Financial Officer



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

For the year ended March 31

(in thousands of dollars)	2016 Planned Results	2016	2015* (Restated note 21)
<b>Expenses</b>			
Defence Combat and Support Operations	<b>1,562,928</b>	<b>1,523,391</b>	1,417,712
Defence Services and Contributions to Government	<b>520,065</b>	<b>488,075</b>	538,513
Defence Ready Force Element Production	<b>3,604,476</b>	<b>3,580,878</b>	3,396,504
Defence Capability Element Production	<b>12,980,071</b>	<b>13,553,244</b>	12,923,307
Defence Capability Development and Research	<b>427,224</b>	<b>441,809</b>	477,030
Internal Services	<b>485,361</b>	<b>414,942</b>	416,475
<b>Total expenses</b>	<b>19,580,125</b>	<b>20,002,339</b>	<b>19,169,541</b>
<b>Revenues</b>			
Sale of goods and services	<b>430,561</b>	<b>449,750</b>	439,437
Gains on disposals of assets	<b>23,276</b>	<b>17,771</b>	170,308
Other	<b>20,862</b>	<b>108,865</b>	20,882
Interest and gains on foreign exchange	<b>10,531</b>	<b>20,758</b>	13,407
Revenues earned on behalf of Government	<b>(21,449)</b>	<b>(18,251)</b>	(43,144)
<b>Total revenues</b>	<b>463,781</b>	<b>578,893</b>	<b>600,890</b>
<b>Net cost from continuing operations</b>	<b>19,116,344</b>	<b>19,423,446</b>	<b>18,568,651</b>
<b>Transferred operations (note 19)</b>			
Expenses	-	<b>1,338</b>	1,311
<b>Net cost of transferred operations</b>	-	<b>1,338</b>	<b>1,311</b>
<b>Net cost of operations before government funding and transfers</b>	<b>19,116,344</b>	<b>19,424,784</b>	<b>18,569,962</b>
<b>Government funding and transfers</b>			
Net cash provided by Government		<b>18,395,768</b>	17,566,888
Change in due from Consolidated Revenue Fund		<b>180,554</b>	92,986
Services provided without charge by other government departments (note 18)		<b>735,364</b>	720,303
Transfer of Accounts receivable to Public Services and Procurement Canada (note 19)		<b>(307)</b>	(59,621)
Transfer of assets and liabilities from (to) other government departments (note 14)		<b>(528)</b>	(7,372)
<b>Net cost of operations after government funding and transfers</b>		<b>113,933</b>	<b>256,778</b>
Departmental net financial position — beginning of year		<b>37,138,185</b>	<b>37,394,963</b>
<b>Departmental net financial position — end of year</b>		<b>37,024,252</b>	<b>37,138,185</b>

Segmented information (note 20)

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

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



## CONSOLIDATED STATEMENT OF CHANGE IN DEPARTMENTAL NET DEBT (UNAUDITED)

For the year ended March 31

(in thousands of dollars)	2016	2015 (Restated note 21)
<b>Net cost of operations after government funding and transfers</b>	<b>113,933</b>	256,778
<b>Change due to tangible capital assets</b>		
Acquisition of tangible capital assets	<b>2,763,740</b>	2,852,844
Amortization of tangible capital assets	<b>(2,490,333)</b>	(2,603,950)
Proceeds from disposal of tangible capital assets	<b>(12,706)</b>	(17,145)
Loss on disposals of tangible capital assets	<b>(420,222)</b>	(721,972)
Adjustments of tangible capital assets	<b>349,520</b>	496,741
Transfer to other government departments	<b>(528)</b>	(7,372)
<b>Total change due to tangible capital assets</b>	<b>189,471</b>	(854)
<b>Change due to inventories</b>	<b>(92,917)</b>	(102,747)
<b>Change due to prepaid expenses</b>	<b>(133,661)</b>	153,978
<b>Net increase in departmental net debt</b>	<b>76,826</b>	<b>307,155</b>
Departmental net debt — beginning of year	<b>2,169,487</b>	1,862,332
<b>Departmental net debt — end of year</b>	<b>2,246,313</b>	<b>2,169,487</b>

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)	2016	2015 (Restated note 21)
<b>Operating activities</b>		
<b>Net cost of operations before government funding and transfers</b>	<b>19,424,784</b>	18,569,962
<b>Non-cash items included in net cost of operations:</b>		
Amortization of tangible capital assets	<b>(2,490,333)</b>	(2,603,950)
Loss on disposals of tangible capital assets	<b>(420,222)</b>	(721,972)
Adjustments of tangible capital assets	<b>349,520</b>	496,741
Services provided without charge by other government departments	<b>(735,364)</b>	(720,303)
<b>Transition payments for implementing salary payments in arrears</b>	<b>307</b>	59,621
<b>Variations in Statement of Financial Position:</b>		
Increase (decrease) in accounts receivables	<b>159,058</b>	(654,073)
Increase (decrease) in loans and advances	<b>2,812</b>	(4,635)
Increase (decrease) in prepaid expenses	<b>(133,661)</b>	153,978
Increase (decrease) in inventories	<b>(92,917)</b>	(102,747)
Decrease (increase) in accounts payable and accrued liabilities	<b>(264,227)</b>	60,223
Decrease (increase) in vacation pay and compensatory leave	<b>6,128</b>	9,626
Decrease (increase) in deposits and trust accounts	<b>1,521</b>	(2,448)
Decrease (increase) in deferred revenue	<b>(2,488)</b>	3,451
Decrease (increase) in Canadian Forces pension and insurance accounts	<b>46,737</b>	63,447
Decrease (increase) in employee future benefits	<b>74,705</b>	33,226
Decrease (increase) in remediation liabilities	<b>(74,550)</b>	37,036
Decrease (increase) in future asset restoration liabilities	<b>(270,760)</b>	676
<b>Cash used by operating activities</b>	<b>15,581,050</b>	<b>14,677,859</b>
<b>Capital investing activities</b>		
Acquisitions of tangible capital assets	<b>2,763,740</b>	2,852,844
Proceeds from disposal of tangible capital assets	<b>(12,706)</b>	(17,145)
<b>Cash used by capital investing activities</b>	<b>2,751,034</b>	<b>2,835,699</b>
<b>Financing activities</b>		
Payments against / adjustments to capital lease obligations	<b>63,684</b>	<b>53,330</b>
<b>Cash used by financing activities</b>	<b>63,684</b>	<b>53,330</b>
<b>Net cash provided by Government of Canada</b>	<b>18,395,768</b>	<b>17,566,888</b>

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



## NOTES TO THE CONSOLIDATED 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 (CF) and of all matters relating to National Defence, as well as being responsible for the construction and maintenance of all defence establishments and works for the defence of Canada, and research relating to the defence of Canada and to the development of and improvements in materiel.

#### > Objectives

On behalf of the people of Canada, the Canadian Armed Forces (CAF) and the 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 renewing Canada's proud tradition of international leadership.

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

Defence's performance story and demonstrating results. The activities associated with the Programs were aligned, and in many cases regrouped, in the new PAA as:

#### (a) Defence Combat and Support Operations

The Defence Combat and Support Operations Program delivers military power in combat, security, stability and surveillance operations in response to armed threats, or potential armed aggression, for the purpose of protecting Canadian sovereignty, upholding the values of Canadians, and defending the interests of the Government of Canada. Results are achieved through this Program by the application of Defence capabilities in domestic, continental and international domains, either independently or in combination with allies, where the primary focus is to inflict military effects against threats. The term Defence capability is a collective term that refers to the ability of a military force to achieve a desired effect against a threat during the execution of a Defence operation (or the delivery of a Defence service) by executing tasks according to understood concepts, doctrine and standards. The military forces delivered by Defence are composed of force elements which are organizational entities that are in-turn composed of members of the CAF, and in some cases personnel from DND. Force elements integrate people, with specialized information, materiel (e.g., equipment, platforms, weapon systems) and in some cases real property, so that capabilities can be applied against threats. Force elements have different sizes and compositions according to the capabilities they must apply during an operation. This Program is underpinned by the *National Defence Act*, defence policy, international treaties and agreements, membership in international organizations, and direction received by the Government of Canada. Sub-programs beneath this Program target a range of threats across a variety of operational contexts via different delivery mechanisms in different geographic regions.





## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

### (b) Defence Services and Contributions to Government

The Defence Services and Contributions to Government Program aims to support the delivery of Canadian Government safety and security initiatives and encourage recognition and pride in Canada and the Canadian military. This is accomplished through the provision of unique Defence services in support of other elements of Government or the Canadian public. To encourage and share pride and awareness of Canada's military heritage, contributions, and leadership, Defence provides unique services and opportunities for outreach, awareness, preservation and development. Defence unique services also include operations conducted to ensure or enhance the security, safety, stability and/or well-being of Canadians, or international populations in peril, in accordance with Canadian values and the interests of the Canadian Government, in situations where there may be a need to defend against armed threats but where this is not the primary focus. The operations are delivered through the employment of force elements to achieve a desired effect within specific contexts through execution of tasks according to understood concepts, doctrine and standards. The force elements delivered by Defence are organizational entities which are composed of members of the CAF and in some cases personnel from the DND. Force elements have different sizes and compositions according to the capabilities they must apply during an operation. Defence remains consistently ready to employ force elements under this Program however significant operations do not always occur every fiscal year.

### (c) Defence Ready Force Element Production

The Defence Ready Force Element Production Program produces and renews force elements on a continual basis for use in Defence Combat and Support Operations, as well as for the delivery of Defence Services and Contributions to Government, in order to increase the likelihood of success and decrease risk of failure in the defence of Canada and promotion of Canadian interests. Results are delivered by assembling force elements from the fundamental elements of Defence capability (i.e., military personnel, materiel and information systems, information, and, in some cases, real property), and integrating them through various training and certification programs so that they have the requisite amount of readiness in order to fulfill predefined roles within the operations for which they are destined. The term readiness refers to the volume, endurance, responsiveness and capability attributes of force elements that are not employed. These attributes are used to determine the degree of risk that would be associated with assigning them to fulfill perspective role(s) within on-going or contingency operations. The force elements produced by the Defence Ready Force Elements Production Program are organized into portfolios according to the land, aerospace, and maritime environments in which they operate. There are also portfolios for force elements that operate jointly across these domains and force elements that provide common support functions. Across these portfolios, force elements are produced to meet readiness targets. These readiness targets ensure that production can be sustained over short and medium term time horizons and that the number of force elements available for employment in on-going and contingency operations is in accordance with acceptable levels of operational risk.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

### (d) Defence Capability Element Production

The Defence Capability Element Production Program aims to sustain Defence by producing and maintaining portfolios of the fundamental Defence capability elements so that they are continuously available in the appropriate quantity, combination and condition to sustain the chain of programs delivered by Defence, from the Defence Capability Development and Research Program through to the Defence Ready Force Element Production Program, which collectively give Defence the ability to conduct Defence Combat and Support Operations as well as deliver Defence Services and Contributions to Government. The primary elements of Defence capability are military personnel, materiel and information systems, information, and real property. A fundamental focus of the Defence Capability Element Production Program is to provide an adequate and sustained supply of individual military personnel and materiel in the near term and over long term time horizons so that they can be integrated to produce force elements within the Defence Ready Force Element Production Program. Results are achieved through subordinate programs, each of which focuses on a separate portfolio: military personnel and organization; materiel; real property; or information systems. A lifecycle approach is used to manage each portfolio. The essential aspects of the lifecycle approach are sub-sub-programs that provide the principle lifecycle functions: introduction into service; maintenance, upgrade and supply; release from service; portfolio management; and overarching co-ordination and control. The character of activity that occurs within each of these primary functions depends on the portfolio of entities being produced and therefore the desegregation of the lifecycle functions into sub-sub-programs is unique to each portfolio. The authority for this Program is derived from the *National Defence Act*.

### (e) Defence Capability Development and Research

The Defence Capability Development and Research Program seeks to provide the analytical bases and knowledge to anticipate foreseeable changes in the threat and security environment and to determine

the associated demand for Defence capabilities across near and long term time horizons in order to enable evidence-based strategic decisions that align the introduction, modification and divestment of Defence capabilities and guide the application of existing capabilities with an acceptable levels of risk. Results are achieved by: establishing and monitoring the fulfillment of near term targets for readying force elements and conducting Defence operations; identifying lessons from past operations; assessing defence and security trends; developing and integrating new knowledge and systems/methods for conducting operations; developing approaches and conducting Defence capability analyses at strategic, operational and tactical levels; present to future capability assessments; designing and assessing defence alternatives; providing Defence capability oversight and expertise; and Defence capability use planning for sustainable Defence capabilities in future time horizons. As such, this Program sustains Defence by providing key products and services to the Defence Capability Element Production Program, the Defence Ready Force Element Production Program and parts of the Defence Combat and Support Operations, and Defence Services and Contributions to Government Programs. This Program also directly enables the management and oversight of Defence as a whole.

### (f) Internal Services

Internal Services are groups of related activities and resources that are administered to support the needs of programs and other corporate obligations of an organization. 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 Other Administrative Services. Internal Services include only those activities and resources that apply across an organization and not to those provided specifically to a program.



## NOTES TO THE CONSOLIDATED 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 PSAS. With the exception of the accounting for pension benefits, the presentation and results using the stated accounting policies do not result in any significant differences from PSAS. The pension benefits for members of the CAF follow accounting requirements as outlined in the Treasury Board Accounting Standards, as described in note 2(g) (i), which require the actuarial surpluses or deficiencies to be recognized in the financial statements of the Government of Canada, and not the Department. Further disclosure is presented in note 7.

Significant accounting policies are as follows:

#### (a) Parliamentary Authorities

The Department is financed by the Government of Canada through Parliamentary authorities. Financial reporting of authorities provided to the Department do not parallel financial reporting according to generally accepted accounting principles since authorities are primarily based on cash flow requirements. Consequently, items recognized in the Consolidated Statement of Operations and Departmental Net Financial Position and in the Consolidated Statement of Financial Position are not necessarily the same as those provided through authorities from Parliament. Note 3 provides a reconciliation between the bases of reporting. The planned results amounts in the "Expenses" and "Revenues" sections of the Consolidated Statement of Operations and Departmental Net Financial Position are the amounts reported in the Future-oriented Statement of Operations included in the 2015-16 *Report on Plans and Priorities*. Planned results are not presented in the "Government funding and transfers" section of the Consolidated Statements of Operations and Departmental Net Financial Position, and in the Consolidated Statement of Change in Departmental Net Debt because these amounts were not included in the 2015-16 *Report on Plans and Priorities*.

#### (b) Consolidation

These consolidated financial statements include the accounts of the sub-entities that the deputy head (DH) is accountable for. The accounts of these sub-entities have been consolidated with those of the Department and all inter-organizational balances and transactions have been eliminated. The Department is comprised of the 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 Ombudsman for the Department of National Defence and Canadian Forces; and
- Office of the Judge Advocate General.

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

#### (c) Net Cash Provided by Government

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



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

### (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 has no authority regarding the disposition of non-respendable revenues. As a result, non-respendable revenues are considered to be earned on behalf of the Government of Canada and are therefore presented in reduction of the entity's gross revenues.

### (f) Expenses

Expenses are recorded on an accrual basis:

- Transfer payments are recorded as expenses when authorization for the payment exists and the recipient has met the eligibility (or the entitlements) criteria (for grants) or the performance conditions (for contributions) established for the transfer payment program. In situations where grant payments do not form part of an existing program, payments are recorded as expenses when the Government announces a decision to make a non-recurring transfer, provided the enabling legislation or authorization for payment receives parliamentary approval prior to the completion of the financial statements.
- Vacation pay and compensatory leave are accrued as the benefits are earned by employees under their respective terms of employment.
- Services provided without charge by other government departments for accommodation, employer contributions to the health and dental insurance plans, worker's compensation coverage and legal services are recorded as operating expenses at their estimated cost.

### (g) Employee Future Benefits

#### (i) Pension Benefits

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

The Department administers pension benefits for members of the CAF, both Regular and Reserve forces. The Department contributes towards current



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

and past service of members, and funds any actuarial shortfalls determined by the Chief Actuary of Canada. In addition to the regular contributions, current legislation also requires the Department to make contributions for actuarial deficiencies in the pension plans. These contributions by the Department are expensed in the year they are incurred. This accounting treatment corresponds to the funding provided to departments through Parliamentary authorities. The assets and liabilities related to the Superannuation Account of the CAF pension plan are not reflected in the Department's financial statements, as the Superannuation Account is the responsibility of the Government and is presented in the consolidated financial statements of the Government of Canada. Actuarial surpluses or deficiencies are recognized in the financial statements of the Government of Canada, as the Plan's sponsor.

### (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 fails to occur, and a reasonable estimate of the loss can be made, an estimated liability is accrued and an expense recorded. If the likelihood is not determinable, the contingency is disclosed in the notes to the financial statements.

### (j) Environmental Liabilities

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

#### (i) Contaminated Sites

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



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

### (ii) Asset Retirement Obligations

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

### (iii) Other Environmental Liabilities

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

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

### (k) Inventory

Inventory consists of consumables (such as non-repairables, uniforms and clothing, medical and other equipment and machine tools) and ammunition (including bombs and missiles). Inventory is valued using a moving weighted average price methodology. Inventory managed by contractors and not held in the Defence Resource Management Information System (DRMIS) is valued according to the cost method used by the contractors (first-in, first-out (FIFO), last-in, first-out (LIFO), historical cost or moving weighted average). Items identified for disposal are excluded from the value of inventory as no value is expected to be recovered.

### (l) Foreign Currency Transactions

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

### (m) Tangible Capital Assets

All tangible capital assets having an initial cost of \$30,000 or more, including capital leases, betterments, and leasehold improvements, are recorded at their acquisition cost. The Department does not capitalize intangible assets, works of art and historical treasures that have cultural, aesthetic or historical value, assets located on First Nations Reserves and museum collections. Capitalization threshold values lower than \$30,000 may apply to asset pooled items (API). API represents those items that support capital assets (for example, spare parts, etc.). They are grouped in pools and are treated as capital assets from a financial perspective. API values are included in the values of capital assets they support.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

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

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

API are amortized at the estimated useful life of the prime equipment supported.

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

### (n) Measurement Uncertainty

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



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

### 3. Parliamentary authorities

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

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

(in thousands of dollars)	2016	2015 (Restated note 21)
<b>Net cost of operations before government funding and transfers</b>	<b>19,424,784</b>	18,569,962
<b>Adjustments for items affecting net cost of operations but not affecting authorities:</b>		
Amortization of tangible capital assets	<b>(2,490,333)</b>	(2,603,950)
Services provided without charge by other government departments	<b>(735,364)</b>	(720,303)
Decrease (increase) in employee future benefits	<b>74,705</b>	33,226
Refund of previous year's expenses	<b>68,818</b>	127,453
Decrease (increase) in vacation pay and compensatory leave	<b>6,128</b>	9,626
Loss on disposals of capital assets	<b>(420,222)</b>	(721,972)
Adjustments of tangible capital assets	<b>349,520</b>	496,741
Refund of program expenditures	<b>155,450</b>	(3,344)
Decrease (increase) in deferred revenue	<b>(2,488)</b>	3,451
Decrease (increase) in accrued liabilities not charged to authorities	<b>(2,010)</b>	84,125
Bad debt expense	<b>(155,135)</b>	794
Sale of real property through Canada Lands Company	<b>0</b>	153,166
Decrease (increase) in remediation liabilities	<b>(74,550)</b>	37,036
Decrease (increase) in future asset restoration liabilities	<b>(270,760)</b>	676
Proceeds from disposal of tangible capital assets	<b>(12,706)</b>	(17,145)
Miscellaneous	<b>314,699</b>	(42,290)
<b>Total items affecting net cost of operations but not affecting authorities</b>	<b>(3,194,248)</b>	<b>(3,162,710)</b>
<b>Adjustments for items not affecting net cost of operations but affecting authorities:</b>		
Acquisition of tangible capital assets	<b>2,763,740</b>	2,852,844
Decrease (increase) in lease obligations for tangible capital assets	<b>63,684</b>	53,330
Increase (decrease) in inventory purchases net of usage and adjustments	<b>(92,917)</b>	(102,747)
Increase (decrease) in prepaid expenses	<b>(133,661)</b>	153,978
Transition payments for implementing salary payments in arrears	<b>307</b>	59,621
Revenues collected from prior year receivables	<b>(165,616)</b>	29,660
<b>Total items not affecting net cost of operations but affecting authorities</b>	<b>2,435,537</b>	<b>3,046,686</b>
<b>Current year authorities used</b>	<b>18,666,073</b>	<b>18,453,938</b>





## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

### 3. Parliamentary authorities (continued)

#### (b) Authorities provided and used

(in thousands of dollars)	2016	2015
<b>Vote 1 – Operating expenditures</b>	<b>14,164,552</b>	13,817,380
<b>Vote 5 – Capital expenditures</b>	<b>4,105,468</b>	4,835,558
<b>Vote 10 – Grants &amp; contributions</b>	<b>165,552</b>	178,765
<b>Statutory amounts</b>	<b>1,561,838</b>	1,621,453
<b>Less:</b>		
Authorities available for future years	<b>(1,203,563)</b>	(1,692,267)
Frozen allotments and other planned lapses	<b>(36,063)</b>	(99,929)
Residual lapse	<b>(91,711)</b>	(207,022)
<b>Current year authorities used</b>	<b>18,666,073</b>	<b>18,453,938</b>

### 4. Accounts payable and accrued liabilities

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

(in thousands of dollars)	2016	2015
Accounts payable – other government departments and agencies	<b>109,517</b>	74,805
Accounts payable – external parties	<b>1,668,479</b>	1,495,108
	<b>1,777,996</b>	1,569,913
Accrued liabilities*	<b>826,298</b>	770,154
<b>Total accounts payable and accrued liabilities</b>	<b>2,604,294</b>	<b>2,340,067</b>

\* In *Canada's Economic Action Plan 2012*, the Government announced savings measures to be implemented by departments over the next three fiscal years starting in 2012-13. As a result, the Department has recorded at March 31, 2016, an obligation for termination benefits for an amount of \$22.4 million (\$24.6 million 2014-15) as part of accrued liabilities to reflect the estimated workforce adjustment costs.



## NOTES TO THE CONSOLIDATED 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)	2016	2015
<b>Contractor security deposits</b>		
Deposits, beginning of year	4,554	2,588
Deposits received	7,188	7,037
Refunds	(8,244)	(5,071)
<b>Contractor security deposits, end of year</b>	<b>3,498</b>	<b>4,554</b>
<b>Trust account, estates — Armed Services*</b>		
Trust account, beginning of year	1,239	757
Funds received	1,165	1,783
Payments	(1,630)	(1,301)
<b>Trust account, estates — Armed Services, end of year</b>	<b>774</b>	<b>1,239</b>
<b>Closing balance</b>	<b>4,272</b>	<b>5,793</b>

\* 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)	2016	2015
<b>Foreign governments</b>		
Beginning of year	4,539	5,368
Funds received	89,878	87,677
Revenue recognized	(88,076)	(88,506)
<b>Foreign governments, end of year</b>	<b>6,341</b>	<b>4,539</b>
<b>Other specified purposes</b>		
Beginning of year	5,790	8,412
Funds received	3,727	2,888
Revenue recognized	(3,041)	(5,510)
<b>Other specified purposes, end of year</b>	<b>6,476</b>	<b>5,790</b>
<b>Closing balance</b>	<b>12,817</b>	<b>10,329</b>



## NOTES TO THE CONSOLIDATED 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 CAF. Reserve Force members who have sufficient qualifying service and pensionable earnings are members of either the CFPP or the Reserve Force pension plan (RFPP), which came into force on March 1, 2007, depending on their employment status and earnings.

The Department maintains accounts to record the transactions pertaining to the CF pension plans, which comprise the Canadian Forces Superannuation Account, the 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 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. For further information on PSPIB, please visit [www.pspib.ca](http://www.pspib.ca).

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

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

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 the Canada Revenue Agency (CRA) and a transfer is made annually between the RCA account and the 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, 2016, the total refundable tax transferred amounts to \$382 million (\$362 million in 2014-15).



## NOTES TO THE CONSOLIDATED 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 liability as presented in the Statement of Financial Position:

(in thousands of dollars)	2016	2015 (Restated note 21)
<b>Canadian Forces Pension Fund Account</b>		
Beginning of year	<b>183,465</b>	263,355
Funds received and other credits	<b>1,461,393</b>	1,437,566
Payments and other charges	<b>(626,688)</b>	(577,530)
Transfers to the Public Sector Pension Investment Board	<b>(849,312)</b>	(939,926)
<b>Canadian Forces Pension Fund Account, end of year</b>	<b>168,858</b>	<b>183,465</b>
<b>Reserve Force Pension Fund Account</b>		
Beginning of year	<b>(2,552)</b>	1,609
Funds received and other credits	<b>71,473</b>	95,348
Payments and other charges	<b>(120,113)</b>	(80,450)
Transfers to the Public Sector Pension Investment Board	<b>0</b>	(19,059)
<b>Reserve Force Pension Fund Account, end of year</b>	<b>(51,192)</b>	<b>(2,552)</b>
<b>Retirement Compensation Arrangements Account</b>		
Beginning of year	<b>373,531</b>	351,186
Funds received and other credits	<b>46,898</b>	49,657
Payments and other charges	<b>(28,329)</b>	(27,312)
<b>Retirement Compensation Arrangements Account, end of year</b>	<b>392,100</b>	<b>373,531</b>
<b>Regular Force Death Benefit Account</b>		
Beginning of year	<b>187,511</b>	189,252
Funds received and other credits	<b>28,524</b>	29,775
Payments and other charges	<b>(30,583)</b>	(31,516)
<b>Regular Force Death Benefit Account, end of year</b>	<b>185,452</b>	<b>187,511</b>
<b>Closing balance</b>	<b>695,218</b>	<b>741,955</b>

#### 7a. Canadian Forces Superannuation Account

The Canadian Forces Superannuation Account (hereafter the Superannuation Account) was created in order to record notional transactions for service prior to April 1, 2000. The Superannuation Account does not hold any investment assets. The amount of interest credited on the account is as though net contributions were invested quarterly in 20-year Government of Canada bonds issued at prescribed rates and held to maturity.

The asset and liabilities related to the Superannuation Account are not reflected in the Department's Financial Statements (refer to note 21), as the Superannuation Account is the responsibility of the Government of Canada.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

### 7a. Canadian Forces Superannuation Account (continued)

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

Details of the Superannuation Account, including actuarial surpluses or deficiencies, can be found in the Annual Report of the CF pension plans and in the *Public Accounts of Canada*.

(in thousands of dollars)	2016	2015
<b>Canadian Forces Superannuation Account</b>		
Beginning of year	<b>46,118,651</b>	46,297,376
Funds received and other credits	<b>2,145,885</b>	2,314,616
Payments and other charges	<b>(2,569,383)</b>	(2,493,341)
<b>Canadian Forces Pension Fund Account, end of year</b>	<b>45,695,153</b>	<b>46,118,651</b>

### 8. Lease obligations for tangible capital assets

The Department has entered into agreements to lease buildings and aircraft (refer to note 14) under capital leases with a cost of \$852 million and accumulated amortization of \$618 million as at March 31, 2016 (\$852 million and \$577 million respectively as at March 31, 2015). 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 2016	Balance of obligations 2015
Buildings	110,728	(27,637)	<b>83,091</b>	92,072
Aircraft	252,568	(27,667)	<b>224,901</b>	279,604
<b>Total</b>	<b>363,296</b>	<b>(55,304)</b>	<b>307,992</b>	<b>371,676</b>

#### Future minimum lease payments

(in thousands of dollars)	2016-2017	2017-2018	2018-2019	2019-2020	2020-2021 and thereafter
Buildings	13,531	13,854	11,780	11,185	60,378
Aircraft	70,105	70,105	70,106	38,652	3,600
<b>Total</b>	<b>83,636</b>	<b>83,959</b>	<b>81,886</b>	<b>49,837</b>	<b>63,978</b>



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

### 9. Employee future benefits

#### (a) Pension benefits

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

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

The 2015-16 expense amounts to \$178.4 million (\$182.1 million in 2014-15). For Group 1 members, the expense represents approximately 1.25 times (1.41 times in 2014-15) the employees contributions and, for Group 2 members, approximately 1.24 times (1.39 times in 2014-15) the employees contributions.

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.

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

The members of the CAF 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 2015-16 expense amounts to \$999.7 million (\$1,063.8 million in 2014-15), which represents approximately 2.07 times (1.87 times in 2014-15) the contributions by employees.

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



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

### 9. Employee future benefits (continued)

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

- Annual actuarial adjustments of \$170 million (\$170 million in 2014-15) to fund the deficit in the Canadian Forces pension fund account, and \$1.9 million (\$1.9 million in 2014-15) for the Reserve Force pension fund account until the deficit is funded as per the triennial funding valuation.

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

#### (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.

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

(in thousands of dollars)	2016	2015
<b>Public Service Employees</b>		
Accrued benefit obligation, beginning of year	<b>113,806</b>	87,852
Expenses for the year	<b>9,092</b>	56,220
Benefits paid during the year	<b>(14,197)</b>	(30,266)
<b>Accrued benefit obligation, end of year</b>	<b>108,701</b>	<b>113,806</b>
<b>Canadian Armed Forces Members</b>		
Accrued benefit obligation, beginning of year	<b>861,700</b>	920,880
Expenses for the year	<b>13,902</b>	95,040
Benefits paid during the year	<b>(83,502)</b>	(154,220)
<b>Accrued benefit obligation, end of year</b>	<b>792,100</b>	<b>861,700</b>
<b>Total accrued benefit obligation, end of year</b>	<b>900,801</b>	<b>975,506</b>



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

### 10. Accounts receivables

The following table presents details of accounts receivable:

(in thousands of dollars)	2016	2015
External parties	<b>389,285</b>	110,967
Other government departments and agencies	<b>175,184</b>	135,430
	<b>564,469</b>	<b>246,397</b>
Less: allowance for doubtful accounts on external receivables	<b>161,468</b>	6,918
<b>Gross accounts receivable</b>	<b>403,001</b>	<b>239,479</b>
Accounts receivable held on behalf of Government	<b>(11,898)</b>	(7,434)
<b>Net receivables</b>	<b>391,103</b>	<b>232,045</b>

### 11. Loans and advances

The following table presents details of loans and advances:

(in thousands of dollars)	2016	2015
Imprest accounts, standing advances and authorized loans to CAF members	<b>38,858</b>	36,230
Accountable advances (temporary advances)	<b>194</b>	10
<b>Total loans and advances</b>	<b>39,052</b>	<b>36,240</b>

### 12. Prepaid expenses

The following table presents details of prepaid expenses:

(in thousands of dollars)	2016	2015*
Foreign Military Purchases	<b>209,300</b>	318,044
Mercury Global Military Wideband Satellite Communications Project	<b>184,275</b>	158,132
Airlift Capability Project	<b>80,168</b>	72,459
Sea Sparrow Missiles	<b>75,461</b>	120,588
NATO Flying Training Canada (NFTC)	<b>53,764</b>	53,023
Building rentals	<b>15,217</b>	17,450
Other purchases	<b>25,973</b>	38,123
<b>Total prepaid expenses</b>	<b>644,158</b>	<b>777,819</b>

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





## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

### 13. Inventory

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

(in thousands of dollars)	2016	2015
Ammunition, bombs and missiles	<b>3,484,381</b>	3,550,582
Contractor held inventory	<b>381,016</b>	397,827
Uniforms and clothing	<b>370,566</b>	418,854
Communication, electrical parts/accessories and informatics equipment	<b>335,787</b>	313,183
Metal	<b>295,828</b>	301,078
Engineering, test and technical equipment and machine tools	<b>274,480</b>	272,408
Land equipment spares	<b>229,772</b>	211,153
Ship spares	<b>189,952</b>	187,806
Aircraft spares	<b>148,916</b>	153,558
Sonobuoys, parts and accessories	<b>146,598</b>	134,486
Medical equipment	<b>105,978</b>	113,164
Fuel, petroleum and oil	<b>64,633</b>	68,020
Miscellaneous	<b>206,198</b>	204,903
<b>Total inventory</b>	<b>6,234,105</b>	<b>6,327,022</b>

The cost of consumed inventory recognized as an expense in the Consolidated Statement of Operations and Departmental Net Financial Position is \$587 million in 2015-16 (\$501 million in 2014-15).

The Department is undergoing a review of its inventory holdings. As part of this work an analysis was completed in 2015-16 related to pricing and dormant inventory resulting in an allowance of \$131 million, which is reflected in the table above.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

### 14. Tangible capital assets

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

(in thousands of dollars)	Balance beginning of year (Restated note 21)	Adjustments <sup>(1)</sup>	Acquisitions	Disposals and write-offs	Balance end of year
<b>Land, buildings and works</b>					
Land	86,915	4	0	(654)	<b>86,265</b>
Buildings	9,094,492	590,905	4,691	(48,485)	<b>9,641,603</b>
Works	2,504,086	86,311	33	(4,429)	<b>2,586,001</b>
	<b>11,685,493</b>	<b>677,220</b>	<b>4,724</b>	<b>(53,568)</b>	<b>12,313,869</b>
<b>Machinery and equipment</b>					
Machinery and equipment	6,778,835	173,502	85,690	(50,778)	<b>6,987,249</b>
Informatics hardware	7,040,222	(3,990)	55,050	(2,302)	<b>7,088,980</b>
Informatics software	788,645	113,974	320	(480)	<b>902,459</b>
Arms and weapons	5,992,415	34,597	10,676	(619,403)	<b>5,418,285</b>
Other equipment	104,307	(527)	1,195	(2,208)	<b>102,767</b>
	<b>20,704,424</b>	<b>317,556</b>	<b>152,931</b>	<b>(675,171)</b>	<b>20,499,740</b>
<b>Ships, aircraft and vehicles</b>					
Ships and boats	12,197,569	1,935,957	9,926	(71,659)	<b>14,071,793</b>
Aircraft	17,463,253	1,032,879	19,075	(73,450)	<b>18,441,757</b>
Non-military motor vehicles	870,477	11,142	50,181	(42,531)	<b>889,269</b>
Military vehicles	1,728,768	4,035	2,684	(52,643)	<b>1,682,844</b>
Other vehicles	406,300	18,027	16,051	(4,812)	<b>435,566</b>
	<b>32,666,367</b>	<b>3,002,040</b>	<b>97,917</b>	<b>(245,095)</b>	<b>35,521,229</b>
<b>Leasehold improvements</b>					
Leasehold improvements	66,366	10,100	0	0	<b>76,466</b>
	<b>66,366</b>	<b>10,100</b>	<b>0</b>	<b>0</b>	<b>76,466</b>
<b>Leased tangible capital assets</b>					
Buildings	155,400	0	0	0	<b>155,400</b>
Other equipment	48	0	0	0	<b>48</b>
Aircraft	696,876	0	0	0	<b>696,876</b>
	<b>852,324</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>852,324</b>
<b>Assets under construction</b>					
Buildings	999,944	(601,212)	461,032	0	<b>859,764</b>
Engineering works	79,602	(82,745)	105,292	0	<b>102,149</b>
Informatics software	254,084	(94,824)	44,867	0	<b>204,127</b>
Equipment	6,419,940	(3,630,211)	1,896,977	(4,982)	<b>4,681,724</b>
	<b>7,753,570</b>	<b>(4,408,992)</b>	<b>2,508,168</b>	<b>(4,982)</b>	<b>5,847,764</b>
<b>Gross tangible capital assets</b>	<b>73,728,544</b>	<b>(402,076)</b>	<b>2,763,740</b>	<b>(978,816)</b>	<b>75,111,392</b>

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

During 2015-16, the Department transferred out land (book value of \$12.48 thousands), buildings (net book value of \$1,776.87 thousands), and works and infrastructure (net book value of one dollar) to Public Services and Procurement Canada. Also during 2015-16 the Department transferred in buildings (net book value of one dollar) from Innovation, Science and Economic Development Canada and machinery and equipment (net book value of \$1,261.32 thousands) from Correctional Service Canada. These transfers are included in the adjustments column.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

### 14. Tangible capital assets (continued)

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

(in thousands of dollars)	Balance beginning of year (Restated note 21)	Adjustments	Amortization	Disposals and write-offs	Balance end of year	Net Book Value	
						2016	2015 (Restated note 21)
<b>Land, buildings and works</b>							
Land						<b>86,265</b>	86,915
Buildings	3,994,269	3,030	239,665	(34,031)	<b>4,202,933</b>	<b>5,438,670</b>	5,100,223
Works	1,383,236	213	72,436	(4,074)	<b>1,451,811</b>	<b>1,134,190</b>	1,120,850
	<b>5,377,505</b>	<b>3,243</b>	<b>312,101</b>	<b>(38,105)</b>	<b>5,654,744</b>	<b>6,659,125</b>	<b>6,307,988</b>
<b>Machinery and equipment</b>							
Machinery and equipment	5,118,200	(126,712)	237,904	(47,254)	<b>5,182,138</b>	<b>1,805,111</b>	1,660,635
Informatics hardware	6,194,272	(77,581)	251,526	(1,908)	<b>6,366,309</b>	<b>722,671</b>	845,950
Informatics software	465,356	(267)	59,943	(57)	<b>524,975</b>	<b>377,484</b>	323,289
Arms and weapons	3,575,746	(483,414)	189,449	(311,006)	<b>2,970,775</b>	<b>2,447,510</b>	2,416,669
Other equipment	71,240	(531)	6,742	(1,550)	<b>75,901</b>	<b>26,866</b>	33,067
	<b>15,424,814</b>	<b>(688,505)</b>	<b>745,564</b>	<b>(361,775)</b>	<b>15,120,098</b>	<b>5,379,642</b>	<b>5,279,610</b>
<b>Ships, aircraft and vehicles</b>							
Ships and boats	8,380,342	50,335	532,584	(25,300)	<b>8,937,961</b>	<b>5,133,832</b>	3,817,227
Aircraft	9,591,298	(129,524)	711,865	(25,207)	<b>10,148,432</b>	<b>8,293,325</b>	7,871,955
Non-military motor vehicles	567,044	2,361	57,911	(41,392)	<b>585,924</b>	<b>303,345</b>	303,433
Military vehicles	1,305,683	(1,892)	66,027	(49,530)	<b>1,320,288</b>	<b>362,556</b>	423,085
Other vehicles	273,998	9,210	16,891	(4,579)	<b>295,520</b>	<b>140,046</b>	132,302
	<b>20,118,365</b>	<b>(69,510)</b>	<b>1,385,278</b>	<b>(146,008)</b>	<b>21,288,125</b>	<b>14,233,104</b>	<b>12,548,002</b>
<b>Leasehold Improvements</b>							
Leasehold improvements	27,917	3,704	6,785	0	<b>38,406</b>	<b>38,060</b>	38,449
	<b>27,917</b>	<b>3,704</b>	<b>6,785</b>	<b>0</b>	<b>38,406</b>	<b>38,060</b>	<b>38,449</b>
<b>Leased tangible capital assets</b>							
Buildings	73,834	0	6,803	0	<b>80,637</b>	<b>74,763</b>	81,566
Other equipment	48	0	0	0	<b>48</b>	<b>0</b>	0
Aircraft	503,230	0	33,802	0	<b>537,032</b>	<b>159,844</b>	193,646
	<b>577,112</b>	<b>0</b>	<b>40,605</b>	<b>0</b>	<b>617,717</b>	<b>234,607</b>	<b>275,212</b>
<b>Assets under construction</b>							
Buildings						<b>859,764</b>	999,944
Engineering works						<b>102,149</b>	79,602
Informatics software						<b>204,127</b>	254,084
Equipment						<b>4,681,724</b>	6,419,940
						<b>5,847,764</b>	<b>7,753,570</b>
<b>Total</b>	<b>41,525,713</b>	<b>(751,068)</b>	<b>2,490,333</b>	<b>(545,888)</b>	<b>42,719,090</b>	<b>32,392,302</b>	<b>32,202,831</b>



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

### 15. Environmental liabilities

#### (a) Remediation of contaminated sites

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

The Department has identified approximately 1,184 sites (1,221 sites in 2014-15) where contamination may exist and assessment, remediation and monitoring may be required. Of these, the Department has identified 253 sites (219 sites in 2014-15) where action is possible and for which a liability of \$499,937,631 (\$425,387,988 in 2014-15) has been recorded. This liability estimate was determined after the sites were assessed and is based on scientific/engineering contractors reviewing the results of site assessments, and proposing possible remediation solutions.

In 2015-16, a statistical model was developed by the Government to estimate the liability for unassessed sites based on historical costs incurred for contaminated sites with similar functions. As a result, there are 234 unassessed sites where a liability estimate of \$19,432,968 has been recorded in the Government of Canada’s Financial Statements prospectively in 2015-16. This estimate will be refined and will be recorded in the Department’s Financial Statements in future years as sites are assessed and estimated costs are revised.

These two estimates combined represents management’s best estimate of the amount required to complete the remediation of the sites to the current minimum standard for its use prior to contamination, based on the information

available at the financial statement date. A net present value technique has been used for sites where the cash flows are expected to occur over extended future periods.

Of the remaining 1,184 sites, 66 sites were closed, as they were either remediated or assessed and found not to be contaminated, and there are 865 sites for which an estimated liability has not been determined, primarily due to the fact the sites are not yet fully assessed and contamination has not yet been determined or they have not developed a detailed remediation plan. As the sites are assessed, if contamination is found, and it exceeds the environmental standard, a liability will be recognized as soon as a reasonable estimate can be made.

Of the 865 sites that do not have liabilities, 35 sites are considered high priority for action because they present a higher risk to human health and the environment. These sites are at various stages of testing and evaluation in order to develop a remediation or risk management strategy. Liabilities will be reported as soon as a reasonable estimate can be determined. 376 sites are considered a medium to low priority based on the low level of risk to human health or the environment. Assessment and remediation will be performed on these sites based on the determination of risk and prioritized within departmental plans. 285 sites are not yet classified because they are only at the initial testing stages and contamination has not yet been determined. 141 sites are not considered a priority for action because information indicates there is likely no significant environmental impact or human health threats and there is likely no need for action unless new information becomes available indicating greater concerns, in which case, the site will be re-examined. 28 sites currently have insufficient information in order to classify. Additional information is required to classify the site but is not available at this time. As additional information becomes available the sites will be re-examined.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

### 15. Environmental liabilities (continued)

The following table presents the total estimated amounts of these liabilities by nature and source, the associated expected recoveries and the total undiscounted future expenditures as at March 31, 2016, and March 31, 2015. When the liability estimate is based on a future cash requirement, the amount is adjusted for inflation using a forecast CPI rate of 2%. Inflation is included in the undiscounted amount. The Government of Canada lending rate applicable to loans with similar terms to maturity has been used to discount the estimated future expenditures. The March 2016 rates range from 0.62% for 2 year term to 2.13% for a 25 or greater year term.

2016				
Nature and source	Number of sites	Estimated liability	Estimated undiscounted liability	Expected recoveries
Military and Former Military Sites	112	413,263,501	<b>431,562,359</b>	-
Fuel Related Practices	81	39,618,426	<b>40,838,443</b>	-
Landfill / Waste Sites	42	38,829,243	<b>40,313,521</b>	-
Engineering Assets / Air and Land Transportation	2	961,733	<b>1,018,834</b>	-
Marine Facilities / Aquatic Sites	1	3,354,785	<b>3,416,715</b>	-
Office / Commercial / Industrial Operations	10	1,093,217	<b>1,120,804</b>	-
Other	5	2,816,726	<b>2,855,682</b>	-
<b>Totals</b>	<b>253</b>	<b>499,937,631</b>	<b>521,126,358</b>	-

2015				
Nature and source	Number of sites	Estimated liability	Estimated undiscounted liability	Expected recoveries
Military and Former Military Sites	111	343,158,471	<b>360,746,891</b>	-
Fuel Related Practices	59	33,517,936	<b>34,660,817</b>	-
Landfill / Waste Sites	36	45,420,099	<b>47,365,958</b>	-
Engineering Assets / Air and Land Transportation	1	269,331	<b>277,637</b>	-
Marine Facilities / Aquatic Sites	0	-	-	-
Office / Commercial / Industrial Operations	8	494,466	<b>504,512</b>	-
Other	4	2,527,685	<b>2,566,109</b>	-
<b>Totals</b>	<b>219</b>	<b>425,387,988</b>	<b>446,121,924</b>	-



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

### 15. Environmental liabilities (continued)

#### (b) Other Environmental Liabilities

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

The Department has identified 893 UXO suspected sites (918 sites in 2014-15) for which clearance action may be necessary. Of these sites, 61 sites (57 sites in 2014-15) are confirmed UXO affected sites. Based on the Department's best estimates, a liability of \$272 million (\$1.3 million in 2014-15) has been recorded for clearance action on 10 sites (5 sites in 2014-15) of the confirmed UXO sites; 14 of the sites have been remediated and will be closed in the next fiscal year. The remaining 869 suspected sites (861 sites in 2014-15) are currently in the assessment stage and a reasonable estimate cannot yet be determined. Of these sites, the obligation for clearance action is likely for 61 sites, possible for 667 sites and unlikely for 141 sites.

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

### 16. Contingent liabilities

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

#### Claims and litigations

Claims have been made against the Department in the normal course of operations. These claims include items with pleading amounts and others for which no amount is specified. While the total amount claimed in these actions is significant, their outcomes are not determinable. The Department has recorded an allowance for claims and litigations where it is likely that there will be a future payment and a reasonable estimate of the loss can be made. Claims and litigations for which the outcome is not determinable and a reasonable estimate can be made by management amount to approximately \$3.5 million (\$4.2 million in 2014-15) at March 31, 2016.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

### 17. Contractual obligations

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

(in thousands of dollars)	2016-2017	2017-2018	2018-2019	2019-2020	2020-2021 and thereafter	Total
Fixed Assets	1,652,977	1,523,078	1,064,599	658,105	944,290	<b>5,843,049</b>
Purchases	2,463,428	1,683,308	1,188,639	856,023	6,152,899	<b>12,344,297</b>
<b>Total</b>	<b>4,116,405</b>	<b>3,206,386</b>	<b>2,253,238</b>	<b>1,514,128</b>	<b>7,097,189</b>	<b>18,187,346</b>

### 18. Related party transactions

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

#### (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)	2016	2015
Employer's contributions to the health and dental plans paid by the Treasury Board of Canada Secretariat	<b>648,821</b>	635,004
Accommodation provided by Public Services and Procurement Canada (PSPC)	<b>75,430</b>	74,364
Worker's compensation coverage provided by Employment and Social Development Canada	<b>7,418</b>	7,787
Legal services provided by the Department of Justice Canada	<b>3,695</b>	3,148
<b>Total</b>	<b>735,364</b>	<b>720,303</b>



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

### 18. Related party transactions (continued)

#### (b) Other transactions with related parties

(in thousands of dollars)	2016	2015
Expenses — other government departments and agencies	<b>1,229,420</b>	1,140,588
Revenues — other government departments and agencies	<b>20,871</b>	182,369
<b>Total</b>	<b>1,250,291</b>	<b>1,322,957</b>

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

### 19. Transfers to other government departments

#### (a) Transfer of the transition payments for implementing salary payments in arrears

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

#### (b) Transfer of National Search and Rescue Secretariat to the Department of Public Safety and Emergency Preparedness

Effective July 23, 2015, in accordance with Order-in-Council P.C. 2015-1126, the Department of National Defence transferred the control and the supervision of the National Search and Rescue Secretariat to the Department of Public Safety and Emergency Preparedness. Accordingly, the Department transferred the expenses of \$4.3 million related to salary and benefits of employees. In addition, the 2014-15 figures have been reclassified on the Consolidated Statement of Operations and Departmental Net Financial Position to present the expenses of the transferred operations. No assets and liabilities have been transferred related to the program.

### 20. 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:





## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

### 20. Segmented information (continued)

(in thousands of dollars)	DCSO	DSCG	DRFEP	DCEP
<b>Operating expense</b>				
Salary and employee benefits	840,954	337,056	2,859,271	4,733,102
Amortization	0	0	0	2,490,333
Professional and special services	149,357	25,792	51,649	1,552,837
Repair and maintenance	17,707	900	10,391	1,279,881
Expenses related to tangible assets	17,398	2,534	35,371	820,033
Materials and supplies	83,685	32,381	246,543	464,225
Transportation and communication	53,017	28,968	119,810	477,053
Other services	21,637	7,365	42,945	336,045
Loss on disposals and write-offs and write-downs of assets	420,222	0	0	0
Accommodation	12,951	8,746	25,268	145,594
Equipment and other rentals	15,093	14,519	98,551	32,615
Utilities	1,125	188	(324)	158,684
Bad debts	4,633	1,817	7,067	116,247
Interest on capital lease payments	70,105	0	0	(50,834)
Advertising, printing and related services	2,907	208	853	9,410
Other expenses	(327,625)	21,937	83,483	981,363
<b>Total operating expenses</b>	<b>1,383,166</b>	<b>482,411</b>	<b>3,580,878</b>	<b>13,546,588</b>
<b>Transfer payments</b>				
Transfers to other countries and international organizations	140,225	46	0	0
Transfers to other levels of government	0	4,791	0	771
Transfers to individuals	0	827	0	3,308
Transfers to non-profit organizations	0	0	0	2,577
<b>Total transfer payments</b>	<b>140,225</b>	<b>5,664</b>	<b>0</b>	<b>6,656</b>
<b>Total expenses</b>	<b>1,523,391</b>	<b>488,075</b>	<b>3,580,878</b>	<b>13,553,244</b>
<b>Revenues</b>				
Sale of goods and services	119,598	9,614	12,775	291,043
Other	4,657	0	151	96,248
Interest and gains on foreign exchange	594	36	1,470	11,834
Gains on disposals of assets	46	5	4,200	7,172
Revenues earned on behalf of Government	(3,057)	0	(5,947)	0
<b>Total revenues</b>	<b>121,838</b>	<b>9,655</b>	<b>12,649</b>	<b>406,297</b>
<b>Net cost from continuing operations</b>	<b>1,401,553</b>	<b>478,420</b>	<b>3,568,229</b>	<b>13,146,947</b>

DCSO Defence Combat and Support Operations  
DSCG Defence Services and Contributions to Government  
DRFEP Defence Ready Force Element Production  
DCEP Defence Capability Element Production



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

### 20. Segmented information (continued)

(in thousands of dollars)	DCDR	IS	2016	2015* (Restated note 21)
<b>Operating expense</b>				
Salary and employee benefits	249,916	333,911	<b>9,354,210</b>	<b>9,826,191</b>
Amortization	0	0	<b>2,490,333</b>	<b>2,603,950</b>
Professional and special services	57,650	31,070	<b>1,868,355</b>	<b>1,874,395</b>
Repair and maintenance	4,414	10,212	<b>1,323,505</b>	<b>1,054,564</b>
Expenses related to tangible assets	9,796	1,500	<b>886,632</b>	<b>631,376</b>
Materials and supplies	6,616	2,933	<b>836,383</b>	<b>773,733</b>
Transportation and communication	12,420	5,642	<b>696,910</b>	<b>683,144</b>
Other services	47,338	37,941	<b>493,271</b>	<b>421,330</b>
Loss on disposals and write-offs and write-downs of assets	0	0	<b>420,222</b>	<b>721,972</b>
Accommodation	2,132	3,209	<b>197,900</b>	<b>200,922</b>
Equipment and other rentals	834	1,755	<b>163,367</b>	<b>142,923</b>
Utilities	91	(105)	<b>159,659</b>	<b>179,739</b>
Bad debts	10,114	15,257	<b>155,135</b>	<b>(794)</b>
Interest on capital lease payments	0	0	<b>19,271</b>	<b>22,600</b>
Advertising, printing and related services	1,409	1,013	<b>15,800</b>	<b>18,886</b>
Other expenses	39,145	(29,181)	<b>769,122</b>	<b>(121,607)</b>
<b>Total operating expenses</b>	<b>441,875</b>	<b>415,157</b>	<b>19,850,075</b>	<b>19,033,324</b>
<b>Transfer payments</b>				
Transfers to other countries and international organizations	(191)	0	<b>140,080</b>	<b>116,644</b>
Transfers to other levels of government	127	0	<b>5,689</b>	<b>6,567</b>
Transfers to individuals	(2)	(215)	<b>3,918</b>	<b>9,867</b>
Transfers to non-profit organizations	0	0	<b>2,577</b>	<b>3,139</b>
<b>Total transfer payments</b>	<b>(66)</b>	<b>(215)</b>	<b>152,264</b>	<b>136,217</b>
<b>Total expenses</b>	<b>441,809</b>	<b>414,942</b>	<b>20,002,339</b>	<b>19,169,541</b>
<b>Revenues</b>				
Sale of goods and services	2,484	14,236	<b>449,750</b>	<b>439,437</b>
Other	0	7,809	<b>108,865</b>	<b>20,882</b>
Interest and gains on foreign exchange	1,671	5,153	<b>20,758</b>	<b>13,407</b>
Gains on disposals of assets	263	6,085	<b>17,771</b>	<b>170,308</b>
Revenues earned on behalf of Government	(2,280)	(6,967)	<b>(18,251)</b>	<b>(43,144)</b>
<b>Total revenues</b>	<b>2,138</b>	<b>26,316</b>	<b>578,893</b>	<b>600,890</b>
<b>Net cost from continuing operations</b>	<b>439,671</b>	<b>388,626</b>	<b>19,423,446</b>	<b>18,568,651</b>

DCDR Defence Capability Development and Research

IS Internal Services

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



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

### 21. Accounting changes

#### (a) Removal of the Canadian Forces Superannuation Account

For many years, the Department had reported the Superannuation Account as a liability under “Canadian Forces insurance and pension accounts” and the corresponding receivable from the CRF as a financial assets under “Due from CRF” in the Consolidated Statement of Financial Position.

In accordance with Section 3.6.2 of the Appendix to Treasury Board’s Accounting Standard (TBAS) 1.2, “departments do not record employee future benefits in their Departmental Financial Statements, except for severance liabilities, as the liabilities are not under the responsibility of departments”. As such, the Department has determined that the balances and transactions in the Superannuation Account should be removed from the Consolidated Statement of Financial Position. This change will provide more reliable and relevant information to the users of the Departmental Financial Statements. This change has been applied retroactively and comparative information for 2014-15 has been restated.

The pension promise to the plan members and beneficiaries is not affected by the removal of the Superannuation Account from the Departmental Financial Statements. The *Canadian Forces Superannuation Act* requires that all pension obligations arising from the plan be met.

The Superannuation Account represents a tracking of all contributions, benefit payments, interest, charges and transfers that pertain to service before April 1, 2000. The financial position of the Superannuation Account and the transactions recorded within this account are reported in Note 7a, and have been removed from the Consolidated Statement of Financial Position.

#### (b) Restatement of previous year’s results

The Department is undergoing a multi-year review of its business processes related to the recording and valuation of tangible capital assets and inventory. In 2015-16 this review identified capital assets and inventory that should have been reported in previous fiscal years.

The effect of the resulting retroactive adjustments are as follows:



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

### 21. Accounting changes (continued)

(in thousands of dollars)	2015 As previously stated	Effect of change		2015 Restated
		note 21 (a)	note 21 (b)	
<b>Consolidated Statement of Financial Position</b>				
Canadian Forces pension and insurance accounts	46,860,606	(46,118,651)	-	<b>741,955</b>
Total liabilities	51,173,734	(46,118,651)	-	<b>5,055,083</b>
Due from Consolidated Revenue Fund	48,735,962	(46,118,651)	-	<b>2,617,311</b>
Total gross financial assets	49,011,681	(46,118,651)	-	<b>2,893,030</b>
Total net financial assets	49,004,247	(46,118,651)	-	<b>2,885,596</b>
Tangible capital assets	32,338,247	-	(135,416)	<b>32,202,831</b>
Total non-financial assets	39,443,088	-	(135,416)	<b>39,307,672</b>
Departmental net financial position	37,273,601	-	(135,416)	<b>37,138,185</b>
<b>Consolidated Statement of Operations and Departmental Net Financial Position</b>				
Total expenses	19,153,571	-	15,970	<b>19,169,541</b>
Net cost from continuing operations	18,552,681	-	15,970	<b>18,568,651</b>
Net cost of operations before government funding and transfers	18,553,992	-	15,970	<b>18,569,962</b>
Net cash provided by Government of Canada	17,745,613	(178,725)	-	<b>17,566,888</b>
Change in due from Consolidated Revenue Fund	(85,739)	178,725	-	<b>92,986</b>
Net Cash provided by Government of Canada	240,808	-	15,970	<b>256,778</b>
Departmental net financial position - beginning of year	37,514,409	-	(119,446)	<b>37,394,963</b>
Departmental net financial position - end of year	37,273,601	-	(135,416)	<b>37,138,185</b>
<b>Consolidated Statement of Change in Departmental Net Debt</b>				
Net cost of operations after government funding and transfers	240,808	-	15,970	<b>256,778</b>
Amortization of tangible capital assets	(2,587,980)	-	(15,970)	<b>(2,603,950)</b>
Total change due to tangible capital assets	15,116	-	(15,970)	<b>(854)</b>
<b>Consolidated Statement of Cash Flows</b>				
Net cost of operations before government funding and transfers	18,553,992	-	15,970	<b>18,569,962</b>
Amortization of tangible capital assets	(2,587,980)	-	(15,970)	<b>(2,603,950)</b>
Decrease in Canadian Forces pension and insurance accounts	242,172	(178,725)	-	<b>63,447</b>
Cash used by operating activities	14,856,584	(178,725)	-	<b>14,677,859</b>
Net Cash provided by Government of Canada	17,745,613	(178,725)	-	<b>17,566,888</b>



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the year ended March 31

### 22. Comparative information

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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 2015–16 (UNAUDITED)

### 1. Introduction

This document provides summary information on the measures taken by the Department to maintain an effective system of ICFR, including information on internal control management and assessment results and related action plans.

Detailed information on the Department'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. The Department's System of Internal Control over Financial Reporting

#### 2.1 Internal Control Management

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

- Organizational accountability structures as they relate to financial management, including roles and responsibilities for senior managers in their areas of responsibility;
- A focused internal control management group under the Chief Financial Officer (CFO) to monitor the effectiveness of ICFR across the Department, including reporting on deficiencies and providing assistance to business process owners in the implementation of ICFR as required;

- A continuous improvement approach that includes an ongoing monitoring of key controls for those processes that have reached ICFR maturity and a cyclical assessment of controls in various high risk processes to indicate operating effectiveness. Assessment activities include a department-wide quality assurance program over Procurement, Payables and Payments, directed mandatory stocktaking of designated high risk/high value inventory items and regular audits to confirm valuations and proper execution of key business processes;
- A Defence Ethics Program which is a comprehensive values-based program put in place to meet the needs of the Department and the Canadian Armed Forces (CAF), at both the individual and the organizational levels;
- A comprehensive Fraud Management Strategy that protects the Department's resources from fraud, waste and abuse through a prevention and detection framework;
- An annually updated Corporate Risk Profile;
- Financial management attestations for assistant deputy ministers that confirm financial management responsibilities were fully satisfied with respect to authorities, resources and internal controls within their program area, to support the DM and the CFO in signing the *Statement of Management Responsibility Including Internal Control over Financial Reporting*;
- On-going communication and training on statutory requirements, policies, and procedures for sound financial management and control; and
- Regular updates, at least semi-annually, to departmental senior management, the Departmental Audit Committee (DAC) and to the 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

The Department relies on other organizations for the processing of certain transactions that are recorded in its financial statements, and relies on these service providers



## ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2015–16 (UNAUDITED)

to ensure an adequate system of ICFR is maintained over services provided to the Department. These include the following:

### (i) Common Arrangements:

- Public Services and Procurement Canada (PSPC) centrally administers the payments of salaries, and under the *Transformation of Pay Administration Initiative*, pay administration services for all the Department's civilian public servants have been transferred to the Public Service Pay Centre in Miramichi, New Brunswick, in February 2016. PSPC also centrally administers the procurement of goods and services 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 provides legal services to the Department, as well as information for establishing the contingent liability note to the financial statements and for inclusion in the *Public Accounts of Canada*; and
- Shared Services Canada manages Information Technology General Controls (ITGCs) in the areas of email, data centre and network services.

### (ii) Specific Arrangements:

- Defence Construction Canada provides contracting, construction contract management and related infrastructure services to the Department in accordance with the Memorandum of Understanding between the two organizations and as per the Department's Delegation of Authorities instrument;
- Brookfield Global Relocation Services administers the Department moves under the CAF Integrated Relocation Program (IRP), which represents TBS' approved policy on relocation; and
- The Office of the Superintendent of Financial Institutions (OSFI) provides the Department with the accrued severance liability amount for the CAF.

### 3. The Department's assessment results during fiscal year 2015-16

The Department is one of the largest and most complex organizations in the Government of Canada with annual expenditures of almost \$20 billion, revenues of \$500 million and assets in excess of \$40 billion (net book value). The Department's ICFR framework in support of the Treasury Board's Policy on Internal Control (PIC) has more than 1,000 documented control points across 16 major business cycles in a highly decentralized financial environment. There are three separate payroll systems, all currently undergoing major transformations which annually expend more than \$9 billion in salaries and benefits to more than 100,000 military members and civilian employees. Furthermore, there are two major Enterprise Resource Planning (ERP) systems which support the business of defence including materiel management, real property, human resource management as well as financial services. The establishment of financial controls involves all aspects of the business and extends to every operational area of the Department.

In 2015-16, the Department introduced a formal project management office (PMO) and implemented a detailed multi-year integrated plan focused on the remediation of the remaining 158 outstanding key control deficiencies (approximately 15% of the more than 1,000 documented control points) identified during the evaluation of the Financial Control Framework (FCF) of its high risk processes.

A governance structure involving two senior level committees to provide leadership over the implementation of PIC was also established in 2015-16. These committees are comprised of senior departmental managers who have a shared mandate to facilitate PIC implementation efforts in the Department and have the responsibility to approve and / or endorse recommendations where necessary to remediate control deficiencies and gaps identified under PIC.



## ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2015–16 (UNAUDITED)

The Department also continued to engage in operational effectiveness and various monitoring activities as planned. This is significant progress towards PIC compliance and has brought the Department closer to a mature system of ICFR. Details of assessments and results for 2015-16 are provided in the paragraphs that follow and in Table 1 of this annex.

### 3.1 Design effectiveness of key controls

In 2015-16, the documentation and evaluation of design effectiveness was completed for the Delegation of Financial Signing Authorities business process as a result of the automation of the Department's financial signing authorities in the Department's ERP system. Areas for control improvements have been identified and will undergo remediation in 2016-17. As well, an examination of the financial controls within the CAF Integrated Relocation Program was conducted in response to concerns raised by the Office of the Auditor General of Canada (OAG). Recommendations for improvements to the quality assurance and verification processes in support of the *Financial Administration Act* (FAA) will be assessed in 2016-17.

In addition, planned remediation activities for the resolution of design control gaps continued for the Department's financial business processes related to Financial Reporting and Financial Statement Preparation, Financial Close, Real Property and Capital Equipment Assets, Inventory, Procurement to Payment, Other Payables and Payments and Military Regular and Reserve Force Payroll. Highlights of significant remediation activities include:

- The establishment of an implementation working group focused on delivering a new Payment Card Program designed to address ICFR deficiencies. This program includes a corporate Payment Card Program Guide describing the new program and controls, a mandatory online course for cardholders, a central corporate monitoring program utilizing card issuer tools, a cardholder handbook and job aids for card

coordinators. The new Payment Card Program will be launched in the fall of 2016;

- The development of a Quality Assurance Program and Sampling Plan for Military Payroll processes that includes a risk assessment of pay transactions and an identification of high and low risk transaction types. A statistically-driven sampling program will be used to support a cycle of continuous improvement that includes updating pay administration instructions, directing Site Inspection Visits (SIV) and Site Assistance Visits (SAV) currently conducted across all bases and wings; and
- The establishment and completion of a remediation working group for the Individual Designated Travel Card (IDTC) process to address ICFR deficiencies identified in 2014-15. This evaluation and remediation activity followed the implementation of the Shared Travel Service government-wide travel program rollout in 2014. A remediation action plan was developed with departmental stakeholders and business process owners and will be implemented in 2016-17.

### 3.2 Operating effectiveness of key controls

In 2015-16, remediation of operating effectiveness was completed as planned for Prepaid Expenses (Foreign Military Sales).

The planned validation site visits for opening balance sheet verification for Real Property Assets were also completed. The existence of real property assets was verified to the sub-ledger; however, completeness of the assets could not be fully determined. Remediation will continue on these findings.

In preparation of operating effectiveness testing for Civilian Payroll processes, the Department was engaged with the PSPC following the launch of the new Pay Consolidation environment under the *Transformation of Pay Administration Initiative*. Highlights of significant activities completed include:

- A review of the Pay Centre's documentation outlining central agency and departmental control responsibilities to determine the impact of pay





## ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2015–16 (UNAUDITED)

transformation activities on the Department's current FCF for Civilian payroll. Based on this analysis, the Department will undertake an update of the current FCF in 2016-17 to reflect changes in the overall control environment; and

- The completion of business system requirements for a statistical sampling tool in the Department's financial system to support quality assurance reviews of Civilian Payroll transactions received from the Government of Canada's new payroll system (Phoenix). This tool will be implemented in the Department's financial system in 2016-17 and will provide samples for quality assurance purposes.

### 3.3 On-going monitoring of key controls

In 2015-16, the Department continued on-going monitoring activities for Entity-Level Controls (ELCs) and ITGCs and initiated activities for Prepaid Expenses and Revenue and Receivables business processes to support the ongoing monitoring stage.

After the completion of its updated monitoring plan in 2015-16, the Department assessed ELCs as low risk based on the work completed to date. Accordingly, certain key controls for this process were assessed as part of a three-year rotational schedule as per the Department's ongoing monitoring plan.

The focus of ITGC work in 2015-16 was the remediation of ITGC exceptions for the Department's financial system of record, the Defence Resource Management Information System (DRMIS).

Following operating effectiveness testing, the Department determined that the Revenue and Receivables business process is low risk and will therefore be monitored on a three-year rotational cycle.

The Department also initiated an ongoing monitoring strategy for Prepaid Expenses, to be completed in 2016-17.

### 3.4 Other ICFR achievements

In 2015-16, the Department undertook additional remedial activities in support of an effective system of ICFR and an ongoing monitoring approach. Highlights of significant ICFR activities are as follows:

- The implementation of a standardized, department wide, statistical sampling process has enabled the Department to monitor the ongoing effectiveness of financial controls over Procurement, Payables and Payments across the Department and report to the CFO. As a result, formal standardized procedures and training have been created and delivered in support of the finance community across the Department. Within the National Capital Region (NCR), 13 level one organizations have received training and five Bases/ Wings were visited with over 200 hours of training being delivered. This information has also allowed the Department to update policies and procedures as necessary to strengthen financial management in Defence;
- Workshops were held for business process and related system changes as part of Infrastructure Environment Business Modernization (IEBM) Phase 2. A review of the proposed system changes was conducted to ensure there were no negative impacts to the financial control framework for Real Property Assets;
- The establishment of an Asset and Inventory Strategy and Analysis (AISA) organization under the CFO with responsibility for the financial accounting and reporting for Inventory, Asset-pooled Items (API) and Capital Assets; and
- The update of financial control framework documentation for Creditor and Debtor-initiated Interdepartmental Settlements, DRMIS Payments, Regular Invoice Processing and Acquisition Cards to reflect process and control changes following business transformation initiatives and revised policy direction from central agencies.



**ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2015–16 (UNAUDITED)**

## 4. The Department’s action plan

### 4.1 Progress during fiscal year 2015-16

In 2015-16, the Department made significant progress towards the implementation of an effective system of ICFR for the majority of the Department’s financial business processes by understanding remediation required, working horizontally with stakeholders and by establishing a formal PMO to quantify the number of key controls and control gaps in order to develop a detailed multi-year integrated plan. The project management approach implemented incorporates the use of formal risk and issue tracking, change management and regular senior management engagement through a detailed governance structure and performance reporting.

Table 1 below summarizes a third party assessment of the Department’s progress as at March 31, 2016.

**Table 1 – The Department’s Progress against its 2014-15 Action Plan**

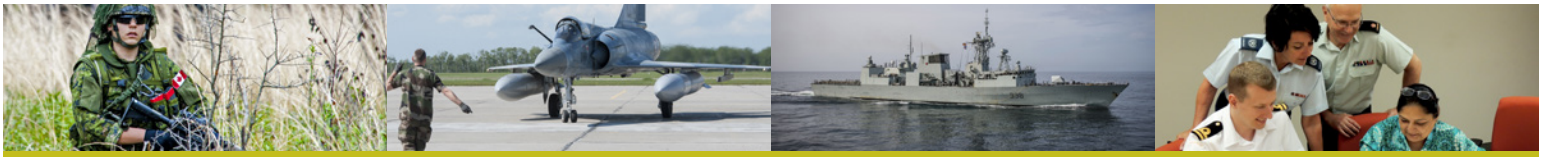
Element in the 2014-15 Action Plan	Status
Entity-level controls (ELC) - Ongoing monitoring rotation	<p>Met</p> <p>After the completion of its updated monitoring plan in 2015-16, the Department assessed ELCs as low risk based on the work completed to date, associated findings and ongoing monitoring. Accordingly, the controls for this process will be tested on a rotational basis every three years as noted in the updated monitoring plan. Work was also performed to prepare for an internal audit review by Assistant Deputy Minister (Review Services) scheduled to commence in June 2016.</p>
Information technology general controls - Ongoing monitoring rotation	<p>Met</p> <p>2015-16 is Year 2 of the ongoing monitoring phase for ITGCs.</p> <p>The focus this year was on remediating the ITGC exceptions for DRMIS. A dedicated resource was embedded within the DRMIS team to review the viability and reasonability of the action plans identified for remediating prior year deficiencies.</p> <p>Work was also performed to prepare for the ITGC audit by the OAG scheduled to commence in June 2016.</p>



**ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2015–16 (UNAUDITED)**

**Table 1 – The Department’s Progress against its 2014–15 Action Plan (continued)**

Element in the 2014-15 Action Plan	Status
Financial reporting and financial statement preparation - Design effectiveness and remediation	<p>Substantially Met</p> <p>In 2015-16, progress continued to be made in remediating gaps previously identified, including remediation pertaining to some of the sub-ledger to general ledger reconciliations. In addition, updates to the financial control framework were performed based on the current process.</p> <p>In 2016-17, the Department plans to perform operating effectiveness testing.</p>
Financial close - Design effectiveness and remediation	<p>Substantially Met</p> <p>In 2015-16, efforts were made to remediate outstanding control deficiencies highlighted through design effectiveness testing. In addition, updates to the financial control framework were performed based on the current process.</p> <p>In 2016-17, the Department plans to perform operating effectiveness testing.</p>
Revenue and receivables - Ongoing monitoring rotation	<p>Met</p> <p>During 2015-16, the Department worked with key departmental stakeholders to confirm implementation of the remediation activities related to operating effectiveness testing.</p> <p>Subsequent to the operating effectiveness testing conducted in 2014-15, the Department assessed revenue and receivables as low risk based on the fact that the significant source of revenue, foreign military training, is audited on an annual basis. As a result, the Department is developing an appropriate monitoring strategy in 2016-17 moving forward given the low level of risk identified.</p>
Prepaid expenses - Operating effectiveness testing and remediation	<p>Met</p> <p>Instructions, checklists and tools were developed for the documentation and determination of the valuation of goods received to remediate issues identified up to 2015-16.</p> <p>In 2016-17, the Department plans to finalize an ongoing monitoring approach and commence ongoing monitoring testing.</p>



**ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2015–16 (UNAUDITED)**

**Table 1 — The Department’s Progress against its 2014–15 Action Plan (continued)**

Element in the 2014–15 Action Plan	Status
Procurement to payment - Design effectiveness testing and remediation	<p>Met</p> <p>In 2015–16, ongoing efforts were made to remediate outstanding control deficiencies within the procurement to payment processes, including feeding into remediation activities and other initiatives within Material Acquisition &amp; Support (MA&amp;S) and real property transformation activities. Areas of focus included procurement in the Materials Management (MM) module, vendor management and commencing remediation efforts to address control deficiencies identified during design effectiveness testing of financial controls for Procurement in the Funds Management (FM) module of DRMIS in 2014–15.</p> <p>In addition, at the request of the OAG, the Department updated financial control framework documentation for sub-processes previously documented to reflect the current processes and control environment. Updated frameworks included Creditor and Debtor-initiated Interdepartmental Settlements, DRMIS Payments and Regular Invoice Processing.</p> <p>In 2016–17, the Department plans to perform operating effectiveness testing for the majority of procure to pay business processes.</p>



**ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2015–16 (UNAUDITED)**

**Table 1 – The Department’s Progress against its 2014–15 Action Plan (continued)**

Element in the 2014-15 Action Plan	Status
Other payables and payments - Design effectiveness testing and remediation	<p>Met</p> <p>Other payables and payments includes unique procure to payment processes such as managing Delegation of Authorities, Acquisition Cards, IRP, Departmental Travel Cards and payments originating from source systems that interface with the Department’s ERP system.</p> <p>In 2015–16, the Department completed the documentation and design effectiveness assessment of IRP, the automated Delegation of Financial Authorities business processes, and completed the documentation of controls within the new Departmental Travel Expense Account (DTEA) Program.</p> <p>The Department also formed working groups for both IDTCs and Acquisition Cards. The IDTC working group was focused on developing a remediation plan to address findings from a 2014–15 design effectiveness assessment whereas the Acquisition Card working group was focused on implementing the remediation plan that was developed in 2014–15. Both working groups achieved their objectives and significant remediation work was completed in 2015–16, strengthening the financial controls in these processes.</p> <p>In addition, at the request of the OAG, the Department updated financial control framework documentation for Acquisition Cards previously documented to reflect subsequent process and control changes achieved through remediation work.</p> <p>In 2017-18, the Department plans to perform operating effectiveness testing for the majority of procure to pay business processes.</p>



**ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2015–16 (UNAUDITED)**

**Table 1 — The Department’s Progress against its 2014–15 Action Plan (continued)**

Element in the 2014–15 Action Plan	Status
<p>Civilian payroll - Operating effectiveness testing and remediation</p>	<p>Met</p> <p>Implementation of the Government of Canada’s Consolidation of Pay Services and Modernization of Pay Projects was delayed until February 2016 and resulted in new pay processes and control activities. As a result, the Department conducted a review of the PSPC Pay Centre FCF documentation and the departmental FCF documentation to determine the impact of pay transformation activities on the Department’s current FCF for Civilian payroll. Based on this analysis, the Department will undertake an update of the current FCF in 2016–17 to reflect changes in the overall control environment in preparation for conducting operating effectiveness testing in 2017-18, delayed due to transformation activities.</p> <p>In the interim, the Department developed business system requirements for a statistical sampling tool in DRMIS to support the quality assurance requirements for financial officers outlined in the TB Directive on Account Verification. With the assistance of PwC, the Department also developed a sampling plan and risk ranking tool in 2015-16 to assess and establish the risk levels for types of pay transactions to be sampled and verified as part of the program. The program will be implemented in 2016-17.</p> <p>In addition, the Department has initiated a working group focused on developing options for a streamlined in/out clearance routine process for the NCR. The Defence Common Administrative Services Headquarters Transformation project has developed and analyzed options that will support strong internal financial controls within the process.</p>
<p>Military Regular and Reserve Force Payroll - Design effectiveness and remediation</p>	<p>Met</p> <p>During 2015–16, the Department designed a Military and Reserve Force payroll quality assurance program, with the assistance of PwC, to support the quality assurance requirement for financial officers as outlined in the TB Directive on Account Verification. This work included developing a risk ranking tool to establish risk levels for types of pay transactions to be sampled and verified as part of the program. In addition to the development of the quality assurance program, the Department also continued to implement the remediation plan that was established after the initial assessment of design effectiveness. Remediation work focused on developing financial policies and procedures, enforcing compliance with the FAA, strengthening controls within the military pay systems and formalizing training and guidance.</p> <p>The Department also continued to provide ongoing support and contributions to the Military Personnel Management Capability Transformation (MPMCT) project from a financial controls perspective through the review and development of future business system requirements.</p> <p>In 2017-18, the Department plans to perform operating effectiveness testing.</p>



**ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2015–16 (UNAUDITED)**

**Table 1 – The Department’s Progress against its 2014–15 Action Plan (continued)**

Element in the 2014-15 Action Plan	Status
<p>Inventories - Design effectiveness and remediation</p>	<p>Met</p> <p>During 2015-16, significant efforts were made to remediate multiple control deficiencies highlighted through design effectiveness testing. Through participation in various working groups and providing input into other ongoing initiatives, identified control gaps have been discussed, plans put in place, approvals obtained and business requirements documentation established for new system capabilities and process changes. The areas affected include Materiel Identification, Disposals, Warehouse Management, and Repair and Overhaul.</p> <p>The Materiel Pricing Project has stood up during the year and made progress identifying key pricing issues including standardization of pricing fields within DRMIS and unforecasted receipts where a price can be added manually to a goods receipt. The most significant issue identified has been the focus of more detailed analysis and investigation with an aim to provide a recommended way forward during 2016-17 for implementation. In 2017-18, the Department plans to perform operating effectiveness testing.</p>
<p>Capital Equipment Assets - Design effectiveness and remediation</p>	<p>Met</p> <p>The Department took steps in 2015-16 to remediate the process associated with the direct purchase of capital assets. During the year, stakeholders have been assembled and a high level process design has been established.</p> <p>While the process design was agreed upon by stakeholders, discussions and planning continue related to roles and responsibilities, system changes, interdependencies, procedural documentation and training for the creation and maintenance of the asset records. Improvements to controls and the documentation of the capital asset disposal processes are also underway.</p> <p>Steps were also taken to formulate system requirements to include mandatory settlement of project costs to help ensure timely and complete capitalization of assets to contribute to the overall accuracy of the Department’s financial statements.</p> <p>In 2017-18, the Department plans to perform operating effectiveness testing.</p>

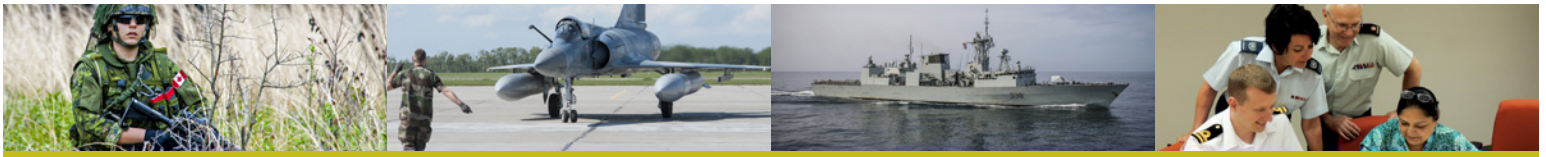


**ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2015–16 (UNAUDITED)**

**Table 1 — The Department’s Progress against its 2014–15 Action Plan (continued)**

Element in the 2014-15 Action Plan	Status
<p>Real property assets - Design effectiveness and remediation</p>	<p>Met</p> <p>The planned site visits for the opening balance sheet verification for real property were completed in 2015-16 and work continues to summarize the results and conclude on the existence and completeness of the real property assets balances.</p> <p>For IEBM Initiative Phase 2, input has been provided throughout the design process to ensure that ICFR controls are being considered into the business requirements and associated solution to be implemented in November 2016. In 2017-18, the Department plans to perform operating effectiveness testing.</p>
<p>Remediation liabilities - Operating effectiveness testing and remediation</p>	<p>Partially Met</p> <p>In support of ongoing remediation, the Department developed communication material that provides an overview of the FCF, key controls and why they are required. The communication material is designed to educate and inform departmental stakeholders about the controls that support remediation liabilities.</p> <p>During 2015-16, site closure procedures and tools were developed for the sites that require no further action. In addition, updates to the financial control framework were performed based on the current process. Although it was previously anticipated that operating effectiveness testing would commence for Remediation Liabilities in 2015-16, operating effectiveness testing will take place following the IEBM Initiative Phase 2 implementation in 2016-17.</p>





## ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2015–16 (UNAUDITED)

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

While the Department continues to work towards full implementation of the PIC, progress is ongoing over multiple years given the size, complexities and decentralized nature of the Department's operations. Furthermore, a number of significant initiatives are underway in the Department which require the inclusion of PIC elements as part of the business transformation to realize success.

Highlights of the business processes impacted by these transformation initiatives and their statuses and action plans follow:

**Procurement to Payment:** Due to the Department's integrated ERP system, processes within this transaction flow are impacted by process changes to materiel acquisition and support and real property transformation activities, resulting in additional documentation, design testing and remediation activities. Following the completion of these activities in 2016-17, the Department will commence operating effectiveness testing.

**Other Payables and Payments:** As business transformation and rationalization activities progress, legacy source systems are expected to be retired and ICFR documentation and implementation of financial controls will progress with these transformation initiatives.

**Military Regular and Reserve Force Payroll:** The MPMCT project for Regular Force and Reserve Force pay administration is planned for full implementation beyond the 2018-19 target for full PIC compliance. Implementation of the remediation action plan will continue during this transformational period and will focus on leveraging relevant elements of the Government of Canada's Pay Modernization Project.

**Civilian Payroll:** The Government of Canada Consolidation of Pay Services Project led by PSPC has a phased implementation approach which began in October 2013. Once implemented and stabilized in 2016-17, the Department will commence the operating effectiveness phase of Civilian Payroll processes by first reviewing and updating the financial control framework within the new pay consolidation environment, followed by operating effectiveness testing in 2017-18.

**Inventory:** There are various transformational projects and plans under the MA&S Transformation Campaign for which PIC remediation activities are dependent upon. With respect to supply management, the focus will be on continuing to work with the Inventory Management Modernization and Rationalization Project to remediate PIC deficiencies identified in various MA&S processes such as Warehouse Management, Repair and Overhaul and Disposal. In addition, it will be important to stay engaged with these initiatives to ensure that internal controls are embedded in any business process re-design.

For inventory valuation, work continues on the Materiel Pricing Project and the development and implementation of an action plan to address the gaps and weaknesses in materiel pricing policies and processes that lead to inaccurate materiel valuation and financial reporting.

The Chief of Defence Staff/DM Directive on Materiel Accountability, which directed mandatory stocktaking of designated high risk/high value items including historical price confirmation, has been embedded into policies and the Department is now monitoring materiel accountability twice yearly through Materiel Accountability Action plans.



## ANNEX TO THE STATEMENT OF MANAGEMENT RESPONSIBILITY INCLUDING INTERNAL CONTROL OVER FINANCIAL REPORTING OF THE DEPARTMENT OF NATIONAL DEFENCE FOR FISCAL YEAR 2015–16 (UNAUDITED)

The Department has made significant advancements to improve the accuracy and completeness of the recording of the value of inventory holdings and the work on internal controls is a key component to ensuring continued progress. For example, materiel identification is a fundamental process that directly impacts the financial treatment and reporting of inventory and capital equipment assets and the Department is standing up a working group to address issues in the materiel identification process (including items identified as a result of PIC work) and will be seeking to stand up a project to resolve these issues.

**Real Property Assets:** Efforts will continue to address completeness of Real Property Asset issues identified in the real property site visits. The IEBM Phase 2 rollout is scheduled to occur in 2016-17. System business requirements and business process documents are being reviewed to ensure the processes include the appropriate ICFR. Operating effectiveness testing will continue after Phase 2 implementation in 2017-18.

The introduction of a formal PMO and integrated plan will continue to provide the necessary governance structure to track the many interdependencies, complexities and competing priorities within the Department and the Government of Canada.

The Department's action plan summarized 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.

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

Key Control Area	ASSESSMENT ELEMENTS		
	Design effectiveness testing and remediation	Operating effectiveness testing and remediation <sup>1</sup>	On-going monitoring rotation <sup>2</sup>
<b>Entity Level Controls (ELCs)</b>	Completed	Completed	Yes
<b>IT General Controls</b>	Completed	Completed	Yes
<b>Financial Reporting and Financial Close</b>	Completed	2017-18	2018-19
<b>Process Level Controls:</b>			
Revenues and Receivables	Completed	Completed	Yes
Prepaid Expenses	Completed	Completed	2016-17
Procurement to Payment	2016-17	2017-18	2018-19
Other Payables and Payments	2016-17	2018-19	2018-19
Civilian Payroll	Completed	2018-19	2018-19
Military Regular & Reserve Force Payroll	2016-17	2018-19	2018-19
Inventories	2016-17	2018-19	2018-19
Capital Equipment Assets	2016-17	2018-19	2018-19
Real Property Assets	Completed	2018-19	2018-19
Remediation Liabilities	Completed	2017-18	2018-19

(1) This phase is done as a two-step process that extends beyond a 12 month period. The process level controls identified are composed of several key control activities and the dates shown indicate the fiscal year in which all work in this process will be completed.

(2) Ongoing monitoring begins in parallel as operating effectiveness is nearing completion and as such the date for this phase may be the same as the completion of the previous one.



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