DEPARTMENT OF FOREIGN AFFAIRS AND INTERNATIONAL TRADE

Statement of Management Responsibility Including Internal Control Over Financial Reporting

Responsibility for the integrity and objectivity of the accompanying financial statements for the year ended March 31, 2010, and all information contained in these statements rests with the management of the Department. These financial statements have been prepared by management in accordance with Treasury Board accounting policies, which are based on Canadian generally accepted accounting principles for the public sector.

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

Management is also responsible for maintaining an effective system of internal control over financial reporting 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 the system of internal control over financial reporting.

An assessment for the year ended March 31, 2010 was completed in accordance with the Policy on Internal Control and the results and action plans are summarized in the annex.

The system of internal control over financial reporting is designed to mitigate risks to a reasonable level based on an on-going process to identify key risks, to assess effectiveness of associated key controls, and to make any necessary adjustments.

The effectiveness and adequacy of the Department's system of internal control is reviewed by internal audit staff, who conduct periodic audits of various areas of the Department's operations. Management is also supported by a Departmental Audit Committee (DAC). The fundamental role of the DAC is to ensure that the Deputy Ministers have objective advice and recommendations on the adequacy of the department's risk management, control and governance processes. The DAC reviews core areas of departmental management, control and accountability, including reporting. Specifically, the DAC reviews the department's financial statements and all significant accounting estimates and judgements therein with management and advises the Deputy Ministers on any apparent material concerns. Additionally, the Chief Audit Executive of the Department has full and unrestricted access to, and meets regularly with the DAC.

The financial statements of the Department have not been audited.

Louis Lévesque
Deputy Minister of International Trade
Ottawa, Canada
Date:

Morris Rosenberg
Deputy Minister of Foreign Affairs
Ottawa, Canada
Date:

Gordon White
Chief Financial Officer & Assistant Deputy Minister
Ottawa, Canada
Date:

DEPARTMENT OF FOREIGN AFFAIRS AND INTERNATIONAL TRADE

Statement of Financial Position (Unaudited)

As at March 31
(in thousands of dollars)

	2010	2009 *restated (Notes 2 and 14)*
Assets		
Financial assets		
Due from the Consolidated Revenue Fund	200,808	237,534
Accounts receivable and advances (Note 4)	75,593	86,899
Inventory held for re-sale (Note 5)	5,179	5,373
Total financial assets	**281,580**	**329,806**
Non-financial assets		
Prepaid expenses	42,170	53,509
Consumable inventory (Note 5)	5,010	6,925
Tangible capital assets (Note 6)	1,168,720	1,094,603
Total non-financial assets	**1,215,900**	**1,155,037**
TOTAL	**1,497,480**	**1,484,843**
Liabilities		
Liabilities		
Accounts payable and accrued liabilities (Note 7)	272,118	317,553
Vacation pay and compensatory leave	45,638	45,276
Deferred revenue (Note 8)	196	107
Employee severance benefits (Note 9)	135,078	119,774
Total	**453,030**	**482,710**
Equity of Canada	**1,044,450**	**1,002,133**
TOTAL	**1,497,480**	**1,484,843**

Contingent liabilities (Note 10)
Contractual obligations (Note 11)

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

Louis Lévesque
Deputy Minister of International Trade
Ottawa, Canada
Date:

Morris Rosenberg
Deputy Minister of Foreign Affairs
Ottawa, Canada
Date:

Gordon White
Chief Financial Officer & Assistant Deputy Minister
Ottawa, Canada
Date:

DEPARTMENT OF FOREIGN AFFAIRS AND INTERNATIONAL TRADE

Statement of Operations (Unaudited)

For the year ended March 31
(in thousands of dollars)

	Planned Results 2010	2010	2009 *restated (Notes 2 and 14)*
Expenses (Note 13)			
Expenses from operations			
Diplomacy and Advocacy	1,215,610	1,135,989	1,059,967
Canada's International Platform: Support at Missions Abroad	525,442	547,936	595,087
Canada's International Platform: Support at Headquarters	369,818	310,671	313,884
Passport Canada Revolving Fund	358,550	303,671	305,805
International Commerce	228,841	239,056	250,256
International Policy Advice and Integration	177,274	163,980	111,086
Internal Services	102,908	97,776	104,925
Consular Affairs	57,270	62,138	55,639
Total expenses	**3,035,713**	**2,861,217**	**2,796,649**
Revenues (Note 13)			
Revenue from operations			
Passport Canada Revolving Fund	296,300	290,688	261,972
Consular Affairs	102,000	102,019	93,377
Canada's International Platform: Support at Missions Abroad	64,100	27,867	9,472
Canada's International Platform: Support at Headquarters	19,700	14,308	17,038
Diplomacy and Advocacy	7,900	13,757	7,364
Internal Services	-	5,244	35,058
International Commerce	3,100	3,221	957
International Policy Advice and Integration	-	899	108
Total revenues	**493,100**	**458,003**	**425,346**
Net results of operations	**2,542,613**	**2,403,214**	**2,371,303**

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

DEPARTMENT OF FOREIGN AFFAIRS AND INTERNATIONAL TRADE

Statement of Equity of Canada (Unaudited)

As at March 31
(in thousands of dollars)

	2010	**2009** *restated (Notes 2 and 14)*
Equity of Canada, beginning of year	1,002,133	732,359
Net results of operations	(2,403,214)	(2,371,303)
Net cash provided by Government of Canada	2,383,057	2,310,743
Change in due from the Consolidated Revenue Fund	(36,726)	237,534
Services provided without charge by other government departments (Note 12)	99,200	92,800
Equity of Canada, end of year	**1,044,450**	**1,002,133**

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

DEPARTMENT OF FOREIGN AFFAIRS AND INTERNATIONAL TRADE

Statement of Cash Flow (Unaudited)

For the year ended March 31
(in thousands of dollars)

	2010	2009 *restated (Notes 2 and 14)*
Operating activities		
Net results of operations	2,403,214	2,371,303
Non-cash items		
Amortization of tangible capital assets	(89,479)	(83,464)
Gain (loss) on disposal of tangible capital assets - Net	(1,568)	11,976
Services provided without charge by other government departments (Note 12)	(99,200)	(92,800)
Variations in Statement of Financial Position:		
Decrease in accounts receivable and advances	(11,306)	(797)
Increase (decrease) in inventory held for re-sale	(194)	1,784
Increase (decrease) in prepaid expenses	(11,339)	37,628
Increase (decrease) in consumable inventory	(1,915)	2,901
Decrease (increase) in accounts payable and accrued liabilities	45,435	(12,469)
Decrease (increase) in vacation pay and compensatory leave	(362)	182
Decrease (increase) in deferred revenue	(89)	266
Increase in employee severance benefits	(15,304)	(9,382)
Cash used by operating activities	**2,217,893**	**2,227,128**
Capital investment activities		
Acquisitions of tangible capital assets	179,640	100,120
Proceeds from disposal of tangible capital assets	(14,476)	(16,505)
Cash used by capital investment activities	**165,164**	**83,615**
Financing Activities		
Net cash provided by Government of Canada	**(2,383,057)**	**(2,310,743)**

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

Notes to the Financial Statements (Unaudited)

1. Authority and objectives

The Department of Foreign Affairs and International Trade (hereinafter called "the Department") operates under the legislation set out in the *Department of Foreign Affairs and International Trade Act*, RSC 1985, c. E-22.

The 2008-2009 *Report on Plans and Priorities* (RPP) was based on the Department's Program Activity Architecture (PAA), as approved by Treasury Board (TB). Financial information in the 2009-2010 *Departmental Performance Report* (DPR) is reported on this basis. The PAA presents the Department's three strategic outcomes stated as end results. Strategic outcomes are supported by a cascading matrix of program activities, sub-activities and sub-sub-activities.

The Department's strategic outcomes can be described in general terms as: (a) providing policy advice and coordination as well as conducting diplomacy and advocacy for the benefit of Canada and Canadians, while reflecting the country's interests and values; (b) assisting Canadians through provision of international commercial, consular and passport services; and (c) managing a network of missions abroad on behalf of the Government of Canada. In short, the strategic outcomes indicate the long-term, enduring benefits for Canadians generated by the Department, as follows:

Strategic Outcome #1: Canada's International Agenda: The international agenda is shaped to Canada's benefit and advantage in accordance with Canadian interests and values.

- *Program Activity #1:* International Policy Advice and Integration - providing strategic direction, intelligence and advice, including integration and coordination of Canada's foreign and international economic policies.

- *Program Activity #2:* Diplomacy and Advocacy - engaging and influencing international players and delivering international programs and diplomacy.

Strategic Outcome #2: International Services for Canadians: Canadians are satisfied with commercial, consular and passport services.

- *Program Activity #3:* International Commerce - managing and delivering commerce services and advice to Canadian business.

- *Program Activity #4:* Consular Affairs - managing and delivering consular services and advice to Canadians.

- *Program Activity #5:* Passport Canada - managing and delivering passport services to Canadians through the use of the Passport Canada Revolving Fund.

Strategic Outcome #3: Canada's International Platform: The Department maintains a mission network of infrastructure and services to enable the Government of Canada to achieve its international priorities.

- *Program Activity #6:* Canada's International Platform: Support at Headquarters - managing and delivering services and infrastructure at headquarters to enable Canada's representation abroad.

- *Program Activity #7:* Canada's International Platform: Support at Missions Abroad - managing and delivering services and infrastructure at missions to enable Canada's representation abroad.

Internal Services are the combination of process- and service-related activities that make possible all of the Department's operations. Overall, Internal Services enable the Department to carry out its mandated functions toward the achievement of its strategic outcomes.

2. Summary of significant accounting policies

The financial statements have been prepared in accordance with Treasury Board accounting policies which are consistent with Canadian generally accepted accounting principles for the public sector. The presentation and results using the stated accounting policies do not result in any significant differences from Canadian generally accepted accounting principles. As a result of changes to Treasury Board accounting policy TBAS 1.2, the 2008-2009 comparative figures have been restated to reflect changes as detailed in Note 14.

Significant accounting policies are as follows:

(a) Parliamentary appropriations: The Department is financed by the Government of Canada through Parliamentary appropriations. Appropriations provided to the Department do not parallel financial reporting according to Canadian generally accepted accounting principles since appropriations are primarily based on cash flow requirements. Consequently, items recognized in the Statement of Operations and the Statement of Financial Position are not necessarily the same as those provided through appropriations from Parliament. Note 3 provides a high-level reconciliation between the basis of reporting.

(b) Consolidation: These financial statements include the accounts of Passport Canada. Revenue and expense transactions and asset and liability accounts between Passport Canada and the Department have been eliminated.

(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 Government is the difference between all cash receipts and all cash disbursements including transactions between departments of the Government.

(d) Amounts due from/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 appropriations to discharge its liabilities.

(e) Revenues: Revenues from regulatory fees are recognized in the accounts based on the services provided in the year.

i. Funds received from external parties for specified purposes are recorded upon receipt as deferred revenue. These revenues are recognized in the period in which the related expenses are incurred.

ii. Funds that have been received are recorded as deferred revenue, provided the Department has an obligation to other parties for the provision of goods, services or the use of assets in the future.

iii. Other revenues are accounted for in the period in which the underlying transaction or event that gave rise to the revenue takes place.

(f) Expenses: Expenses are recorded on the accrual basis:

i. Grants are recognized in the year in which the conditions for payment are met. In the case of grants which do not form part of an existing program, the expense is recognized 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;

ii. Contributions are recognized in the year in which the recipient has met the eligibility criteria or fulfilled the terms of a contractual transfer agreement, provided that the transfer is authorized and a reasonable estimate can be made. Advance payments can be made to recipients in cases where the advance criteria have been met; and when all of the terms of the contractual agreement have not yet been fulfilled;

iii. Vacation pay and compensatory leave are expensed as the benefits accrue to employees under their respective terms of employment;

iv. Services provided without charge by other government departments for accommodation, the employer’s contribution to the health and dental insurance plans, legal services and workers' compensation are recorded as operating expenses at their estimated cost.

(g) Employee future benefits:

i. **Pension benefits:** Eligible Canada-based staff (CBS) 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. Actuarial surpluses or deficiencies are recognized in the financial statements of the Government of Canada, as the Plan's sponsor. Current legislation does not require the Department to make contributions for any actuarial deficiencies. Eligible locally engaged staff (LES) participate in a combination of plans developed and administered based on local law and practice, or in a worldwide pension scheme which is administered at the Department's headquarters.

ii. **Severance benefits:** Employees (CBS and LES) are entitled to severance benefits under labour contracts or conditions of employment. These benefits are accrued as employees render the services necessary to earn them. The CBS obligation relating to the benefits earned by employees is calculated using information derived from the results of the actuarially determined liability for employee severance benefits for the Government as a whole. The LES obligation is established on the basis of operational requirements of the mission, local laws or in practice and is calculated based on the number of eligible employees multiplied by the estimated severance payment based on historical experience.

(h) Cash: Cash for the Department consists of the funds in transit from missions and funds received and not yet deposited, partially offset by credits in imprest accounts. This cash is for the facilitation of operations. All foreign currency accounts are valued at the rate of exchange in effect on March 31.

(i) Accounts receivable: Accounts receivable are stated at amounts expected to be ultimately realized; a provision is made for receivables where recovery is considered uncertain. An allowance for doubtful accounts, resulting in a charge to bad debt, is applied to the accounts receivable balance.

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

(k) Prepaid expenses: Prepaid expenses for the Department consist primarily of rent payments and transfer payments when a recipient requires payment in advance and some of the terms and conditions will be fulfilled in a future fiscal year. Prepaid expenses shall be accounted for as non-financial assets until the related services are rendered, goods are consumed, or terms of the contractual agreement are fulfilled.

(l) Inventories: Inventories consist of parts, material and supplies held for future program delivery and not intended for resale, as well as inventory for sale. All inventories are valued at cost. If they no longer have service potential, they are valued at the lower of cost or net realizable value.

(m) Foreign currency transactions: Transactions involving foreign currencies are translated into Canadian dollar equivalents using rates of exchange in effect at the time of those transactions. Monetary assets and liabilities denominated in a foreign currency are translated into Canadian dollars using the rate of exchange in effect on March 31. Foreign exchange gains and losses have been netted together and the net result is presented in either Expenses or Revenues in the Statement of Operations (and in note 13), depending on if the net result is a loss or gain, respectively.

(n) Tangible capital assets: All tangible capital assets and leasehold improvements having an initial cost of $10,000 or more are recorded at their acquisition cost. The Department does not capitalize intangibles, works of art and historical treasures that have cultural, aesthetic or historical value, and assets located in museum collections.

Amortization of tangible capital assets is done on a straight-line basis over the estimated useful life of the assets. The amortization periods are as follows:

Asset Class	Amortization Period
Buildings	20 to 25 years
Works and infrastructure	30 years
Machinery and equipment	5 to 25 years
Informatics hardware	3 to 15 years
Informatics software	3 to 10 years
Vehicles	5 to 10 years
Leasehold improvements	Term of the lease or 25 years
Assets under construction	Once in service, in accordance with asset type

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

(o) Measurement uncertainty: The preparation of these financial statements in accordance with Treasury Board accounting policies, which are consistent with Canadian generally accepted accounting principles for the public sector, requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses reported in the financial statements. At the time of preparation of these statements, management believes the estimates and assumptions to be reasonable. The most significant items where estimates are used are contingent liabilities, the liability for employee severance benefits and the useful life of tangible capital assets. Actual results could significantly differ from those estimated. Management's estimates are reviewed periodically and, as adjustments become necessary, they are recorded in the financial statements in the year they become known.

3. Parliamentary Appropriations

The Department receives most of its funding through annual Parliamentary appropriations. Items recognized in the Statement of Operations and the Statement of Financial Position in one year may be funded through Parliamentary appropriations 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 purpose of Note 3 is to reconcile the differences from the two basis of reporting. The differences are reconciled in the following tables:

(a) Reconciliation of net cost of operations to current year appropriations used:
(in thousands of dollars)

	2010	**2009** *(restated)*
Net cost of operations	2,403,214	2,371,303
Adjustments for items affecting net cost of operations but not affecting appropriations:		
Add (Less):		
Services provided without charge by other government departments	(99,200)	(92,800)
Amortization of tangible capital assets	(89,479)	(83,464)
Refunds of prior year expenditures	13,985	12,459
Revenue not available for spending	132,918	136,790
Gain (loss) on disposal and writedown of tangible capital assets	(1,568)	11,976
Decrease (increase) in the allowance for bad debt expenses	(3,974)	1,106
Decrease in accounts payable not affecting appropriations	4,700	10,300
Decrease (increase) in vacation pay and compensatory leave	(362)	182
Decrease (increase) in employee severance benefits	(15,304)	(9,382)
Other	5,821	(1,299)
	2,350,751	2,357,171
Adjustments for items not affecting net cost of operations but affecting appropriations		
Add (Less):		
Acquisitions of tangible capital assets	179,640	100,120
Increase (decrease) in prepaid expenses	(11,339)	37,628
Increase (decrease) in inventory held for re-sale	(194)	1,784
Increase (decrease) in consumable inventory	(1,915)	2,901
Current year appropriations used	**2,516,943**	**2,499,604**

Appropriations are provided on cash basis while the net cost of operations is reported on an accrual accounting basis. As a result, the two will always be different. The variance is mainly explained by accruals and revenue not available for spending as they do not affect appropriations, but are included in the net cost of operations. The variance is also explained by various elements classified as Assets in the Statement of Financial Position (i.e. inventory, prepaid expenses and capital assets) that affect appropriations used, but are not included in the net cost of operations.

(b) Appropriations provided and used

(in thousands of dollars)

	Appropriations provided 2010	2009 *(restated)*
Vote 1 - Operating Expenditures	1,502,948	1,372,698
Vote 5 - Capital Expenditures	197,423	182,001
Vote 10 - Grants and Contributions	899,359	817,142
Vote 11b - Passport Canada - Capital expenditures	10,000	13,516
Vote 13c - Passport Canada - Operating expenditures	-	12,888
Statutory	166,074	179,441
	2,775,804	2,577,686
Less:		
Appropriations available for future years	48,367	52,955
Lapsed appropriations: Operating (1)	128,609	11,171
Lapsed appropriations: Capital	9,109	9,119
Lapsed appropriations: Grants and Contributions	72,610	1,145
Lapsed appropriations: Passport Canada Capital expenditures	166	3,692
	258,861	78,082
Total appropriations used	**2,516,943**	**2,499,604**

Parliamentary appropriations provided (i.e. appropriations available from prior years for Passport Canada, proceeds from the disposal of surplus Crown assets, and funds provided through the Main Estimates and Supplementary Estimates in the current year) are reconciled to Parliamentary appropriations used in the current year and agree with amounts shown as "Available for Use and Authorities Used" as reflected in the "Summary of Source and Disposition of Authorities" in Volume II of the Public Accounts.

	2010
(1) Lapsed appropriations: Operating	**128,609**
NAFTA Chapter 11 Trade litigation settlements (Frozen Allotment)	(50,724)
Other Frozen Allotments	(18,812)
Special Purpose Allotments	(16,962)
Other directed lapses (Currency fluctuations and Softwood Lumber litigation)	(12,270)
Adjusted Public Accounts Operating Budget Lapse	**29,841**
Funding from partner departments for their operations abroad	(6,424)
Re-spendable revenues from the International Youth Exchange Program	(1,997)
The Department's net lapse of its operating appropriation is:	**21,420**

4. Accounts Receivable and Advances

The following table presents details of accounts receivable and advances *(in thousands of dollars)* :

	2010	2009 *(restated)*
Receivables from external parties	16,108	14,875
Other advances	32,995	46,076
Employee advances	21,515	18,734
Cash in transit	7,596	5,710
Receivables from other government departments and agencies	11,182	11,333
Sub-total	89,396	96,728
Allowance for doubtful accounts on external receivables and advances	(13,803)	(9,829)
Total receivables and advances, net of allowances	**75,593**	**86,899**

5. Inventory

The following table presents details of the inventory measured at the average cost method:

	2010	2009
		(in thousands of dollars)
Materials	4,956	6,855
Passport inventory material for resale	5,179	5,373
Other	54	70
Total inventory	**10,189**	**12,298**

The cost of consumed inventory recognized as an expense in the Statement of Operations is $23,313,519 in 2009-2010 ($19,320,127 in 2008-2009).

6. Tangible Capital Assets

(in thousands of dollars)

	Cost				Accumulated amortization					
Capital Asset Class	**Opening Balance** *(restated)*	**Acquisitions**	**Disposals & Write-offs**	**Closing Balance**	**Opening Balance** *(restated)*	**Amortization**	**Disposals, Write-offs & Adjust-ments**	**Closing Balance**	**2010 Net Book Value**	**2009 Net Book Value** *(restated)*
Land	224,374	5,132	(1,390)	228,116	-	-	-	-	228,116	224,374
Buildings	1,147,591	78,392	(3,101)	1,222,882	576,781	55,553	(1,378)	630,956	591,926	570,810
Works and infrastructure	1,452	-	-	1,452	84	50	-	134	1,318	1,368
Machinery and equipment	77,830	39,045	(3,917)	112,958	57,055	10,781	1,059	68,895	44,063	20,775
Informatic hardware	62,578	341	(4,002)	58,917	50,533	5,547	(6,708)	49,372	9,545	12,045
Vehicles	42,328	2,925	(5,277)	39,976	22,138	4,902	(4,493)	22,547	17,429	20,190
Leasehold Improvements	176,582	18,283	(162)	194,703	90,268	12,646	492	103,406	91,297	86,314
Assets under construction	158,727	35,522	(9,223)	185,026	-	-	-	-	185,026	158,727
Total	**1,891,462**	**179,640**	**(27,072)**	**2,044,030**	**796,859**	**89,479**	**(11,028)**	**875,310**	**1,168,720**	**1,094,603**

Amortization expense for the year ended March 31, 2010 is $89,478,773 (2009 - $83,463,608).

Disposals of assets under construction represent assets that were put into use in the year and have been transferred to the other capital asset classes as applicable.

7. Accounts Payable and accrued liabilities

The following table presents the details of the Department's accounts payable and accrued liabilities *(in thousands of dollars)* :

	2010	**2009** *(restated)*
Accounts payable to other government departments and agencies	69,327	43,357
Accounts payable to external parties	139,326	250,960
	208,653	294,317
Accrued liabilities	63,465	23,236
	272,118	**317,553**

8. Deferred Revenue

Deferred revenue is comprised of monies received as prepayment for services to be performed by the Department on behalf of third parties and deposits and unclaimed cheques for passport fees. Details of the transactions related to this account are as follows *(in thousands of dollars)* :

	2010	**2009**
Opening Balance	107	373
Funds Received	109	-
Revenue Recognized	(20)	(266)
Closing Balance	196	107

9. Employee Benefits

(a) Pension benefits: The Department's CBS participate in the Public Service Pension Plan, which is sponsored and administered by the Government of Canada. Pension benefits accrue up to a maximum period 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/Quebec Pension Plans benefits and are indexed to inflation.

Both the employees and the Department contribute to the cost of the Plan. The 2009-2010 Departmental expense amounts to $86,945,252 ($76,138,004 in 2008-2009), which represents approximately 1.9 times (2.0 in 2008-2009) the contributions by employees.

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

Locally engaged staff participate in a combination of pension plans developed and administered based on local law and practice, or in the worldwide pension scheme which is administered at the Department's headquarters. The Government of Canada is the sponsor of all plans which may be defined contribution, defined benefit and either prefunded or pay-as-you go. The 2009-2010 employer contributions amount to $19,412,613 ($17,236,287 in 2008-2009).

(b) Severance benefits: The Department provides severance benefits to its employees based on eligibility, years of service and final salary. The severance benefit liability for Canada-based staff is based on a percentage provided by Treasury Board, applied to the eligible payroll as at March 31. Treasury Board determines the percentage based on an actuarial evaluation of the future liability for the entire government's eligible employees. The rate as at March 31, 2010 was 27.36% (26.92% as at March 31, 2009). For locally engaged staff, the liability is based on historical data whereby an average severance payment per locally engaged staff is calculated. This cost is multiplied by the total number of eligible locally engaged staff as at March 31, 2010 and a layoff/payout rate of 65%.

These severance benefits are not pre-funded. Benefits will be paid from future appropriations. Information about the severance benefits, measured as at March 31, is as follows:

	2010	2009
		(in thousands of dollars)
Accrued benefit obligation, beginning of year	119,774	110,392
Expense or adjustment for the year	29,207	25,798
Benefits paid during the year	(13,903)	(16,416)
Accrued benefit obligation, end of year	135,078	119,774

The Canada-based staff severance benefits liability amounts to $52 million, whereas the locally engaged staff liability is $83 million.

10. Contingent Liabilities

Claims have been made against the Department in the normal course of operations. These claims include items with pleading amounts and other for which no amount is specified. Based on the Department's assessment, legal proceedings for claims estimated at $18,383,029,488 ($15,729,334,907 as at March 31, 2009) were pending at March 31, 2010. Pending claims and litigation legal proceedings in which the outcome is not determinable totaled approximately $6,335,989,084 as at March 31, 2010 ($14,668,602,897 as at March 31, 2009). Of this amount, $501,111,600 ($765,837,540 as at March 31, 2009) relates to litigation where another Government department has been named as a co-defendant. Some of these potential liabilities may translate into actual liabilities as a result of court decisions or out-of-court settlements. To the extent to which future legal decisions are assessed as unfavourable, and a reasonable estimate of the loss can be made, estimated liabilities are accrued and an expense is recorded in the financial statements. An accrual of $3,000,000 ($3,153,010 as at March 31, 2009) has been recorded in the Statement of Financial Position.

11. 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. These obligations include long-term rental agreements for chancery offices, and transfer payments. Significant contractual obligations that can be reasonably estimated are summarized as follows:

(in thousands of dollars)	**2011**	**2012**	**2013**	**2014**	**2015**	**2016 and there-after**	**Total**
Purchase of passport materials	15,000	6,000	-	-	-	-	21,000
Lease of office space in Gatineau Quebec	6,000	6,000	6,000	5,000	5,000	3,000	31,000
Lease of office and parking space in Moscow	4,000	4,200	4,300	4,400	4,600	163,500	185,000
Chancery lease Consul General in New York	3,200	800	-	-	-	-	4,000
Chancery lease Permanent Mission of Canada to the United Nations in New York	1,500	1,600	1,600	1,600	1,600	6,200	14,100
Chancery lease in Chicago	579	595	611	629	646	4,260	7,320
Transfer payments for the purpose of assistance to countries of the former Soviet Union	17,051	-	-	-	-	-	17,051
Transfer payments for dismantlement of nuclear submarines	13,850	1,927	-	-	-	-	15,777
Transfer payments to the United Nations Office on Drugs and Crime	10,014	-	-	-	-	-	10,014
Total	**71,194**	**21,122**	**12,511**	**11,629**	**11,846**	**176,960**	**305,262**

12. Related party transactions

The Department is related as a result of common ownership to all Government of Canada departments, agencies, and Crown corporations. The Department enters into transactions with these entities in the normal course of business and on normal trade terms. Also, during the year, the Department received services which were obtained without charge from other Government departments as presented in part (a).

(a) Services provided without charge by other government departments:

During the year, the Department received services without charge from other government departments (accommodation, legal fees, the employer's contribution to the health and dental insurance plans and workers' compensation coverage). These services without charge have been recognized in the Department's Statement of Operations *(in thousands of dollars)* as follows:

	2010	**2009**
Accommodation	30,100	31,000
Employer's contribution to the health and dental insurance plans	67,300	60,000
Legal services	1,400	1,400
Workers compensation charges	400	400
Total	**99,200**	**92,800**

(b) Payables and receivables outstanding at year end with related parties *(in thousands of dollars)* :

	2010	**2009** *(restated)*
Receivables from other government departments and agencies	11,182	11,333
Payables to other government departments and agencies	69,327	43,357

(c) Administration of programs on behalf of other government departments:

The Department has a number of memorandums of understanding (MOUs) with partner departments for the administration of unique, in-year programs delivered abroad. The Department administered approximately $179,000,000 ($224,000,000 in 2008-2009) for operational and program activities on behalf of our partner departments. The Department also collected approximately $227,000,000 ($267,000,000 in 2008-2009) in revenues on behalf of our partner departments. These expenses and the revenues remitted to the partner departments are reflected in the financial statements of those departments and are not recorded in these financial statements.

d) Management and administration of Common Services:

In accordance with the Treasury Board Common Service Policy (February 1997), and the Department of Foreign Affairs and International Trade Act (1985), the Department has the mandate to manage the procurement of goods, services and real property at missions abroad. These common services are mandatory for departments to use when required to support Canada's diplomatic and consular missions abroad.

MOUs are in force to cover the roles and responsibilities of DFAIT, partner departments, Crown corporations and non-federal organizations. These MOUs outline the principles and operational guidelines for the management and administration of the common services regime, the specifications with respect to services and service delivery standards, the funding of common services, the responsibilities of parties, and dispute resolution.

i. Common Services provided to other government departments

To facilitate the efficient and cost effective delivery of common services in support of the international programs of all federal departments and agencies of the Government of Canada, the Interdepartmental Memorandum of Understanding on Operations and Support at Missions Abroad (the Generic MOU) was signed in April 2004.

In the fiscal year ended March 31, 2010, expenses related to changes made to partner departments' representation abroad are reflected in the financial statements of the Department. Appropriations for the Department are adjusted via the Annual Reference Level Updates (ARLU) and the fiscal year's Supplementary Estimates.

This activity amounted to approximately $8,570,000 ($24,854,000 in 2008-2009) of permanent funding handled through the ARLU and $17,193,000 ($27,018,000 in 2008-2009) of in-year funding received via Supplementary Estimates.

ii. Common Services provided to co-locators

To facilitate the efficient and cost effective delivery of common services in support of the international programs of co-locators, individual MOUs are signed with each co-locator. Co-locators comprise all non-departmental entities, and include Crown corporations, provincial or territorial governments, foreign governments, and non-governmental organizations co-located at DFAIT's missions abroad.

In the fiscal year ended March 31, 2010, this activity amounted to approximately $15,565,000 ($9,065,000 in 2008-2009) of in-year funds received via the Specified Purpose Accounts and Net-Voted Revenues.

This activity represents the recovery of costs incurred, where a portion can be re-spent under the TB Decision Letter on Net-Voting.

DEPARTMENT OF FOREIGN AFFAIRS AND INTERNATIONAL TRADE

Notes to the Financial Statements (Unaudited)

13. Segmented Information

Presentation by segment is based on the Department's program activity architecture. The presentation by segment is based on the same accounting policies as described in the Summary of significant accounting policies in note 2. The following table presents the expenses incurred and revenues generated for the main program activities, by major object of expenses and by major type of revenues. The segment results for the period are as follows *(in thousands of dollars)* :

	Diplomacy and Advocacy	**Support at Missions Abroad**	**Support at Headquarters**	**Passport Canada Revolving Fund**	**International Commerce**	**International Policy Advice and Integration**	**Internal Services**	**Consular Affairs**	**2010 Total**	**2009 Total** *(restated)*
Transfer payments										
Other countries and international organizations	435,964	-	-	-	-	3,617	-	-	439,581	399,488
Non-profit organizations	338,520	-	25	-	4,521	23,331	-	-	366,397	356,654
Other Transfers to any Other Sector	15,096	-	-	-	-	83	-	-	15,179	5,597
Other levels of government in Canada	12,665	-	-	-	-	-	-	-	12,665	11,404
Industry	-	-	-	-	1,546	-	-	-	1,546	1,599
International Development Assistance	-	-	-	-	758	-	-	-	758	-
Individuals	-	-	118	-	-	-	-	-	118	129
Total Transfer payments	**802,245**	**-**	**143**	**-**	**6,825**	**27,031**	**-**	**-**	**836,244**	**774,871**
Operating expenses										
Salaries and employee benefits	208,277	259,110	104,450	180,105	173,810	102,609	75,247	38,294	1,141,902	1,084,611
Professional and special services	33,537	86,855	44,843	26,763	19,289	6,315	5,257	4,238	227,097	249,253
Rentals	43,189	79,876	43,386	15,173	20,636	7,065	2,945	4,061	216,331	207,205
Transportation	23,767	48,134	18,267	30,677	1,042	15,749	5,165	12,583	155,384	156,597
Amortization	239	5,501	65,929	9,758	2,312	638	5,022	80	89,479	83,464
Acquisition of machinery and equipment, including parts and consumables	3,901	9,178	813	26,978	2,183	640	1,168	456	45,317	77,526
Utilities, materials and supplies	7,860	19,333	10,273	230	4,691	1,352	619	877	45,235	46,566
Repairs and maintenance	4,068	10,554	11,388	5,887	2,621	745	805	464	36,532	41,132
Telecommunications	5,642	13,877	6,913	3,753	3,359	967	394	630	35,535	38,660
Information	2,516	6,202	3,040	3,726	1,499	431	170	282	17,866	33,246
Foreign exchange loss (gain) - Net	(530)	6,918	(664)	(60)	(311)	(92)	(39)	(59)	5,163	823
Bad debt	738	1,198	466	1	759	431	927	172	4,692	1,021
Other	537	1,134	629	74	313	91	35	59	2,872	1,674
Loss on disposal of tangible capital assets - Net	3	66	795	606	28	8	61	1	1,568	-
Total operating expenses	**333,744**	**547,936**	**310,528**	**303,671**	**232,231**	**136,949**	**97,776**	**62,138**	**2,024,973**	**2,021,778**
Total expenses	**1,135,989**	**547,936**	**310,671**	**303,671**	**239,056**	**163,980**	**97,776**	**62,138**	**2,861,217**	**2,796,649**
Revenues										
Sale of Goods and Services	13,697	27,723	12,584	290,556	3,186	889	4,718	102,012	455,365	408,918
Other non-tax revenue	6	15	1,661	132	4	1	412	1	2,232	3,876
Interest on non-tax revenue	54	129	63	-	31	9	114	6	406	576
Gain on disposal of tangible capital assets - Net	-	-	-	-	-	-	-	-	-	11,976
Total revenues	**13,757**	**27,867**	**14,308**	**290,688**	**3,221**	**899**	**5,244**	**102,019**	**458,003**	**425,346**
Net results of operations	**1,122,232**	**520,069**	**296,363**	**12,983**	**235,835**	**163,081**	**92,532**	**(39,881)**	**2,403,214**	**2,371,303**

14. Adoption of new Treasury Board accounting policies

As indicated in Note 2, the Department adopted the revised Treasury Board accounting policy TBAS 1.2: Departmental and Agency Financial Statements effective for the 2009-2010 fiscal year. As a result, the 2008-2009 comparatives figures were restated. The major change in the accounting policies of the Department required by the adoption of the revised TBAS 1.2 is the recording of amounts due from the Consolidated Revenue Fund as an asset on the Statement of Financial Position and the removal of the investments in Crown corporations (Canadian Commercial Corporation, Export Development Canada, International Development Research Centre). In addition, as per a recommendation from the Office of the Comptroller General, the Department's financial statements no longer include the Canada Account. As such, the 2008-2009 figures were restated to reflect only DFAIT and Passport Canada's figures.

The adoption of the new Treasury Board accounting policies have been accounted for retroactively with the following impact on the comparative results for 2008-2009 *(in thousands of dollars)* :

	2009 As previously stated	Effect of changes	2009 *(restated)*
Statement of Financial Position			
Assets			
Due from the Consolidated Revenue Fund	-	237,534	237,534
Temporary Investments	3,141	(3,141)	-
Accounts receivable and advances	219,496	(132,597)	86,899
Inventory held for re-sale	5,373	-	5,373
Investments in Crown corporations	1,341,200	(1,341,200)	-
Canada Account loans	2,066,549	(2,066,549)	-
Prepaid expenses	54,224	(715)	53,509
Consumable inventory	6,925	-	6,925
Tangible capital assets	1,176,891	(82,288)	1,094,603
Total Assets	**4,873,799**	**(3,388,956)**	**1,484,843**
Liabilities			
Accounts payable and accrued liabilities	359,709	(42,156)	317,553
Vacation pay and compensatory leave	45,276	-	45,276
Deferred revenue	107	-	107
Employee severance benefits	119,774	-	119,774
Total Liabilities	**524,866**	**(42,156)**	**482,710**
Equity of Canada	**4,348,933**	**(3,346,800)**	**1,002,133**
Total Liabilities and Equity	**4,873,799**	**(3,388,956)**	**1,484,843**

	2009 As previously stated	Effect of changes	2009 *(restated)*
Statement of Operations			
Expenses			
Diplomacy and Advocacy	1,096,473	(36,506)	1,059,967
Canada's International Platform: Support at Missions Abroad	592,342	2,745	595,087
Canada's International Platform: Support at Headquarters	325,633	(11,749)	313,884
Passport Canada Revolving Fund	305,770	35	305,805
International Commerce	265,276	(15,020)	250,256
International Policy Advice and Integration	154,749	(43,663)	111,086
Internal Services	-	104,925	104,925
Consular Affairs	55,583	56	55,639
Sub-total expenses	**2,795,826**	**823**	**2,796,649**
Canada Account expenses	333,104	(333,104)	-
Total Expenses	**3,128,930**	**(332,281)**	**2,796,649**
Revenues			
Passport Canada Revolving Fund	263,135	(1,163)	261,972
Consular Affairs	94,417	(1,040)	93,377
Canada's International Platform: Support at Missions Abroad	23,987	(14,515)	9,472
Canada's International Platform: Support at Headquarters	20,610	(3,572)	17,038
Diplomacy and Advocacy	13,551	(6,187)	7,364
Internal Services	-	35,058	35,058
International Commerce	5,960	(5,003)	957
International Policy Advice and Integration	2,863	(2,755)	108
Sub-total revenues	**424,523**	**823**	**425,346**
Canada Account revenues	783,615	(783,615)	-
Total Revenues	**1,208,138**	**(782,792)**	**425,346**
Net results of operations	**(1,920,792)**	**(450,511)**	**(2,371,303)**

	2009 As previously stated	Effect of changes	2009 *(restated)*
Statement of Equity of Canada			
Equity of Canada, beginning of year	3,530,945	(2,798,586)	732,359
Net results of operations	(1,920,792)	(450,511)	(2,371,303)
Net cash provided by Government of Canada	2,645,980	(335,237)	2,310,743
Change in due from the Consolidated Revenue Fund	-	237,534	237,534
Services provided without charges by other government departments	92,800	-	92,800
Equity of Canada, end of year	**4,348,933**	**(3,346,800)**	**1,002,133**

15. Comparative information

Comparative figures have been reclassified to conform to the current year's presentation. In 2009-2010, the Department did not have to reallocate the Internal Services revenues and expenses to all the other Program Activity Architecture. In addition, transportation and telecommunications expenses were disclosed separately this fiscal year. To review the 2008-2009 financial statements, visit http://www.international.gc.ca/finance/statements-2009-etats/table_of_contents-table_des_matieres.aspx.

DEPARTMENT OF FOREIGN AFFAIRS AND INTERNATIONAL TRADE

Annex to the

Statement of Management Responsibility Including Internal Control over Financial Reporting

Fiscal Year 2009-10

1. Introduction

This document is an annex to the Department of Foreign Affairs and International Trade's (DFAIT) *Statement of Management Responsibility Including Internal Control Over Financial Reporting* for the fiscal-year 2009-2010. As required by the new Treasury Board *Policy on Internal Control* (PIC), effective April 1st 2009, this document provides summary information on the measures taken by DFAIT to maintain an effective system of internal control over financial reporting (ICFR). In particular, it provides summary information on the assessments conducted by DFAIT as at March 31, 2010, including progress, results and related action plans along with some financial highlights pertinent to understanding the control environment unique to the Department.

It is important to note that the system of ICFR is not designed to eliminate every possible risk, rather to mitigate risk to a reasonable level with controls that are balanced with, and proportionate to, the risks they aim to mitigate. The maintenance of an effective system of ICFR is an on-going process designed to identify, assess effectiveness and adjust as required, key risks and associated key controls as well as to monitor its performance in support of continuous improvement. As a result, the scope, pace and status of those departmental assessments of the effectiveness of their system of ICFR will vary from one organization to another based on risks and taking into account their unique circumstances.

1.1 Authority, Mandate and Program Activities

The strategic direction given to the Department's mandate and role comes from the three strategic outcomes as identified in the Department's Program Activity Architecture:

- **Canada's International Agenda:** The international agenda is shaped to Canada's benefit and advantage in accordance with Canadian interests and values;
- **International Services for Canadians:** Canadians are satisfied with commercial, consular and passport services; and
- **Canada's International Platform:** The Department of Foreign Affairs and International Trade maintains a mission network of infrastructure and services to enable the Government of Canada to achieve its international priorities.

In accordance with the Department of Foreign Affairs and International Trade Act, the Department has the mandate to manage and direct Canada's diplomatic and consular missions. This includes the supervision of the official activities of the various departments and agencies of the Government of Canada represented abroad.

Detailed information on DFAIT's authority, mandate and program activities can be found in the *Departmental Performance Report* (http://www.tbs-sct.gc.ca/dpr-rmr/2008-2009/index-eng.asp?acr=1478) and the *Report on Plans and Priorities* (http://intranet.dfait-maeci.gc.ca/department/PDD/pdf/2009-2010ext-eng.pdf).

1.2 Financial highlights

The financial statements (unaudited) of DFAIT for fiscal-year 2009-2010 can be found at http://www.international.gc.ca/finance/statements-2010-etats/table_of_contents-table_des_matieres.aspx. Information can also be found in the Public Accounts of Canada.

- Total expenses were $2.9B. Salaries and wages comprise the majority (38% or $1.1B) followed by transfer payments (29% or $836M).
- Total revenues were $458M, related primarily to the sale of goods and services (99%, or $455M).
- Tangible capital assets represent 79% of departmental total assets ($1.2B). Accounts payable and accrued liabilities comprise over 60% of total liabilities ($453M).
- DFAIT's operations are conducted at the National Headquarters in the National Capital Region, in 18 offices across Canada and in more than 170 missions abroad. Support at missions abroad represent 27% of the Department's operating expenses. Financial reporting and financial operations (domestic and international) are centralized under the Corporate Accounting, Finance, Policy and Financial Systems Bureau in the National Capital Region.
- DFAIT utilizes IMS, a SAP-based software, as its primary financial system, with feeder systems providing source information to IMS.
- Passport Canada is a separate operating agency whose financial results are consolidated in the Department's financial statements. Passport Canada's financial statements are audited by an independent external auditor.

1.3 Service arrangements relevant to financial statements

DFAIT relies on other government departments for the processing of many of the transactions that are recorded in its financial statements:

- PWGSC centrally administers the payment of Canada based salaries and the procurement of goods and services as well as the provision of accommodations in Canada.
- Treasury Board Secretariat provides the Department with information used to calculate various accruals and allowances, such as the accrued severance liability for Canada based staff.
- The Department has a number of memorandums of understanding (MOUs) with partner departments for the administration of programs delivered abroad. DFAIT also has the mandate to manage the procurement of goods, services and real property at missions abroad, and pay the salary of locally engaged staff abroad that deliver DFAIT and partner programs.

1.4 Material changes in fiscal-year 2009-2010

A significant change in the presentation of the Department's financial statements occurred in 2009-10. For the year ended March 31, 2010 the Canada Account will no longer be reflected in DFAIT's departmental financial statements.

During the year, the Department adopted the revised Treasury Board accounting policy TBAS 1.2 which is effective for the Department for the 2009-2010 fiscal year. The major change in the accounting policies of the Department required by the adoption of the revised TBAS 1.2 is the recording of amounts due from the Consolidated Revenue Fund as an asset on the Statement of Financial Position.

In April 2010, Gordon White replaced Bruce Hirst as the Department's Chief Financial Officer. In June 2010, Morris Rosenberg replaced Len Edwards as the Deputy Minister of Foreign Affairs.

2. DFAIT's control environment relevant to ICFR

DFAIT recognizes the importance of setting the tone from the top to help ensure that staff at all levels understand their roles in maintaining effective systems of internal control and are well equipped to exercise these responsibilities effectively. The objective of DFAIT's control environment is to help ensure risks are managed appropriately and to enable continuous improvement at a manageable cost.

2.1 Key Positions, Roles and Responsibilities

Deputy Head - As the Accounting Officer for DFAIT, the Deputy Minister of Foreign Affairs is the Deputy Head of the Department and assumes overall responsibility and leadership for the stewardship, management and oversight of departmental resources, as well for the measures taken to maintain an effective system of internal control. In this role, the Deputy Head chairs the Executive Council.

Deputy Minister of International Trade and Associate Deputy Minister of Foreign Affairs in accordance with section 8.1 of the Department of Foreign Affairs and International Trade Act "…exercise and perform such powers, duties and functions as deputies of the Minister and otherwise as the Minister may specify".

Chief Financial Officer - DFAIT's CFO reports directly to the Deputy Head and provides leadership for the coordination, coherence and focus on the design and maintenance of an effective and integrated system of ICFR, including its annual assessment. The CFO is part of the Executive Council, providing functional leadership and a focus on financial management.

Senior Departmental Managers – DFAIT's senior departmental managers in charge of program delivery are responsible for maintaining and reviewing the effectiveness of the system of ICFR falling within their mandate.

Heads of Mission (HOMs) - DFAIT's Heads of Mission are responsible for the management and direction of his/her mission's activities including maintaining and reviewing the effectiveness of the system of ICFR falling within their area of accreditation.

Chief Audit Executive (CAE) - DFAIT's CAE reports directly to the Deputy Head and provides assurance through periodic internal audits which are instrumental to the maintenance of an effective system of ICFR.

Departmental Audit Committee (DAC) - The DAC is an advisory committee that provides objective views on the Department's risk management, control and accountability processes. It is comprised of 4 external members, including the Chair. As stated in the Policy on Internal Control, the DAC will be engaged, as applicable, on the Department's risk-based assessment plans and associated results related to the effectiveness of the departmental system of internal control over financial reporting.

Executive Council – reviews and approves the recommendations of all Committees and Boards, but specifically those that have an impact on the financial management of the Department.

2.2 Key Organization-Wide Controls in DFAIT

DFAIT's control environment also includes a series of measures to equip its staff to manage risks well through raising awareness, providing appropriate knowledge and tools as well as developing skills.

Key measures include:

- Resource Management Committee, Transformation Management Committee, Missions Board, Core Services Board, and Committees on Mission Management;
- A Values and Ethics Division led by the Inspector General, and reporting directly to the Deputy Head;
- DFAIT's Conduct Abroad Code and the Public Service Values and Ethics Code;

- Regularly updated delegated authorities matrix;
- Preparation of a Corporate Risk Profile which helps the Department establish a direction for managing corporate risks by presenting a snapshot of DFAIT's risk status;
- A requirement for accounting designations in key financial management positions;
- Training program and communications in core areas of financial management;
- Departmental policies tailored to DFAIT's control environment;
- A dedicated Quality Control and Monitoring function for the Department's financial reporting;
- IT processing systems to achieve greater security, integrity, efficiency and effectiveness;
- A risk-based internal audit plan, with annual coverage of governance and risk management; and
- Mission inspections performed annually by the Office of the Inspector General.

3. Assessment of DFAIT's system of ICFR

3.1 Assessment baseline

In 2004, the Government of Canada commenced an initiative to determine the ability of departments to sustain control-based audits of their financial statements, thus placing reliance on well functioning internal controls. As a result, in 2007, DFAIT underwent an audit readiness assessment conducted by an independent external consulting firm. The assessment provided the baseline for DFAIT to move forward in both preparing for a controls-reliant audit of its financial statements, and to meet the requirements of the Policy on Internal Control, in its first year of implementation.

Whether it is to support control-based audits, or meet the requirements of the *Policy on Internal Control*, in both cases, departments need be able to maintain an effective system of ICFR with the objectives to provide reasonable assurance that transactions are: a) appropriately authorized, b) financial records are properly maintained, c) assets are safeguarded, and d) applicable laws, regulations and policies are complied with.

Going forward, DFAIT will assess the design effectiveness and the operating effectiveness of its system of ICFR and ultimately will need to have in place an on-going monitoring program to sustain and continuously improve the departmental system of ICFR.

Design effectiveness means to ensure that key control points are identified, documented, in place and that they are aligned with the risks they aim to mitigate and that any remediation is addressed. This includes the mapping of key processes and IT systems to the main accounts by location, as applicable.

Operating effectiveness means that key controls have been tested over a defined period and that any remediation is addressed.

On-going monitoring program means that a systematic integrated approach to monitoring is in place, including periodic risk-based assessments and timely remediation.

3.2 Scope and approach to DFAIT's assessment

In proceeding with its preparations for a controls-based audit, DFAIT has taken measures to assess its system of ICFR starting with its financial statements and a study of material accounts. The methodology used to perform the readiness assessment was designed to identify key improvement areas in the system of internal control over financial reporting and to develop an action plan to prepare the Department for an audit of its financial statements performed under Canadian generally accepted auditing standards. The readiness assessment focused on significant classes of transactions, account balances and disclosures, and the business processes that support them. Significance was assessed relative to the qualitative and quantitative measures of materiality specified by departmental management.

All "in-scope" accounts and locations identified were linked to the related financial processes that generate the financial account information. The results of this exercise were to identify the following key priority areas of DFAIT's system of ICFR that need to be addressed in order for DFAIT to sustain a control-based audit:

Foundational elements:

- Entity level controls
- Information technology (IT) general controls

Business process elements

- Financial reporting (National Headquarters)
- Capital assets and asset management (National Headquarters & Missions)
- Payroll (National Headquarters & Missions)
- Procurement (National Headquarters & Missions)
- Revenues (National Headquarters & Missions)
- Grants and contributions (National Headquarters)

The completion of these priority areas will also contribute to meeting the requirements of the PIC.

In 2010, DFAIT documented its entity level controls and IT general controls (IT infrastructure), which form the foundation of its system of ICFR. A PIC implementation plan is being developed by DFAIT, which will include, as one element, the documentation of key risk and control points for significant business processes.

DFAIT has completed tests of the design of the IT general controls. The PIC implementation plan will include design tests of entity-level controls and the identification of key process controls, as well as tests of the operating effectiveness of those key controls.

4. DFAIT's Assessment Results

As the result of the assessment approach described above, DFAIT developed an inventory of all key IT general control points by main IT system, and an understanding of entity-level controls.

As at year end 2009-10, DFAIT completed all testing of design effectiveness related to the IT general controls for the Department's key information systems. The Department has also documented its key Entity Level Controls.

4.1 Design effectiveness of key controls

DFAIT's key business processes have been developed to ensure appropriate internal controls are in place. These controls provide assurance that the financial information is complete, reliable, relevant, timely, and that all authorities and regulations are respected, in particular, Sections 33 and 34 of the *Financial*

Administration Act (FAA). DFAIT's PIC implementation plan will include tests of the design effectiveness of entity-level controls, as well as key process controls in 2010-11 and 2011-12.

As part of the Department's audit readiness preparations, high-level design effectiveness matters were considered for process controls. Based upon this, DFAIT identified the following significant adjustments required:

Documentation:

- greater consistency in the quality, reliability and availability of documentation of controls and procedures.
- further documentation in some areas, including the rationale for requiring specific accounting treatments under the departmental Accounting for Capital Assets Policy.

Data reconciliation and integrity:

- greater consistency of reconciliations and source data;
- strengthened consistency of vendors listed in the Department's vendor master file, to facilitate the generation of control reports which form part of the Department's ICFR related to purchases and payables;
- improved verification of the existence of individual capital assets across the Department; and
- analysis of the capital asset recording threshold, including the application of standards for capitalization of software development projects and related eligible expenses.

Monitoring and quality assurance of financial statement preparation:

- enhanced capacity of the financial reporting function to provide for an improved challenge function and quality assurance over the trial balance or amounts and disclosures in the financial statements.

When completing IT General Controls design effectiveness testing, DFAIT completed all documentation (including its validation by process owners) and verified whether the general computer controls are in place and correspond to actual practices. Design effectiveness also included ensuring appropriate alignment of each key control with risks. Based upon this, it was identified that the following significant adjustments were required: strengthen controls related to change management procedures, security settings at various technology layers, access controls, segregation of duties between the development and production environments, and backup and recovery procedures.

4.2 Operating effectiveness of key controls

DFAIT has not yet commenced testing of the operating effectiveness of key controls, however there are compensating controls in place which provide a level of assurance that controls are effective. These compensating controls include:

- During 2009-10, Internal Audit assessed the departmental governance structures, systems governance, and the Department's risk management process. In addition, Internal Audit assessed controls related to expenditures and IT asset management.
- Ongoing quality assurance on financial accounts assessed the operating effectiveness of certain controls related to the financial reporting process.
- Verification of the Department's compliance with sections 33 and 34 of the FAA. has been examined by Internal Audit and this process was found to be working effectively.

- The application approval process for Grants and Contributions is established in each program's accountability risk framework. The programs are subject to evaluations and internal audits. In addition, there are also recipient audits conducted by the Inspector General.

More extensive tests of the operating effectiveness of IT general controls, and process controls will be required for DFAIT to meet the requirements of the PIC. Once tests of the design effectiveness of key process controls have been completed by the Department, tests of operating effectiveness will need to be linked to specific key controls by business process.

5. DFAIT's forward plan

5.1 Progress as of March 2010

DFAIT has completed work to address the following necessary adjustments:

- Established the Internal Control section to develop the Department's formal assessment plan guiding the Department's implementation activities over time and on a risk and priority basis;
- Completion of the documentation and assessment of the IT general controls for National Headquarters for information systems impacting the Department's financial reporting;
- The implementation of a quality assurance process on financial accounts;
- Improved capacity of the financial reporting function through the addition of staff resources; and
- The introduction of a capital asset certification process to provide evidence towards the accuracy of the Department's accounting for capital asset items.

DFAIT has substantially advanced work to address the following necessary adjustments:

- Remediation of findings from the 2009-2010 review of IT general controls relative to; control access to IT programs and data, IT program changes, and backup and recovery of data.

DFAIT has commenced or partially completed work to address the following necessary adjustments:

- Enhancements to the process to maintain vendor master file data; and
- DFAIT has commenced a financial statement risk assessment to identify and address risks of a material misstatement related to significant financial statement components and underlying business processes.

5.2 Action plan

To March 31, 2010, DFAIT has focused on the core elements of the Department's system of internal control over financial reporting – entity level controls, and information technology general controls.

Entity level controls are the foundation for the Department's control environment. Fundamental weaknesses in entity level controls will significantly reduce the effectiveness of information technology controls, and key process controls.

Information technology general controls help ensure that the IT systems of the Department are operating effectively and as intended. Most importantly, they provide comfort concerning the integrity of the data within the information systems, and system reports.

Moving forward, the Department's action plan is focused on the documentation and assessment of key control procedures. ***Key control procedures*** are built upon the entity level and IT general controls, and help ensure that the objectives of a process are being met.

By end of 2010-11, DFAIT plans to:

- Remediate the identified design gaps in the ITGC process;
- Assess the design effectiveness of the entity level controls and identify gaps for remediation;
- Complete the identification of business processes to be documented through a formal planning and prioritizing exercise;
- Develop an ICFR framework that will provide a standard approach for documenting processes and related controls, and evaluating design of process controls and entity level controls;
- Commence the documentation of significant business processes. The business processes to be documented will be the payroll cycle and the procure-to-pay cycle. Subsequent business processes to be documented will be prioritized based on risk and impact on DFAIT;
- Complete the financial statement risk assessment, and identify and address risks of a material misstatement related to significant financial statement components and underlying business processes; and
- An updated Section 33 monitoring methodology, such as statistical sampling, will be developed and implemented.

By end of 2011-12 DFAIT plans to:

- As resources permit, complete the documentation of the remaining significant business processes including the identification of risks, and tests of design effectiveness; and
- As resources permit, develop a monitoring plan for the testing of operating effectiveness of internal controls over financial reporting for significant business processes, entity level controls and financial reporting related IT general controls.