DEFENCE CONSTRUCTION CANADA

2017–2018 FIRST QUARTER FINANCIAL REPORT

PERIOD ENDED JUNE 30, 2017

Management's Discussion and Analysis, and Unaudited Interim Condensed Financial Statements

Defence Construction Canada
Construction de Défense Canada

Canada

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MANAGEMENT'S DISCUSSION AND ANALYSIS

This management's discussion and analysis (MD&A) outlines the financial results and operational changes for the first quarter ended June 30, 2017, for Defence Construction (1951) Limited (the "Corporation" or "DCC"). This discussion should be read with the unaudited interim condensed financial statements for the period ended June 30, 2017. These statements were prepared in accordance with International Accounting Standard 34, Interim Financial Reporting, and the Treasury Board of Canada Standard on Quarterly Financial Reports for Crown Corporations, and are reported in Canadian dollars. We also recommend that this information be read in conjunction with the Corporation's MD&A and annual financial statements for the year ended March 31, 2017 (the "*Annual Report 2016–2017*"). Financial results reported in the MD&A are rounded to the nearest thousand. Related percentages are based on numbers rounded to the nearest thousand. DCC management is responsible for the information presented in the MD&A and unaudited interim condensed financial statements.

1.0 MATERIALITY

In assessing what information is to be provided in the MD&A, management applies the materiality principle. Management considers information to be "material" when it is probable that its omission or misstatement would influence decisions that users make on the basis of the financial information.

2.0 CORPORATE PROFILE

Defence Construction (1951) Limited, operating as Defence Construction Canada (DCC), is a Crown corporation that provides innovative and cost-effective contracting, construction, contract management, infrastructure and environmental, and life-cycle support services for Canada's defence requirements. It has two primary Client-Partners: the Infrastructure and Environment (IE) community at the Department of National Defence (DND), and the Communications Security Establishment (CSE). The Corporation also provides services to Shared Services Canada relating to the expansion of the electronic data centre at CFB Borden.

From project needs planning to facility decommissioning, DCC's work covers a broad spectrum of activities. DCC's resources are divided among five service lines.

CONTRACT SERVICES

The Contract Services team oversees the procurement of goods and professional, construction and maintenance services to fulfill Canada's domestic and international defence infrastructure needs.

CONTRACT MANAGEMENT SERVICES

The Contract Management Services team supports the creation, renovation and maintenance of facilities for DND's IE program.

ENVIRONMENTAL SERVICES

The Environmental Services team helps DND meet environmental performance targets, comply with regulatory requirements, and manage due diligence and risk.

PROJECT AND PROGRAM MANAGEMENT SERVICES

The Project and Program Management Services team advises on matters such as infrastructure requirements, program planning, and schedule and document control.

REAL PROPERTY MANAGEMENT SERVICES

From needs planning to facility decommissioning, the Real Property Management Services team supports the efficient operation of DND's infrastructure.

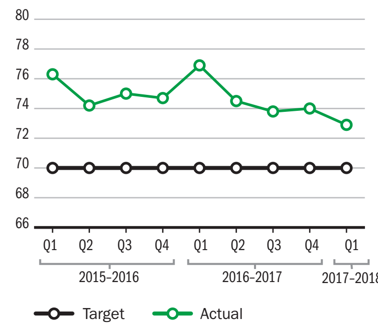
3.0 OPERATIONAL PERFORMANCE INDICATORS

3.1 UTILIZATION RATE

The utilization rate indicates the hours spent directly on service delivery functions that are billable to the Client-Partners, as opposed to administrative functions that are considered overhead support. This rate is an important indicator of efficiency and effectiveness, and a key financial management tool. A higher utilization rate is a positive indicator that DCC is using its resources more for revenue-generating activities and less for overhead administrative functions. DCC's target utilization rate is 70%.

For the first quarter of 2017–18 (year to date), the Corporation achieved a utilization rate of 72.8%, a decrease from the rate of 76.9% for the same period in 2016–17. This decrease was due to lower activity levels in the first quarter, resulting from changes to the Client-Partners' funding processes, timing of project completion and to the end of the Federal Infrastructure Investment Program (FIIP) projects at the end of fiscal 2016–17.

Utilization Rate
(Percentage of employee hours spent on billable contract work — year to date)

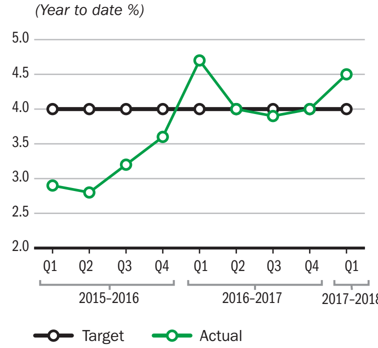


3.2 PROFESSIONAL DEVELOPMENT TO SALARY COST RATIO

DCC's ability to serve its Client-Partners depends heavily on the skills of its employees. Maintaining a skilled and professional workforce is a key corporate objective. For 2017–18, DCC has established an annual overall corporate target for spending on training and development of 4% of base salary costs. This target encompasses all costs associated with training and development activities, including internal employee time and third-party costs.

For the first quarter of 2017–18, the professional development to salary cost ratio was 4.5%, a decrease from 4.7% in the comparable period last year. The decrease was due to timing of staff training compared to the prior year.

Professional Development to Salary Cost Ratio
(Year to date %)



4.0 RISK MANAGEMENT

There have been no material changes to the corporate risks identified by management and discussed in Section 5.0, Risk Management, of the MD&A in DCC's *Annual Report 2016–2017*.

5.0 FINANCIAL PERFORMANCE

5.1 BASIS OF PRESENTATION

The Corporation prepared this quarterly report as per the requirements of the *Financial Administration Act*. This statute requires all federal Crown corporations to prepare and make public a report within 60 days of the end of each fiscal quarter.

This quarterly financial report was prepared in accordance with International Accounting Standard 34, Interim Financial Reporting, and the Treasury Board of Canada Standard on Quarterly Financial Reports for Crown Corporations.

In the following analysis, all references to the first quarter refer to the three months ended June 30, 2017. All references to the previous year's first quarter relate to the three months ended June 30, 2016.

5.2 REVENUE

SERVICES REVENUE

Services revenue for all activities combined was $24.8 million in the first quarter, an increase of $1.7 million or approximately 8% from the previous year. This increase resulted from an increase in billing rates of 4.5% compared to the prior year and from higher demand from DND for services.

CONTRACT MANAGEMENT

Revenue from contract management increased by 11% in the first quarter compared to the same period in the previous year, reflecting an increase in billing rate and increased demand from Client-Partners. Fluctuations in the DND program have a direct impact on the revenue this activity generates.

PROJECT PLANNING

Project planning revenue increased by 2% in the first quarter over the first quarter of 2016–17. An increase due to higher billing rates was partially offset by lower demand from DND for this service.

REAL PROPERTY TECHNICAL SUPPORT

Real property technical support revenue increased in the first quarter by 16% over the prior year. The increase was due to an increase in billing rates and higher demand from DND for this activity.

CONSTRUCTION TECHNICAL SUPPORT

Revenue from construction technical support increased by 4% in the first quarter compared to the same period in the previous year. The increase was the result of an increase in billing rates, as demand for this service was consistent with that in the prior year.

PROCUREMENT

Procurement revenue in the first quarter decreased by 5% compared to the same period in the previous year. The decrease was due to lower demand from DND, as a result of process changes. The decrease was partially offset by an increase in billing rate.

ENVIRONMENTAL TECHNICAL SUPPORT

Environmental technical support revenue increased by 17% in the first quarter compared to the first quarter of 2016–17. The increase was due to an increase in billing rates and to higher demand from DND for these services. Fluctuations in the DND program have a direct impact on the revenue this activity generates.

REVENUE, BY ACTIVITY

(in thousands of dollars)	Three months ended June 30, 2017	Three months ended June 30, 2016	**Change** $	**Change** %
Contract management	$ 11,233	$ 10,121	1,112	11%
Project planning	6,329	6,191	138	2%
Real property technical support	2,161	1,864	297	16%
Construction technical support	1,966	1,892	74	4%
Procurement	1,674	1,770	(96)	-5%
Environmental technical support	1,485	1,269	216	17%
Total revenue	**$ 24,848**	**$ 23,107**	**1,741**	**8%**

INVESTMENT REVENUE

Investment revenue, which is generated from the Corporation's average cash balance in its bank account and from investments, increased in the first quarter by $5,000 or 3% compared to the same period in the previous year. The increase was primarily the result of payment of interest on guaranteed investment certificates (GICs) in the investment portfolio.

(in thousands of dollars)	Three months ended June 30, 2017	Three months ended June 30, 2016	**Change** $	%
Investment revenue	**$ 181**	**$ 176**	**5**	**3%**

5.3 EXPENSES

SALARIES AND EMPLOYEE BENEFITS

Salaries totalled $20.0 million in the first quarter, an increase of $2.1 million, or approximately 12%, over the same period in the previous year. Three percentage points of this increase resulted from salary increases. The remaining nine percentage points were due to an increase in the workforce, due to planned higher demand for services than in the prior period.

Employee benefits were $5.0 million in the first quarter, an increase of $168,000 or approximately 4% from the same period in the previous year. The increase was due mainly to the overall increase in salaries. Benefits as a percentage of salaries decreased, due to lower costs for the Corporation related to accruals for employee future benefits and lower costs for the employer portion of the Public Service Pension Plan.

(in thousands of dollars)	Three months ended June 30, 2017	Three months ended June 30, 2016	**Change** $	%
Salaries	$ 19,979	$ 17,869	2,110	12%
Employee benefits	4,951	4,783	168	4%
	$ 24,930	**$ 22,652**	**2,278**	**10%**
Employee benefits as a percentage of salaries	25%	27%		

OPERATING AND ADMINISTRATIVE EXPENSES

Operating and administrative expenses were $2.0 million in the first quarter of 2017–18, an increase of $289,000 or 17% over the first quarter of 2016–17. Material variances are shown in the following table. Some prior year amounts have been reclassified to conform with current year presentation.

			Change		
(in thousands of dollars)	Three months ended June 30, 2017	Three months ended June 30, 2016	$	%	Variance analysis
Rent	$ 481	$ 441	40	9%	The increase was due to higher rent and operating and maintenance costs at certain locations.
Information technology (IT) maintenance agreements	391	238	153	64%	The increase was due to higher maintenance costs related to user productivity software and cyber security solutions.
Training and development	312	259	53	20%	The increase was due to timing of training activities.
Professional services	222	145	77	53%	The increase was due to higher use of professional services in IT and human resources (HR), and auditing expenses.
Telephone and communications	202	151	51	34%	The variance was due to the Corporation reducing expenses in the prior year, in relation to an overpayment a year earlier.
Travel	137	141	(4)	-3%	The variance was not material.
Office supplies	62	80	(18)	-23%	The decrease was due to the fact that DCC purchased ergonomic equipment in the prior fiscal year.
Relocation	56	98	(42)	-43%	The decrease was due to decreased demands to relocate staff.
Communications	37	19	18	95%	The increase was due to the timing of costs related to printing corporate materials.
Hospitality	27	23	4	17%	The increase was due to the timing of events.
IT Hardware	24	35	(11)	-31%	The decrease was due to lower demand for IT hardware.
Subscriptions	18	12	6	50%	The increase was due to timing of purchases of subscriptions for the Corporation.
IT software	14	19	(5)	-26%	The decrease was due to lower demand for IT software.
Printing and stationery	12	16	(4)	-25%	The decrease was due to higher use of electronic document storage and electronic signatures, which reduces the need for printing and stationery costs.
Office furniture and fixtures	8	–	8	100%	The increase was due to the purchase of office furniture and fixtures for offices that were required to relocate.
Postage, freight and courier	5	6	(1)	-17%	The variance was not material.
Recruiting	–	31	(31)	-100%	The decrease was due to lower activity related to recruitment.
Other	–	5	(5)	-100%	The decrease was due to lower costs for leasehold improvements.
Total	**$ 2,008**	**$ 1,719**	**289**	**17%**	

DEPRECIATION AND AMORTIZATION

Depreciation and amortization decreased by 4% or $14,000 in the first quarter over the first quarter of 2016–17. The decrease in amortization of intangible assets was due to the low number of additions to the pool of assets in the prior year.

			Change	
(in thousands of dollars)	Three months ended June 30, 2017	Three months ended June 30, 2016	$	%
Depreciation of property, plant and equipment	$ 250	$ 249	1	0%
Depreciation of assets under finance lease	24	26	(2)	-8%
Amortization of intangible assets	51	64	(13)	-20%
Total	**$ 325**	**$ 339**	**(14)**	**-4%**

5.4 LOSS AND TOTAL COMPREHENSIVE LOSS

The Corporation realized a loss and total comprehensive loss of $2.2 million for the first quarter, compared with a loss and total comprehensive loss of $1.4 million for the same period in the previous year. This was an increase of 56%. The first quarter loss in the current year was due mainly to the timing of project implementation and to higher compensation and operating costs than in the prior year.

			Change	
(in thousands of dollars)	Three months ended June 30, 2017	Three months ended June 30, 2016	$	%
Loss and total comprehensive loss	**$ (2,236)**	**$ (1,429)**	**(807)**	**56%**

5.5 LIQUIDITY AND CAPITAL RESOURCES

FINANCIAL AND CASH MANAGEMENT

DCC's financial and cash management policy is discussed in the *Annual Report 2016–2017*.

CASH AND INVESTMENTS

Cash and investments totalled $20.5 million at June 30, 2017, a decrease of $6.8 million from March 31, 2017.

The cash balance at June 30, 2017, was $785,000, a decrease of $6.2 million or 89% from the 2016–17 year end. In the three-month period after March 31, 2017, the Corporation used $6.6 million in cash for operating activities, spent $69,000 on capital expenditures, redeemed $499,000 from investments and spent $23,000 to meet finance lease obligations.

Investments (both current and long term) at June 30, 2017, totalled $19.7 million, a decrease of $526,000 from the 2016–17 year end. The decrease was due mainly to cash from the portfolio being transferred to the cash position. Investments consist of non-derivative financial assets with fixed or determinable payments and fixed maturity. The Corporation currently invests in listed bonds, guaranteed investment certificates and mutual funds that are recorded at cost and amortized using the effective interest method. The investments held meet the requirements of the policy approved by the Board of Directors. It is the Corporation's intention to hold the investments to maturity.

TRADE RECEIVABLES

Trade receivables are due mainly from one of the Corporation's Client-Partners, DND. At June 30, 2017, the amount of trade receivables was $22.6 million, an increase of $4.0 million or 22% from March 31, 2017. The increase was due to the timing of the collection of receivables from DND.

CURRENT LIABILITIES

Current liabilities were $14.2 million at June 30, 2017, a decrease of $1.6 million or 10% from March 31, 2017. The decrease in current liabilities was primarily due to a decrease in accounts payable related to the timing of payments.

LIQUIDITY AND CAPITAL RESOURCES

(in thousands of dollars)	As at June 30, 2017	As at March 31, 2017	**Change** $	**Change** %
Cash	$ 785	$ 7,022	(6,237)	-89%
Investments	19,704	20,230	(526)	-3%
Cash and investments	**$ 20,489**	**$ 27,252**	**(6,763)**	**-25%**
Trade receivables	**$ 22,637**	**$ 18,596**	**4,041**	**22%**
Current liabilities	**$ 14,157**	**$ 15,721**	**(1,564)**	**-10%**

5.6 EMPLOYEE BENEFITS

The Corporation records a liability for the estimated cost of sick leave for employees, and health, dental and life insurance benefits for retirees. Every three years, an actuary determines this estimate. The accrued sick leave and other benefits balance as at June 30, 2017, was $23.3 million, an increase of $628,000 or 3% from the 2016–17 year end. The increase reflected the actuary's estimates of accrued benefits for the current fiscal year, minus payments of benefits for retirees.

(in thousands of dollars)	As at June 30, 2017	As at March 31, 2017	**Change** $	**Change** %
Current portion	$ 2,277	$ 2,277	–	0%
Long-term portion	21,061	20,433	628	3%
Total employee benefits	**$ 23,338**	**$ 22,710**	**628**	**3%**

5.7 ASSETS UNDER FINANCE LEASE AND FINANCE LEASE OBLIGATION

The Corporation leases multifunctional devices for copying, scanning and faxing. At the end of the first quarter, the value of assets under finance lease had decreased by $29,000 or 9% since the 2016–17 year end. The decrease was the result of DCC replacing part of its inventory of copiers with less expensive machines than it had previously leased.

(in thousands of dollars)	As at June 30, 2017	As at March 31, 2017	Change $	Change %
Assets under finance lease	**$ 280**	**$ 309**	**(29)**	**-9%**

The finance lease obligation at the end of the first quarter decreased by $28,000, or 9%, from the 2016–17 year end, due to adjustments to the value of assets of $5,000 and payments of $23,000.

(in thousands of dollars)	As at June 30, 2017	As at March 31, 2017	Change $	Change %
Current portion	$ 95	$ 95	–	0%
Long-term portion	191	219	(28)	–13%
Finance lease obligation	**$ 286**	**$ 314**	**(28)**	**–9%**

5.8 CAPITAL EXPENDITURES

The Corporation's capital expenditures for the first quarter totalled $69,000, a decrease of $42,000 or 38% from the same period in the previous year. The decrease was due to the timing of computer equipment replacement cycles.

(in thousands of dollars)	Three months ended June 30, 2017	Three months ended June 30, 2016	Change $	Change %
Intangible assets	$ 2	$ 12	(10)	-83%
Computer equipment	60	99	(39)	-39%
Furniture and equipment	7	–	7	100%
Leasehold improvements	–	–	–	0%
	$ 69	**$ 111**	**(42)**	**-38%**

5.9 ACTUAL PERFORMANCE VERSUS PLAN

The Corporation's actual performance compared to the Corporate Plan (the Plan) for the three months ended June 30, 2017, was lower than reported in the Plan.

Services revenue was 7% lower than forecasted in the Plan. This decrease is due to lower activity levels in the first quarter resulting from changes to the Client-Partner's funding processes, timing of project implementation and the end of FIIP projects at the end of fiscal 2016-17. Investment revenue was higher than anticipated in the Plan due to a higher-than-expected return on investment.

Salaries and benefits were consistent with the Plan.

Operating and administrative costs were 37% lower than projected, due to timing of implementation of the Corporation's cyber strategy and other operating expenses, primarily training, development and travel costs.

Capital expenditures were 86% lower than projected, due to the timing of planned acquisitions related to the cyber strategy and IT renewal plan.

ACTUAL PERFORMANCE VERSUS PLAN

(in thousands of dollars)		**Actual**		**Plan**	**Change** $	**Change** %
Revenue						
Services revenue	$	24,848		26,700	(1,852)	-7%
Travel and disbursement revenue		351		375	(24)	-6%
Investment revenue		181		130	51	39%
		25,380		**27,205**	**(1,825)**	**-7%**
Expenses						
Salaries and employee benefits		24,930		25,090	(160)	-1%
Operating and administrative costs		2,010		3,167	(1,157)	-37%
Travel and disbursement expenses		351		375	(24)	-6%
Depreciation and amortization		325		362	(37)	-10%
		27,616		**28,994**	**(1,378)**	**-5%**
Loss and total comprehensive loss	**$**	**(2,236)**	**$**	**(1,789)**	**(447)**	**25%**
Capital expenditures	**$**	**69**	**$**	**483**	**(414)**	**-86%**

UNAUDITED INTERIM CONDENSED FINANCIAL STATEMENTS

MANAGEMENT RESPONSIBILITY STATEMENT

Management is responsible for the preparation and fair presentation of these unaudited interim condensed financial statements in accordance with International Accounting Standard 34, Interim Financial Reporting, and the Treasury Board of Canada Standard on Quarterly Financial Reports for Crown Corporations. Management is also responsible for such internal controls as it determines are necessary to enable the preparation of unaudited interim condensed financial statements that are free from material misstatement. In addition, management is responsible for ensuring that all other information in this quarterly financial report is consistent, as appropriate, with the unaudited interim condensed financial statements.

Based on our knowledge, these unaudited interim condensed financial statements present fairly, in all material respects, the financial position, results of operations and cash flows of the Corporation, as at the date of and for the periods presented in the interim condensed financial statements.

James S. Paul
President and Chief Executive Officer

Juliet Woodfield, CPA, CA
Vice-President, Finance & Human Resources, and Chief Financial Officer

Ottawa, Canada
August 29, 2017

DEFENCE CONSTRUCTION (1951) LIMITED

INTERIM CONDENSED STATEMENT OF FINANCIAL POSITION

Unaudited

(in thousands of dollars)	Notes	**As at June 30, 2017**	As at March 31, 2017
Assets			
Cash		**$ 785**	$ 7,022
Investments	5	**2,630**	3,100
Trade receivables	10	**22,637**	18,596
Other receivables		**2,088**	2,124
Prepaids and other current assets		**1,770**	1,951
Current assets		**29,910**	32,793
Investments	5	**17,074**	17,130
Property, plant and equipment	7	**2,059**	2,242
Intangible assets		**349**	398
Assets under finance lease		**280**	309
Non-current assets		**19,762**	20,079
Total assets		**$ 49,672**	$ 52,872
Liabilities			
Trade and other payables		**$ 11,553**	$ 13,349
Deferred revenue	6	**232**	–
Current portion—finance lease obligation		**95**	95
Current portion—employee benefits	8	**2,277**	2,277
Current liabilities		**14,157**	15,721
Finance lease obligation		**191**	219
Employee benefits	8	**21,061**	20,433
Non-current liabilities		**21,252**	20,652
Total liabilities		**35,409**	36,373
Equity			
Share capital—authorized—1,000 common shares of no par value		**–**	–
Issued—32 common shares		**–**	–
Retained earnings		**14,263**	16,499
Total equity		**14,263**	16,499
Total liabilities and equity		**$ 49,672**	$ 52,872

Contingent liabilities (Note 11)

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

DEFENCE CONSTRUCTION (1951) LIMITED

INTERIM CONDENSED STATEMENT OF PROFIT AND LOSS AND OTHER COMPREHENSIVE INCOME

Unaudited

(in thousands of dollars)	Notes	Three months ended June 30, 2017	Three months ended June 30, 2016
Services revenue		**$ 24,848**	$ 23,107
Travel and disbursement revenue		**351**	438
Investment revenue		**181**	176
Total revenue		**25,380**	23,721
Salaries and employee benefits		**24,930**	22,652
Operating and administrative expenses	9	**2,008**	1,719
Travel and disbursement expenses		**351**	438
Depreciation of property, plant and equipment	7	**250**	249
Depreciation of assets under finance lease		**24**	26
Amortization of intangible assets		**51**	64
Finance costs		**2**	2
Total expenses		**27,616**	25,150
Loss for the period and total comprehensive loss		**$ (2,236)**	$ (1,429)

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

DEFENCE CONSTRUCTION (1951) LIMITED

INTERIM CONDENSED STATEMENT OF CHANGES IN EQUITY

Unaudited

(in thousands of dollars)	Share capital	Retained earnings	Total equity
Balance at March 31, 2017	$ –	$ 16,499	$ 16,499
Loss for the period		(2,236)	(2,236)
Balance at June 30, 2017	**$ –**	**$ 14,263**	**$ 14,263**
	Share capital	Retained earnings	Total equity
Balance at March 31, 2016	$ –	$ 30,555	$ 30,555
Loss for the period		(1,429)	(1,429)
Balance at June 30, 2016	**$ –**	**$ 29,126**	**$ 29,126**

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

DEFENCE CONSTRUCTION (1951) LIMITED

INTERIM CONDENSED STATEMENT OF CASH FLOWS

Unaudited

(in thousands of dollars)	Notes	Three months ended June 30, 2017	Three months ended June 30, 2016
Cash flow from (used in) operating activities			
Loss for the period		**$ (2,236)**	$ (1,429)
Adjustments to reconcile loss for the period to cash provided or used by operating activities			
Employee benefits expense		**730**	566
Employee benefits paid		**(102)**	(43)
Depreciation of property, plant and equipment	7	**250**	249
Depreciation of assets under finance lease		**24**	26
Amortization of intangible assets		**51**	64
Amortization of investment premiums		**27**	29
Change in non-cash operating working capital			
Trade receivables		**(4,041)**	(2,801)
Other receivables		**36**	21
Prepaids and other current assets		**181**	(1,079)
Trade and other payables		**(1,796)**	(818)
Deferred revenue		**232**	1,980
Net cash flows provided used in operating activities		**(6,644)**	(3,235)
Cash flows from investing activities			
Acquisition of investments		**(1)**	(893)
Disposition of investments		**500**	725
Acquisition of property, plant and equipment	7	**(67)**	(99)
Acquisition of intangible assets		**(2)**	(12)
Net cash flows provided by (used in) investing activities		**430**	(279)
Cash flows from financing activities			
Repayment of finance lease obligations		**(23)**	(23)
Net cash flows used in financial activities		**(23)**	(23)
Decrease in cash during the period		**(6,237)**	(3,537)
Cash at the beginning of the period		**7,022**	18,378
Cash at the end of the period		**$ 785**	$ 14,841

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

NOTICE TO READERS

These interim condensed financial statements have not been audited or reviewed by an external auditor and must be read in conjunction with the most recent financial statements for the year ended March 31, 2017, and with the MD&A included in this quarterly financial report.

DEFENCE CONSTRUCTION (1951) LIMITED

NOTES TO THE UNAUDITED FINANCIAL STATEMENTS

Unless otherwise stated, all amounts are in thousands of Canadian dollars.

NOTE 1: SUMMARY OF BUSINESS AUTHORITY AND OBJECTIVES

Defence Construction (1951) Limited (the "Corporation" or "DCC") was incorporated under the *Companies Act* in 1951 pursuant to the authority of the *Defence Production Act* and continued under the *Canada Business Corporations Act*. The Corporation's Head Office is located at 350 Albert Street, Ottawa, Ontario, Canada. DCC is an agent Crown corporation named in Part 1 of Schedule III to the *Financial Administration Act*. Responsibility for the Corporation rests with the Minister of Public Services and Procurement. The Corporation is not subject to income taxes.

The mandate of the Corporation is to provide procurement, construction contract management, professional, operations and full life-cycle infrastructure support for the defence and security of Canada. The prime, but not exclusive, beneficiary of the Corporation's services has always been the Department of National Defence (DND). Other government departments and agencies that play a role in Canada's defence and security may also avail themselves of DCC's services. Revenue is generated from fees charged for specific services provided.

NOTE 2: BASIS OF PREPARATION AND PRESENTATION

These interim condensed financial statements are prepared by the Corporation in accordance with International Accounting Standard 34 (IAS 34), Interim Financial Reporting, as issued by the Accounting Standards Board, and the Standard on Quarterly Financial Reports for Crown Corporations issued by the Treasury Board of Canada. As permitted under IAS 34, these interim condensed financial statements do not include all of the disclosures required for annual financial statements and should be read in conjunction with the Corporation's audited financial statements for its fiscal year ended March 31, 2017.

The interim condensed financial statements have been prepared according to the International Financial Reporting Standards (IFRS) effective when these statements were prepared.

The statements have been prepared on a historical cost basis, except as permitted by the IFRS and as otherwise indicated in these notes.

NOTE 3: SUMMARY OF ACCOUNTING POLICIES

These interim condensed financial statements follow the same accounting policies and methods of computation described in Note 3 to the Corporation's audited financial statements for the year ended March 31, 2017. The accounting policies and methods of computation have been applied consistently to all the periods presented.

NOTE 4: CRITICAL ACCOUNTING ESTIMATES

Under the Corporation's accounting policies, management is required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors considered relevant. Actual results may differ from the judgments, estimates and assumptions.

The estimates and underlying assumptions are reviewed regularly. Revisions to accounting estimates are recognized in the period in which the estimates are revised, when the revision affects only that period, or in the period of the revision and future periods, when the revision affects both current and future periods. Critical judgments and key sources of estimation uncertainty are disclosed in Note 4 to the Corporation's annual financial statements for the year ended March 31, 2017.

NOTE 5: INVESTMENTS

Investments consist of Canadian, provincial and corporate bonds with fixed interest rates ranging from 2.85% to 7.2%, guaranteed investment certificates (GICs) with fixed interest rates ranging from 1.7% to 2.1%, and mutual funds with variable interest rates. The maturity dates of the bonds vary from 2017 to 2031 and those of the GICs from 2017 to 2021, and the Corporation intends to hold all of them to maturity. The mutual funds can be liquidated on demand. The carrying amounts, measured at the amortized cost and fair value of these investments, are shown in the following table.

The fair values of the investments can be determined by (a) quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1); (b) inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., prices) or indirectly (i.e., derived from prices) (Level 2); or (c) inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3). The fair values of DCC's investments are not quoted in an active market, but rather are determined from quoted prices from a decentralized, over-the-counter market, which is considered Level 2 in the fair value hierarchy.

The "current portion" of the Corporation's investments consists of instruments maturing in the next 12 months.

	As at June 30, 2017	As at March 31, 2017
Current portion	**$ 2,630**	$ 3,100
Non-current portion	**17,074**	17,130
Net book value	**$ 19,704**	$ 20,230

	As at June 30, 2017	As at March 31, 2017
Carrying amount at amortized cost		
Bonds		
Federal	**$ 505**	$ 506
Provincial	**8,572**	9,086
Corporate	**4,309**	4,321
Total bonds	**13,386**	13,913
Guaranteed investment certificates	**5,925**	5,925
Mutual funds	**393**	392
Total	**$ 19,704**	$ 20,230

	As at June 30, 2017	As at March 31, 2017
Fair value		
Bonds		
Federal	**$ 537**	$ 539
Provincial	**8,988**	9,583
Corporate	**4,555**	4,540
Total bonds	**14,080**	14,662
Guaranteed investment certificates	**5,962**	5,947
Mutual funds	**392**	392
Total	**$ 20,434**	$ 21,001

NOTE 6: DEFERRED REVENUE

Deferred revenue arises when, at a reporting date, the amount invoiced exceeds the services delivered through fixed-fee service-level arrangements. For the period ended June 30, 2017, deferred revenue was $232. The figure as at March 31, 2017, was $0. Timing differences on fixed-fee service-level arrangements can occur during the reporting periods of the fiscal year but are reconciled and reduced to $0 by the year-end reporting date.

NOTE 7: PROPERTY, PLANT AND EQUIPMENT

	As at June 30, 2017	As at March 31, 2017
Cost	$ 7,275	$ 7,208
Less: Accumulated depreciation	5,216	4,966
Net book value	**$ 2,059**	**$ 2,242**
Net book value by asset class		
Computer equipment	$ 1,810	$ 1,979
Furniture and fixtures	202	209
Leasehold improvements	47	54
Net book value	**$ 2,059**	**$ 2,242**

The changes in property, plant and equipment are shown in the following table.

	Computer equipment	Furniture and fixtures	Leasehold improvements	Total
Cost				
Balance as at March 31, 2017	$ 4,395	$ 789	$ 2,024	$ 7,208
Plus: Additions	60	7	–	67
Less: Disposals	–	–	–	–
Balance as at June 30, 2017	**$ 4,455**	**$ 796**	**$ $2,024**	**$ 7,275**

The changes in accumulated depreciation are shown in the following table.

	Computer equipment	Furniture and fixtures	Leasehold improvements	Total
Accumulated depreciation				
Balance as at March 31, 2017	$ 2,416	$ 580	$ 1,970	4,966
Plus: Depreciation	229	14	7	250
Less: Disposals	–	–	–	–
Balance as at June 30, 2017	**$ 2,645**	**$ 594**	**$ 1,977**	**$ 5,216**

There was no impairment of property, plant and equipment.

NOTE 8: EMPLOYEE BENEFITS

POST-EMPLOYMENT AND OTHER LONG-TERM EMPLOYEE BENEFITS

Post-employment and other long-term employee benefits represent the Corporation's estimated costs of sick leave for employees, and health, dental and life insurance benefits for retirees. The benefit plan is not funded and thus has no assets, resulting in a plan deficit equal to the accrued benefit obligation.

	As at June 30, 2017	As at March 31, 2017
Current portion of employee benefits	$ 2,277	$ 2,277
Long-term portion of employee benefits	21,061	20,433
Total employee benefits	**$ 23,338**	**$ 22,710**

The significant actuarial assumptions are disclosed in the *Annual Report 2016–2017*. The measurement date for the last actuarial valuation of the provision for employee benefits was April 1, 2017. The next actuarial valuation is planned for April 2020.

NOTE 9: OPERATING AND ADMINISTRATIVE EXPENSES

Some prior year amounts have been reclassified to conform with current year presentation.

	Three months ended June 30, 2017	Three months ended June 30, 2016
Rent	**$ 481**	$ 441
IT maintenance agreements	**391**	238
Training and development	**312**	259
Professional services	**222**	145
Telephone and communications	**202**	151
Travel	**137**	141
Office supplies	**62**	80
Relocation	**56**	98
Communications	**37**	19
Hospitality	**27**	23
IT hardware	**24**	35
Subscriptions	**18**	12
IT software	**14**	19
Printing and stationery	**12**	16
Office furniture and fixtures	**8**	–
Postage, freight and courier	**5**	6
Recruiting	**–**	31
Other	**–**	5
	$ 2,008	$ 1,719

NOTE 10: RELATED-PARTY TRANSACTIONS AND BALANCES

The Corporation is related in terms of common ownership to all Government of Canada departments, agencies and Crown corporations. The Corporation enters into transactions with these entities in the normal course of business under its stated mandate. These transactions are measured at fair value, which is the actual amount of the consideration given or received for the services provided. The Corporation's services revenue, and travel and disbursement revenue, in the first quarter of 2017–18 totalled $25,199, compared to $23,545 in the comparable period of 2016–17. These revenues were generated from services provided to DND (including the Canadian Forces Housing Agency), the Communications Security Establishment and Shared Services Canada.

The Corporation incurred expenses with other departments of the Government of Canada. These transactions totalled $23 in the first quarter of 2017–18, compared with $21 in the same period of 2016–17.

In accordance with a memorandum of understanding between DND and the Corporation, DND is to provide office accommodations free of charge to the Corporation's service delivery personnel at DND-owned bases and wings, and at other locations. Where office space is not provided, and for the Corporation's service delivery personnel who cannot be accommodated at a DND-owned facility, DCC recovers accommodation costs either as an out-of-pocket reimbursable disbursement or through the hourly billing rates established for the services provided.

	As at June 30, 2017	As at March 31, 2017
Due from		
Department of National Defence	$ 20,613	$ 17,325
Canadian Forces Housing Agency	1,734	1,087
Shares Services Canada	169	119
Communications Security Establishment Canada	121	65
	$ 22,637	**$ 18,596**
Due to		
Shares Services Canada	–	12
	$ –	**$ 12**

10.1 COMPENSATION OF KEY MANAGEMENT PERSONNEL

Key management personnel are those persons (including members of the Board of Directors) having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly. The remuneration of DCC's key management personnel is shown in the following table.

	Three months ended June 30, 2017	Three months ended June 30, 2016
Short-term benefits	$ 853	$ 718
Post-employment benefits	92	77
Total	**$ 945**	**$ 795**

NOTE 11: CONTINGENT LIABILITIES

11.1 LEGAL CLAIMS

The Corporation's efforts to resolve contract disputes are reflected in the number and value of contract claims before the courts. As at June 30, 2017, there were seven ongoing claims totalling $1,944. As at March 31, 2017, there were eight ongoing claims totalling $1,944.

In accordance with the memorandum of understanding between the Corporation and DND, DND accepts the legal and financial risks associated with claims resulting from third-party contracts put in place by the Corporation. Thus, the financial risk associated with settling these contractual claims does not have any financial impact on the Corporation. As a result, the Corporation does not consider it necessary to record any provision in its financial statements relating to legal claims from third-party contracts.